

Question 1 is Compulsory which carries 20 Marks. Attempt any five Other Questions

1.	Answer all the questions:										
a)	<p>Heraklion Co is a manufacturer of footballs and is a new audit client for your firm. You are an audit supervisor of Spinalonga & Co [CA Firm] and are currently preparing for the forthcoming audit for the year ending 31 October 20X6. The following information is available:</p> <p><u>Sales ordering, goods despatched and invoicing</u></p> <p>Heraklion Co sells footballs to a range of large and small sports equipment retailers in several countries. Sales are made through a network of sales staff employed by Heraklion Co, but new customer leads are generated through a third party company. Sales staff is responsible for assessing new customers' creditworthiness and proposing a credit limit which is then authorised by the sales director. The sales staff has monthly sales targets and is able to use their discretion in granting sales discounts up to a maximum of 10%. They then record any discount granted in the customer master data file. The sales staff visit customer sites personally and orders are completed using a two-part pre-printed order form. One copy is left with the customer and the other copy is retained by the sales person. The sales order number is based on the sales person's own identification (ID) number. The company markets itself on being able to despatch all orders within three working days. Once the order is taken, the sales person emails the finance department and warehouse despatch team with the customer ID and the sales order details and from this a pick list is generated. Sequentially numbered goods despatched notes are completed and filed in the warehouse. Sequentially numbered invoices are generated using the pick lists for quantities and the customer master data file for prices. Standard credit terms for customers are 30 days and on a monthly basis sales invoices which are over 90 days outstanding are notified to the relevant sales person to chase payment directly with the customer.</p> <p><u>Payroll fraud</u></p> <p>The finance director, Montse Mirabelle, has informed you that a significant fraud took place during the year in the payroll department. A number of fictitious employees were set up on the payroll and wages were paid into one bank account. This bank account belonged to two supervisors, who were married, and were employed by Heraklion Co. One had sole responsibility for setting up new joiners in the payroll system and the other processed and authorised bank transfer requests for wages and supplier payments. These employees no longer work for the company and Montse has asked the audit firm for recommendations on how to improve controls in this area to prevent this type of fraud occurring again. Heraklion Co operates a Human Resources department.</p> <p>Required:</p> <p>(a) Identify and explain deficiencies in the sales system of Heraklion Co and recommend how to address each of these deficiencies.</p> <p>(b) In relation to the payroll fraud, identify and explain controls Heraklion Co should implement to reduce the risk of this type of fraud.</p> <p>Hint:</p> <table border="1" data-bbox="215 1232 1524 2054"> <thead> <tr> <th align="center" colspan="2" data-bbox="215 1232 1524 1265">Part (a)</th> </tr> <tr> <th align="center" data-bbox="215 1265 869 1299">Control deficiency</th> <th align="center" data-bbox="869 1265 1524 1299">Control recommendation</th> </tr> </thead> <tbody> <tr> <td data-bbox="215 1299 869 1534"> <p>New customers' creditworthiness is assessed by a salesperson who sets the credit limit, which is authorised by the sales director.</p> <p>The sales staff has sales targets, and hence may suggest that new customers are creditworthy simply to meet their targets. This could result in sales being made to poor credit risks.</p> </td> <td data-bbox="869 1299 1524 1534"> <p>New customers should complete a credit application which should be checked through a credit agency with a credit limit set. Once authorised by the sales director, the limit should be entered into the system by a credit controller.</p> </td> </tr> <tr> <td data-bbox="215 1534 869 1758"> <p>Sales staff has discretion to grant sales discounts to customers of up to 10%. This could result in a loss of revenue as they may award unrealistic discounts simply to meet sales targets.</p> <p>The discounts granted by sales staff are not being reviewed and could result in unauthorised discounts allowed.</p> </td> <td data-bbox="869 1534 1524 1758"> <p>All discounts to be granted to customers should be authorised in advance by a responsible official, such as the sales director. 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Any such amendments to master file data should be restricted so that only supervisors and above can make changes.</p> <p>An exception report of changes made should be generated and reviewed by a responsible official.</p> </td> </tr> </tbody> </table>	Part (a)		Control deficiency	Control recommendation	<p>New customers' creditworthiness is assessed by a salesperson who sets the credit limit, which is authorised by the sales director.</p> <p>The sales staff has sales targets, and hence may suggest that new customers are creditworthy simply to meet their targets. This could result in sales being made to poor credit risks.</p>	<p>New customers should complete a credit application which should be checked through a credit agency with a credit limit set. Once authorised by the sales director, the limit should be entered into the system by a credit controller.</p>	<p>Sales staff has discretion to grant sales discounts to customers of up to 10%. 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<p>Inventory availability does not appear to be checked by the sales person at the time the order is placed. In addition, Heraklion Co markets itself on being able to despatch all orders within three working days.</p> <p>There is a risk that where goods are not available, the customer would not be made aware of this prior to placing their order, leading to unfulfilled orders and customer dissatisfaction, which would impact the company's reputation.</p>	<p>Prior to the salesperson finalising the order, the inventory system should be checked in order for an accurate assessment of the availability of goods to be notified to customers.</p>
<p>Customer orders are recorded on a two-part pre-printed form, one copy is left with the customer and one with the sales person.</p> <p>The sales department of Heraklion Co does not hold these orders centrally and hence would not be able to monitor if orders are being fulfilled on a timely basis. This could result in a loss of revenue and customer goodwill.</p>	<p>The order form should be amended to be at least four-part.</p> <p>The third part of the order should be sent to the warehouse department and the fourth part sent to the finance department.</p> <p>The copy the sales person has should be stored centrally in the sales department. Upon despatch, the goods despatch note should be matched to the order; a regular review of unmatched orders should be undertaken by the sales department to identify any unfulfilled orders.</p>
<p>Customer orders are given a number based on the sales person's own identification (ID) number. These numbers are not sequential. Without sequential numbers, it is difficult for Heraklion Co to identify missing orders and to monitor if all orders are being despatched in a timely manner, leading to a loss of customer goodwill.</p>	<p>Sales orders should be sequentially numbered. On a regular basis, a sequence check of orders should be undertaken to identify any missing orders.</p>
<p>The sales person emails the warehouse despatch team with the customer ID and the sales order details, rather than a copy of the sales order itself, and a pick list is generated from this.</p> <p>There is a risk that incorrect or insufficient details may be recorded by the sales person and this could result in incorrect orders being despatched, orders being despatched late or orders failing to be despatched at all, resulting in a loss of customer goodwill and revenue.</p>	<p>The third part of the sales order as mentioned previously should be forwarded directly to the warehouse department.</p> <p>The pick list should be generated from the original order form and the warehouse team should check correct quantities and product descriptions are being despatched, as well as checking the quality of goods being despatched to ensure they are not damaged.</p>
<p>Sequentially numbered goods despatched notes (GDNs) are completed and filed by the warehouse department. If the finance department does not receive a copy of these GDNs, they will not know when to raise the related sales invoices.</p> <p>This could result in goods being despatched but not being invoiced, leading to a loss of revenue.</p>	<p>Upon despatch of goods, a four-part GDN should be completed, with copies to the customer, warehouse department, sales department to confirm despatch of goods and a copy for the finance department. Upon receipt of the GDN, once matched to the fourth part of the sales order form, a clerk should raise the sales invoices in a timely manner, confirming all details to the GDN and order.</p>
<p>The sales person is given responsibility to chase customers directly for payment once an invoice is outstanding for 90 days. This is considerably in excess of the company's credit terms of 30 days which will lead to poor cash flow.</p> <p>Further, as the sales people have sales targets, they are more likely to focus on generating sales orders rather than chasing payments. This could result in an increase in bad debts and reduced profit and cash flows.</p>	<p>A credit controller should be appointed and it should be their role, rather than the salesperson, to chase any outstanding sales invoices which are more than 30 days old.</p>

Part (b)	
Control	Mitigate risk
Proof of identity checks should be undertaken by the Human Resources (HR) department and recorded on individuals' personnel files for all new employees set up on the payroll system.	This should reduce the risk of fictitious employees being set up, as in order to be set up on the system a fictitious set of identification would be required which would be an onerous process.
A count should be undertaken of the number of employees in each department of Heraklion Co; this should be reconciled to the number of employees on the payroll system.	This would identify if there are extra employees on the payroll system, which could then be investigated further.
The HR department should initiate the process for setting up new joiners by asking new employees to complete a joiner's form which will be approved by the relevant manager and HR. This request should then be forwarded to the payroll department, who should set up the employee.	This control introduces segregation of duties as in order to set up employees both the HR and payroll departments are involved. Without collusion with an HR employee, the payroll supervisor would be unable to set up fictitious employees.
All new joiners should be only be set up by payroll on receipt of a joiner's form and any additions to the system should be authorised by the payroll director. An edit report should be generated and reviewed by HR.	As all new joiners would be authorised by the payroll director, it is unlikely that payroll employees would risk establishing fictitious joiners. A further review by the HR department would also detect any employees without an authorised joiner form.
Where possible, employees who are related should not be allowed to undertake processes which are interrelated whereby they can breach segregation of duty controls for key transaction cycles. A regular review of job descriptions of related employees should be carried out by HR.	This should reduce the risk of related staff colluding and being able to commit a fraud.
The payroll system should be amended to run an exception report which identifies any employees with the same bank account name or number and this should be reviewed by HR.	Identifying the same bank account name or number will prevent multiple fraudulent payments being made to the same employees.
All bank transfer requests should be authorised by a senior responsible official, who is independent of the processing of payments; they should undertake spot checks of payments to supporting documentation, including employee identification cards/records.	This would introduce an additional layer of segregation of duties, which would reduce the risk of fraud occurring. In addition, the spot checks to employee identification cards/records would confirm the validity of payments.
b)	<p>ABC Limited declared dividend several years ago but it remained unclaimed for certain shareholders and hence the company transferred such unclaimed amount to the credit of Investor Education and Protection Fund established by the Central Government. Mr. X, one of shareholder of the company now appears after 2 years of the company having been made transfer of amount to such 'Fund' and has filed a claim before administrative authority of such 'Fund' to refund the amount of unclaimed dividend belonging to him which was credited by the Company in the past years. Advise can the authority sanction his refund under the provisions of the Companies Act, 2013.</p> <p>Hint: Section 125(3) of the Companies Act, 2013 states that the Fund shall be utilised for the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon, in accordance with such rules as may be prescribed.</p>
c)	<p>Certain discrepancies were notice by the Internal Auditors of PQR Limited in the financial statements of the company belonging to the financial years 2013-2014, 2015-2016 and 2016-2017. It was observed by him that these financial statements were not prepared and presented in accordance with the notified Accounting Standards. During the financial year 2017-2018, hence, the Board of Directors have decided to revise these financial statements, so that the shareholders are given the right state of affairs of the company. Advise how the Directors can implement their decision.</p> <p>Can they re-revise the already revised financial statements?</p> <p>Hint: Section 131(1) of the Companies Act, 2013 provides that the directors of the company may prepare revised financial statement or a revised report in respect of any of the three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar.</p> <p>Such revised financial statement or report shall not be prepared or filed more than once in a financial year.</p>

d)	<p>Explain the concept of Audit risk: (i) At the level of financial statements; (ii) At the level of account balance and class of transactions</p> <p>Hint: Concept of audit risk at various levels: (i). At the Level of Financial Statements:</p> <ul style="list-style-type: none"> • Management’s experience and knowledge and changes in management during the period, • Unusual pressures on management, • The nature of the entity’s business, • Factors affecting the industry in which the entity operates. <p>(ii). At the level of Account Balance and Class of Transactions:</p> <ul style="list-style-type: none"> • Quality of the accounting system. • Financial statements are likely to be susceptible to misstatement, for example, accounts which required adjustment in the prior period or which involve a high degree of estimation. • The complexity of underlying transactions and other events which might require using the work of an expert. • The degree of judgement involved in determining account balances. • Susceptibility of assets to loss or misappropriation, • The completion of unusual and complex transactions, particularly at or near period end. • Transactions not subjected to ordinary processing.
2.	Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:
(a)	<p>Mr. Rahul, a locally based fresh Chartered Accountant, accepted the tax audit of ABC Limited at a fee lower than that charged by the previous auditor, who was stationed in another town and had to spend a lot of money on travel for which he did not charge separately. He also communicated to previous auditor (a CA Firm with 5 partners) through registered post acknowledgement due mode and the previous auditor advised him not to accept the audit as his audit fees is not paid by the company. The audit fee for the previous tax auditor was not paid by ABC Limited because their tax audit report was signed by some other partner of the firm instead of the partner who signed the letter of engagement. He also printed QR Code, mission, values and vision of his firm on his visiting card. (4 Marks)</p> <p>Hint: As per Section 8, 21A, 21B and 22 of the Chartered Accountants Act, 1949 read with Schedules issued thereunder, a member of ICAI in practice shall be deemed guilty of professional misconduct if:</p> <p>(i) he solicits clients or professional work, directly or indirectly, through circular, advertisement, interview, personal communication etc.. However, there is no solicitation if work is being requested from other CA in practice or response is being given to tenders or enquiries given by various users of financial statements, CA services, etc.;</p> <p>(ii) he secures professional business through unauthorised means;</p> <p>(iii) he do not communicate in writing with the previous auditor/ predecessor, before accepting the position as an auditor. As per ICAI clarification, such communication shall be in a mode which ensures that actual communication has taken place, such as by hand delivery or through registered post acknowledgement due mode;</p> <p>(iv) he contravenes any of the provisions of the Chartered Accountants Act and/ or Regulations issued thereunder;</p> <p>Further, under Central Council General Guidelines, 2008, a member of ICAI in practice, shall be deemed guilty of professional misconduct, if:</p> <p>(i) he accepts the position as an auditor where the undisputed audit fees of the previous auditor has not been paid by the client. Undisputed audit fees means a fees, the provision for which has been created in the financial statements signed both by the auditor and the auditee. ICAI also clarified that the tax audit report can be signed by any of the partner on behalf of all the other partners.</p> <p>Further, a member of ICAI is also deemed guilty of other misconduct, if he brings disrepute to the profession, by his act, whether committed in his professional/ non-professional capacity.</p> <p>Conclusion: Thus, in the given question Mr. Rahul is not guilty of any misconduct because of the following reasons:</p> <p>(i) no solicitation or unauthorised means have been adopted by him to secure the client/ professional work, as he is justifiable grounds of charging lower fees on account of he being a local resident CA;</p> <p>(ii) the communication with the predecessor has been made through registered post acknowledgement due mode, which is prescribed by ICAI;</p> <p>(iii) the fees payable to the previous tax auditor is disputed (as could be evident from the facts in the question as the client wanted that report should have been signed only by the partner who signed the letter of engagement)</p> <p>Further, in accordance with ICAI clarification QR code is permitted to be given on visiting card, but any photograph, logo other than CA logo, description of services provided by the firm, mission, values and vision of</p>

	the firm, are not allowed to be given on the visiting card. To that extent he would be deemed guilty of professional misconduct.
(b)	<p>The superannuation-cum-pension fund for the employees of a listed company was under a separate trust. Both the company and the trust were under the same management. The auditor, who was auditing the accounts of the company as well as the trust noted some irregularities in the operation of the trust and commented upon these irregularities in the confidential report given to the trustees, but did not mention about these irregularities in his report on the annual accounts of the trust. He also charged a statutory audit fee of Rs. 2.50 lacs from the company and Rs. 3.00 lacs as audit fees from the trust for the ensuing year under audit. (4 Marks)</p> <p>Hint: Section 8, 21A, 21B and 22 of the Chartered Accountants Act, 1949 read with Schedules issued thereunder, state that a member of ICAI in practice shall be deemed guilty of professional misconduct, if: (i) he fails to disclose/ report material facts/ misstatements, in his report. However, in <i>Allen Craig & Co., Re</i>, it was held that it is not the part of auditors duties to ensure that their report has been circulated to each and every member. Their reporting duty comes to end once the report is being submitted to the governing body of the entity; (ii) he is grossly negligent in his professional duties; (iii) he contravenes any of the provisions of the Act and/ or Regulations issued thereunder Further, a member of ICAI shall be deemed guilty of other misconduct if he brings disrepute to the profession, by his act, whether committed in his professional/ non-professional capacity. Further, under Central Council General Guidelines, 2008, a member of ICAI in practice, shall be deemed guilty of professional misconduct, if: (i) he charges from his same specified client (PSU, Govt. Co., Listed Co., Other Public Company having turnover of atleast Rs. 50 crores in a financial year), a statutory audit fees at an amount which is lower than the fees for other services/ work. Conclusion: Thus, in the given question, the auditor would be deemed guilty of misconduct, because of the following reasons: (i) he has not appropriately disclosed the irregularities in the report on annual accounts of the trust (<i>Allen Craig & Co. case</i>) [Assumption: The auditors have disclosed irregularities in the confidential report as a matter of communication of matters to those charged with governance]; (ii) Central Council General Guidelines would not be applicable as fees is charged from two different clients (and not from the same specified client), namely (i) listed company; and (b) trust.</p>
(c)	<p>M/s XYZ a firm of Chartered Accountants received Rs. 2 lakhs in January, 2015 on behalf of M/s S Pvt. Limited an OPC client in which Mr. X's step sister holds 100% interest as member, for being utilised to deposit client's advance tax. The firm deposited the amount in their Bank account but the firm, meanwhile, changed its stand and adjusted this amount towards amount recoverable from client w.r.t. the audit fees and certification fees to the extent of Rs. 1.50 lakhs and forecast certification fees to the extent of Rs. 50,000. (4 Marks)</p> <p>Hint: As per Section 8, 21A, 21B and 22 of the Chartered Accountants Act, 1949, read with Schedules issued thereunder, a member of ICAI in practice shall be deemed guilty of professional misconduct, if: (i) he fails to deposit client's money in a separate bank account or to use such money within reasonable time. Client's money here shall mean the money received by the member in practice in his professional capacity (ii) he defalcates/ embezzles money received by him in his professional capacity; (iii) he contravenes any of the provisions of the Act and/ or Regulations issued thereunder Further, ICAI clarified that the audit fees recoverable cannot be adjusted with the amount payable to the client, as it results in impact upon independence of the member in practice. Further, a member of ICAI shall be deemed guilty of other misconduct if he brings disrepute to the profession, by his act, whether committed in his professional/ non-professional capacity. Conclusion: Accordingly on the basis of above, it may be concluded that in the given question, M/s XYZ a firm of Chartered Accountants shall be deemed guilty of misconduct because they made a contravention in depositing clients' money in separate Bank Account and for adjusting their recoverable fees against clients' money. Caution: The question is not asking about appointment of M/s XYZ as statutory or tax auditor and thus there is no role of the step sister in this question.</p>
(d)	<p>Mr. J.J. a practicing Chartered Accountant engages himself as part time finance manager of Quick Return Securities Limited. He is of the view that as both functions are independent, he need not take permission from the Institute. Would your answer be different if he is appointed as a statutory auditor of Quick Return Securities Limited in which his father is the finance manager and he quoted his fees to be paid only if it earns profits from its portfolio management services. (4 Marks)</p> <p>Hint: As per Section 8, 21A, 21B and 22 of the Chartered Accountants Act, 1949, read with Schedules issued thereunder, a member of ICAI in practice shall be deemed guilty of professional misconduct, if he:</p>

	<p>(i) engages himself in other business/ occupation or undertakes full time employment elsewhere, without obtaining prior permission of ICAI. However, there is no misconduct, if he alongwith practice engages in those services which are permitted under Regulation 190A or undertakes employment in a CA firm. It should be noted that portfolio management services, underwriting services and brokering services are not permitted to be provided by virtue of Regulation 190A. In the second part of the question, the portfolio management services are provided by Quick Return Securities Limited and not by Mr. J.J., a practicing CA;</p> <p>(ii) expresses opinion on the financial statements of the entity in which he himself or his partner or his firm or his relatives hold substantial interest. In the second part of the question, his father is only a finance manager but does not hold any substantial interest (i.e. atleast 20% of the voting power in Quick Return Securities Limited);</p> <p>(iii) charges his fees on the basis of percentage of profits and/ or contingent findings. But there would not be any professional misconduct if the fee from specified services is being charged on percentage basis while acting as auditor of cooperative society, liquidator of an entity or valuer for the purposes of direct taxation [Regulation 192]</p> <p>Further, a member of ICAI shall be deemed guilty of other misconduct if he brings disrepute to the profession, by his act, whether committed in his professional/ non-professional capacity.</p> <p>Conclusion: Accordingly on the basis of above, it may be concluded that in the given question, Mr. J.J., a practicing CA would be deemed guilty of professional misconduct, because of the following reasons:</p> <p>(i) he engages himself as part time finance manager of Quick Return Securities Limited, without obtaining prior permission from ICAI;</p> <p>(ii) he quoted his fees on the basis of contingent findings.</p>
3. (a)	<p>Draft audit report u/s 143(3)(g) of the Companies Act, 2013 on the following 3 aspects in for XYZ Ltd. as on 31.3.2018: (6 Marks)</p> <p>(i) Where all directors have given written representations that they have not defaulted u/s 164(2) of the Co. Act, 2013.</p> <p>(ii) Where one of the directors, Mr. Flexible has failed to produce written representation that he has not defaulted u/s 164(2) of the Companies Act, 2013.</p> <p>(iii) Where on the basis of written representations received from the directors it is noticed that one of the directors, Mr. Rigid has defaulted in terms of Section 164(2) of the Companies Act, 2013.</p> <p>Hint:</p> <p>(i) Where the directors have not defaulted: “On the basis of the written representations received from the directors and taken on record by the Board of Directors, we report that none of the directors is disqualified as on 31 March, 2018 from being appointed as a directors in terms of Section 164 of the Companies Act, 2013.”</p> <p>(ii) Where one of the directors failed to produce written representation. “Mr. Flexible who is also a director of XYZ Ltd. has not produced any written representation to the company as to whether XYZ Ltd. as at 31.03.2016 had not defaulted in terms of Section 164 of the Companies Act, 2013. In the absence of the representation we are unable to comment whether Mr. Flexible is disqualified from being appointed as director in terms of Section 164 of the Companies Act, 2013. As far as other directors are concerned on the basis of the written representation received from such directors and taken on record by the Board, we report that none of the remaining directors is disqualified as on 31.3.2018 from being appointed as a director in terms of Section 164 of the Companies Act, 2013”.</p> <p>(iii) Where a director is found to be disqualified. “On the basis of the written representation received from Mr. Rigid who is a director of XYZ Ltd. as on 31.3.2018 and taken on record by the board, we report that Mr. Rigid is disqualified from being appointed as a director in terms of Section 164 of the Companies Act, 2013. As far as other directors are concerned, on the basis of written representations received and taken on record by the board we report that none of the remaining directors is disqualified as on 31.3.2016 from being appointed as director in terms of Section 164 of the Companies Act, 2013.”</p>
(b)	<p>Draft a letter of engagement to carry out systems audit of a listed PSU subjected to review under Clause 41 of listing agreement, clearly stating within such letter of engagement the important characteristics of an effective system of Computer Audit Programme in cloud computing environment and the audit factors that should be considered while using the work of BPO units?</p> <p>Whether such letter of engagement is subjected to be reviewed by the Peer Reviewer. If yes, then can he obtain a copy of such letter for his peer review working papers to be submitted to Peer Review Board. Advise about the services rendered by practice unit which are not subjected to peer review (6 Marks)</p> <p>Hint:</p> <p>Draft letter of engagement clearly stating that: The management is primarily responsible for ensuring the existence of important characteristics of an effective system of computer audit program:</p> <p>(a) The system has to be simple to use and eliminate the need to remember countless details normally required</p>

	<p>in writing or revising computer programs.</p> <p>(b) It has to be easily understandable even by those with little computer expertise and easy to use.</p> <p>(c) It has to be capable of being used with different configuration of computers.</p> <p>(d) The package has to include adequate support at the time of installation, provide adequate training to the staff and to provide documentation. There should be a provision for future revision of the program.</p> <p>(e) The package should have statistical sampling capability.</p> <p>(f) The system has to be acceptable to all users in terms of easy execution and compatible with the existing system.</p> <p>(g) The program has to be capable of processing different types of applications.</p> <p>(h) The program should have strong report writing function including the ability to prepare multiple reports in a single program run and to generate flexible output report formats.</p> <p>Also clearly mention that the reviewers may require Type A/ B report from the auditor of the service organization. Such letter of engagement is also subjected to be reviewed by the Peer Reviewer but he cannot obtain a copy of such letter for his peer review working papers to be submitted to Peer Review Board.</p> <p>Services not under the Scope of peer review are as follows:</p> <ol style="list-style-type: none"> 1) Management Consultancy; 2) Representation before authorities; 3) Due diligence services; 4) Giving Expert opinion; 5) Testifying as Expert; 6) Compilation of financial statements; 7) Preparation of financial information; 8) Taxation services such as tax return preparation or giving tax advice/ opinion <p><i>Caution:</i> Bear in mind that question is not asking you to draft letter of engagement to carry out review under Clause 41.</p>
(c)	<p>A CA firm is providing a range of services to individuals, partnership firms and companies that include statutory and internal audits. One of its clients has recently announced the launch of a real estate company with the objective of entering the villa and raw house segment in joint development with another leading real estate company. It has been approached to perform the functions of the internal auditor of the newly set-up company. Accordingly, it is in the process of compiling the internal audit manual and as part of this exercise it seeks your inputs on the specific legislations that would be applicable to companies operating in the real estate segment which it can include as part of the Audit Manual. (4 Marks)</p> <p>Hint: The key pieces of legislation that typically apply to companies in the real estate sector and which form part of a model internal audit manual are summarized below:</p> <ol style="list-style-type: none"> 1. The Real Estate (Regulation and Development) Act, 2016; 2. The Urban Land (Ceiling and Regulation) Act 3. The Land Acquisition Act 4. The Environmental Protection Act 5. The Transfer of Property Act 6. The Registration Act 7. The Indian Stamp Act 8. Property Tax <p>The Employment of construction workers is regulated by an array of legislations including: The Minimum Wages Act, 1948, The Payment of Bonus Act, 1965, The Building and Other Construction Workers (Regulation of Employment and Conditions of Service) , Act, 1966, The Employees Provident Funds and Miscellaneous Provisions Act, 1952, The Payment of Gratuity Act, 1972, The Workmen's Compensation Act, 1923 , The Payment of Wages Act, 1936</p>
4. (a)	<p>List the main areas to be covered by the auditor in the case of energy and environment audit of an industrial unit. (4 Marks) [Hint: See Chapter on Other Aspects (Direct Theory Question)]</p> <p style="text-align: center;">Or</p> <p>Examine the possibility of filing non-adopted balance sheet with the Registrar of Companies and preparation of subsequent year's accounts with the balance taken from such a balance sheet. Also examine the possibility of filing unaudited balance sheet with the Registrar (4 Marks)</p> <p>Hint: As per the provisions of Sec. 137 of the Companies Act, 2013:</p> <ol style="list-style-type: none"> 1. Where the audited financial statements are not adopted at the AGM then such unadopted audited financial statements shall be filed with ROC within 30 Days from the date of such AGM; 2. These unadopted audited financial statements should be recorded by ROC on provisional basis until adopted

	<p>audited financial statements are filed with ROC within 30 days of adoption of these financial statements in the adjourned AGM. However, in terms of Section 137, unaudited financial statements cannot be filed with ROC.</p>
(b)	<p>State the salient features of the directions (questionnaire) to the auditors of Government companies issued by the Comptroller and Auditor General of India u/s 143(3) & (5) of the Companies Act, 2013 in relation to performance audit of: (i) Assets and Investments, and (ii) Inventory and Contracting. Also examine the directors' responsibility, if any, when the statutory auditor as well as C&AG have issued qualified report for the Government Company. (4 Marks) [Hint: See Chapter on Audit of Government Companies for Questionnaire u/s 143(3)&(5) [mentioned in the Class Booklet] and Section 134 for Directors' Responsibilities to explain reservations is only for Statutory Auditors and not for CAG - see your class booklet for the Chapter on Audit Reports (Direct Theory Question)]</p> <p style="text-align: center;">Or</p> <p>HWP (P) Ltd. is having only 2 members H & W. During the audit for the year ended on 31.3.2015, you as an auditor found that: (4 Marks) (i) H, who is in charge of purchases has introduced fictitious purchase bills of Rs. 50 lakhs; (ii) W, who is in charge of sales, has sold goods worth Rs. 1 crore without bringing the same in the books of account. You raise the matter with H and W in their capacity as directors. They contest that as this is a position known to them and within their own fold, you should not report the same under the Companies Act, 2013. Discuss whether these arguments are acceptable under the Companies Act, 2013 for non-reporting. If not, state the reasons and the manner of reporting. (4 Marks)</p> <p>Hint: The arguments put forth by H and W, directors of H.W.P. Pvt. Ltd., for non-reporting of fictitious purchases of Rs. 50 lakhs and omission of recording of sales of Rs. 1 crore under the Companies Act, 2013 are not acceptable in view of the following reasons: (i) The scope of audit of a company is determined by provisions of the Companies Act, 2013. Even the terms of the engagement cannot restrict the scope of audit in relation to matters which are prescribed by legislation [SA 200R read with <i>Newton v. Birmingham Small Arms Co.</i>] (ii) Section 143 requires the auditor to state whether "in his opinion and to the best of his information and according to the explanations given to him", the accounts "give a true and fair view in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year and in the case of the profit and loss account, of the profit or loss for its financial year". Thus, the primary duty of the auditor is to determine whether the balance sheet shows a true and fair view of the state of the company's affairs as at the end of the financial year and whether the profit and loss account shows a true and fair view of the working results of the company for the year. (iii) The fact that there are only two members and they are fully aware of such transactions would not have any impact as far as scope of audit is concerned. Therefore, it would, therefore, be obligatory on the part of auditor to report these aspects in the audit report. The following paragraph in the audit report under section 143 of the Companies Act, 2013 should be included: "On the basis of information and explanation given to us, together with our audit examination, subject to the purchases of Rs..... as reflected in the profit and loss account being overstated by Rs.50 lakhs and sales of Rs.....as reflected in the Profit and Loss Account being understated by Rs.1 crore and thus resulting in understating the profits of the company by Rs.1.50 crores, we report that the financial statements are reflecting true and fair view" Notes: (i) <i>The Students could also discuss fraud reporting to CG u/s 143(12) committed by them in their capacity as directors (being employees).</i> (ii) <i>The Students could also discuss about the adverse impact on functioning of the company on account of effect on the stock positions reflected in the stock ledgers and on the physical inventory vis-à-vis ineffective internal control system thereto.</i></p>
(c)	<p>(i) Khaas Aadmi Party, a political party registered with Election Commission of India, has received huge amount of contributions for funding its election contests. The Election Commission of India has appointed you to audit the political contributions received by the party. Draft the audit programme for such an audit. (4 Marks)</p> <p>Hint:</p> <ul style="list-style-type: none"> • Study the Memorandum/ Articles of the political party to ensure that fund raising activities are carried out as per the object clause and proper authorisation • Examine the legal requirements/ code of conduct for fund raising through donations as laid down by Election Commission of India for political parties; • Verify the modes of organizing fund raising activities • Where contributions have been received through foreign entities, examine the compliance of Foreign

	<p>Contribution Regulation Act, 1976</p> <ul style="list-style-type: none"> • Check whether the contributions are received synonymously or anonymously • See for the utilisation of political contributions received by the political party • Correlate with any other significant observation made during the compliance and reporting under Income Tax Act, 1961 <p>(ii) M/s ABC and Co., a chartered accountant firm was the statutory auditor of ABC Limited. The firm was reconstituted with all the new partners as M/s XYZ and Co. The reconstituted firm also printed on its visiting card and published on the official website that its one of the top and leading firm in India. Comment. (1 Mark)</p> <p>Hint: Since there is a complete change in the constitution of the firm M/s ABC and Co., it would result in casual vacancy u/s 139(8) and such casual vacancy shall be filled within 30 days by the Board wherein the Board can appoint M/s XYZ & Co. as Statutory Auditor of ABC Limited. Printing on its visiting card and publishing on the official website that its one of the top and leading firm in India will result in professional misconduct under Clause 7 of Part I of First Schedule of the Chartered Accountants Act, 1949.</p> <p>(iii) The Board of Directors of a company have filed a complaint against their statutory auditors, with the ICAI, for their failing to attend AGM of the shareholders in which audited accounts were considered. Mr. A is an auditor of a company. He was to be paid Rs. 45,000 towards his remuneration (comprising Rs. 25,000 as audit fees, including service tax; Rs. 10,000 towards preparing and filing Form 8, 13 regarding registration of charges and Rs. 10,000 as other charges). Mr. A was not paid this statutory audit fees for two years. For the current year he told the secretary of the company to bring the cheques of all the three years and take delivery of the audit report. How would you disclose this remuneration in the Statement of P & L by examining the righteousness of contention raised by Mr. A. (3 Marks)</p> <p>Hint: The complaint filed to ICAI is admissible because as per Section 146 of the Companies Act, 2013, the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, <i>who shall also be qualified to be an auditor</i>, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor. As per Schedule III of the Companies Act, 2013, the auditors' remuneration shall be disclosed as follows: Payments to the auditor as: (a) auditor; (b) for taxation matters; (c) for company law matters; (d) for management services; (e) for other services; and (f) for reimbursement of expenses Further, the auditors are duty bound to issue their audit report and hence it's improper for them for correlating the issuance of their audit report with the payment of their audit remuneration. They cannot exercise right of lien on the books and records of the company if their fees is not paid to them.</p> <p style="text-align: center;">Or</p> <p>(iii) One of the members of AKA Limited has proposed the name of Mr. Fame for appointment as a director of the company in the annual general meeting and given a notice under Section 160. Mr. Fame is also one of the partners of Fame and Fame, Chartered Accountants, who are the retiring auditors of the company. But the audit of the company is being looked after by another partner of the firm. Examine whether Fame and Fame can be reappointed as auditors, if Mr. Fame is appointed as director (3 Marks)</p> <p>Hint: If Mr. Fame is appointed as a director, he will be considered as an officer or employee of the company and this will make him disqualified to be appointed or reappointed as auditor of the company. The firm 'Fame and Fame' would also be disqualified and the fact that the audit work is being looked by some other partner of the firm will not make any difference [Section 141 of the Companies Act, 2013]</p>
5. (a)	<p>Mention <i>any</i> 15 reporting Clauses of Form 3CD (Revised) as notified by CBDT for reporting to be made by Tax Auditors under Section 44AB of Income Tax Act, 1961. (5 Marks)</p> <p>Hint: The significant reporting Clauses of Form 3CD (Revised) are as follows: 1) Clause 12: Presumptive Profits; 2) Clause 13: Method of Accounting including reconciliation with ICDS; 3) Clause 14: Method of Stock Valuation; 4) Clause 17: Reporting u/s 43CA and 50C; 5) Clause 18: Depreciation;</p>

- 6) Clause 21 & 23: Special expenses, Sec 40(a), 40(b) and 40A;
- 7) Clause 26: Reporting u/s 43B;
- 8) Clause 27: CENVAT and Prior Period Items;
- 9) Clause 28 & 29: Reporting u/s 56(2)(viiia)/ (viib);
- 10) Clause 30 & 31: Sec 69D and Sec 269SS/ 269T;
- 11) Clause 33: Deductions under Chapter VI-A and u/s 10A, 10AA;
- 12) Clause 34: TDS
- 13) Clause 35: Stock Qty
- 14) Clause 40: Accounting Ratios [Gross profit/turnover; Net profit/turnover; Stock-in-trade/turnover; Material consumed/finished goods produced]
- 15) Clause 41: Reporting about Demand or Refund other than DT Laws

Or

Draft an audit programme for (i) Audit of Public Trust under Income Tax Act, 1961; & (ii) Audit of Indirect Taxes and Audit under GST regime (5 Marks)

Hint:

Audit of Public Trusts under Income Tax Act: The audit of public trust under Income Tax Act, 1961 can be carried out by considering the following points:

1. Obtain a resolution from the trust specifying the appointment as also indicating the scope of audit. In particular, the resolution should specify the duties of the auditor in relation to the items specified in the annexure to Form No. 10B;
2. Obtain a letter of appointment from the trust;
3. Obtain a certificate as to the opening balances of assets and liabilities and the fund;
4. Obtain a list of books of accounts which are maintained by the trust;
5. Obtain a written representation from the trust as to the system of accounting and internal control;
6. Obtain from the trust a list of the institutions/ activities run/ carried out by the trust;
7. Obtain from the trust a certified true copy of the Deed of Trust or any other scheme containing the objects and conditions of the trust as operative from time to time.
8. Vouch the transactions of the trust to satisfy that:
 - (a) the transaction is properly authorised by the trustees or other delegated authority as may be permissible in law;
 - (b) all incomes have been properly accounted for on the basis of the system of accounting followed by the trust;
 - (c) all expenses and outgoings of the trust are recorded as per the system of accounting followed by the trust; and
 - (d) amounts shown as applied towards the object of the trust are covered by the objects of the trust as specified in the document governing the trust.
9. Obtain a trial balance on the closing date certified by the trustees;
10. Obtain the Balance Sheet and Profit & Loss Account of the trust authenticated by the trustees and check the same with the trial balance with which they should agree.
11. Obtain from the trustees, a certified list of persons covered by Section 13(3)

Audit of Indirect Taxes: Some areas of concern in an audit of indirect taxes would be:

- (i) Non availment or short / excess availment of control or export incentives.
- (ii) Goods imported duty free or payment at concessional rates without properly complying with conditions.
- (iii) Valuation Issues – valuation not in line with customs rules.
- (iv) Applicability of the relevant control excise exemptions.
- (v) Valuation of goods not removed in normal course using valuation methods not in line with Central Excise Valuation Rules.
- (vi) Ignoring Liability under Service Tax on services provided or availed.
- (vii) Procedural non-compliance w.r.t. filing of periodic returns, timely deposit of taxes, etc.

Audit under GST regime: direct theory question from the Class Booklet.

- (b) "The auditor should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity." Briefly state the matters to be included in such Communication including a situation where you noticed a misstatement resulting from fraud or suspected fraud during the audit and concluded that it is not possible to continue the performance of audit. (5 Marks)

Hint:

The following are the audit matters of governance interest which are to be communicated as per SA 260:

- (i) The general approach and overall scope of audit including expected limitations.
- (ii) The selection of or change in significant accounting policies and practices that have a material effect on the entity's financial statements.

- (iii) The potential effect on the financial statements of any significant risks and exposures.
- (iv) Adjustment to financial statements arising out of audit which have a significant effect on the financial statement.
- (v) Material uncertainties that may cast significant doubt on the entity's ability to continue as a going concern.
- (vi) Disagreement with management on matters which could have significant impact to the F.S. and to audit report.
- (vii) Expected modifications to the audit report.
- (viii) Others matters like material weakness in internal control measures, management's integrity, frauds, etc.
- (ix) Other matters agreed in terms of audit engagement.

If an auditor concludes that it is not possible to continue the performance of auditing because of misstatement resulting from fraud or suspected fraud, he should take action in accordance with the requirement of SA 240 in relation to the Auditor's Responsibility to consider Fraud and Error:

- (i) He should consider the professional and legal responsibilities applicable in the circumstances including whether there is a requirement for the auditor to report to the person(s) who made the audit appointment.
- (ii) He should consider whether he has to report to the regulatory authorities.
- (iii) If the auditor withdraws, he should discuss with the appropriate level of management and those who charged with the governance about the reasons for the withdrawal.

In view of the exceptional nature of circumstances and the need to consider the legal requirement, he may also seek legal advice for determining the appropriate course of action.

Or

While commencing the statutory audit of B Company Limited, the auditor undertook the risk assessment and found that the detection risk relating to certain class of transactions cannot be reduced to acceptance level. Further he is of the view that assessment of materiality is dependent upon the professional judgement of the audit team.

Comment (5 Marks)

Hint:

As per SA 315 read with SA 330 in relation to Risk Assessments and Internal Control the auditor should use professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. "Detection risk" is the risk that an auditor's substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material. The higher the assessment of inherent and control risks, the more audit evidence the auditor should obtain from the performance of substantive procedures. When both inherent and control risks are assessed as high, the auditor needs to consider whether substantive procedures (e.g. vouching and verification, analytical procedures) can provide sufficient appropriate audit evidence to reduce detection risk, and therefore audit risk, to an acceptably low level. The auditor should use his professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. If it cannot be reduced to an acceptable level, the auditor should express a qualified opinion or a disclaimer of opinion as may be appropriate.

- (c) (i) What are the propriety elements to be reported by Auditors pursuant to enquiry under Companies Act, 2013 (3 Marks)

Hint:

Enquiry under Section 143(1) of Companies Act, 2013:

Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:—

- (a) **Loans and advances:** whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
- (b) **Transactions by book entries:** whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
- (c) **Securities sold at less than purchase price by other than investment or banking company:** where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- (d) **Loans and advances shown as deposits:** whether loans and advances made by the company have been shown as deposits;
- (e) **Personal expenses:** whether personal expenses have been charged to revenue account;
- (f) **Allotment of shares for cash:** where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment.

and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading

(ii) Advise XYZ Ltd. for appointment of statutory auditors and cost auditors if: (3 Marks)

Date of incorporation: 3-10-2015 and Date of receipt of certificate of commencement of business: 18-10-2015
Nominal value of Equity shares held (Rs. in Lakhs)

Uttar Pradesh Government	11,600
Central Government	8,000
Bharat Heavy Electricals Ltd. (A Corporation controlled by CG)	8,000
Private Sector Companies	8,800
Indian Mutual Funds	4,000
Foreign Financial Institution	4,000
Individual Members	3,600
Total	48,000

Extract from Statement of P & L Account: [the Co. is involved in manufacturing and sale of one type of product only]

Intra State Sale	Rs. 140 Lakhs
Inter State Sale	Rs. 155 Lakhs
Exports to US	Rs. 490 Lakhs
Exports to UK	Rs. 690 Lakhs
Total Revenue	Rs. 1475 Lakhs

Answer: The company M/s XYZ Ltd. is not a Government company, since the aggregate holding of the Central Government and State Governments does not amount to 51% or more of the paid up share capital of M/s XYZ Ltd. However, since more than 51% of paid up share capital of AJD Limited is held by Central Government, Uttar Pradesh Government, and the Corporations owned or controlled by Central Government (*Bharat Heavy Electricals Ltd.*), the appointment of first auditors of AJD Limited shall be made by the Comptroller and Auditor General of India (CAG), within 60 days month from the date of incorporation of the company (i.e. *on or before 1-12-2015*). The remuneration of auditors of AJD Limited shall be determined in the general meeting. As per Cost Accounting and Audit Rules, 2014 (as amended), the requirement for cost audit shall not be applicable to a company:

1. Whose export revenue in foreign exchange > 75% of its total revenue; or
 2. Which is operating from a special economic zone; or
 3. Which is engaged in generation of electricity for captive consumption through Captive Generating Plant
- Since, Total Exports = Rs. 1,180 Lakhs and these account for 80% of Total Revenue [i.e. $1,180/1,475 \times 100$], cost audit is not applicable to the Company [Note that although no cost audit is required but cost accounting records are still required to maintained by the Company]

Note: Statutory auditors cannot be appointed as cost auditors of the same company and vice versa [Section 148 of the Companies Act, 2013]

6. (a) (i) Explain the scope of (i). Concurrent audit of a bank, (ii). LFAR, (iii) Memorandum of Changes and (iv) CBS in Banks. (4 Marks)

Hint: Direct theory questions from Class Notes

Or

(ii) Advise whether Mr. X can accept the following respective of various companies:

(a) He is proposed to be appointed as a statutory auditor of:

- A. 4 private limited companies having paid up share capital of less than Rs. 100 crores,
- B. 1 producer company having paid up share capital of Rs. 50 lakhs,
- C. 2 one person companies,
- D. 1 dormant company,
- E. 1 small company and
- F. 1 private company having paid up share capital of Rs. 90 crores but which is a subsidiary of a public company.

He already holds 20 statutory audits of various public limited companies;

Hint: Private Companies, OPC, Dormant Companies and Small Companies exempted to be counted u/s 141(3)(g) of the Companies Act, 2013. Producer Companies are treated as private companies u/s 581C of the Companies Act, 1956 read with Section 465 of the Companies Act, 2013. As per Council General Guidelines, 2008 issued by ICAI, Limits u/s 141(3)(g) + Exemptions u/s 141(3)(g) \leq 30 statutory audits per CA in practice. Thus, Mr. X cannot be

- appointed as statutory auditor of deemed public company mentioned at point 'F' above.
- (b) Of which of the above companies he can be appointed as a tax auditor;
Hint: As per section 288 of the Income Tax Act, 1961, if a person is disqualified to appointed as a statutory auditor of a company then he is also disqualified to be appointed as tax auditor of such company;
- (c) CA X is holding full time COP and is also having right to receive 10% share from another partnership firm of Chartered Accountants, on account of work being referred to them through his connections. Can he be appointed as tax auditor of such partnership firm. Would yours answer be different if he is appointed as tax consultant.
Hint: Disqualified u/s 288 of the Income Tax Act, 1961; No disqualification u/s 288 for tax consultant.
- (d) CA X and CA Y joined hands together as founders and registered a society under Societies Registration Act, 1860 as "All India Chartered Accountants Society". Advise whether CA 'X' can be appointed as tax auditor for this society. Would your answer be different if his relative or partner is proposed to be appointed as tax auditor instead of him being appointed in that capacity.
Hint: Disqualified u/s 288 of the Income Tax Act, 1961

- (b) (i) The auditor of the company requested one of its vendors to confirm the account balances due appearing in its books of account for a longer period of time. Despite several repeated requests the vendor did not reply and hence the auditor assumed that balances are not misstated and issued an unqualified audit report as not much of the audit risk is involved since these balances accounted only for 2% of the total net worth of the entity. (6 Marks)

Hint:

Refer Case Study in Class Notes under the heading "External Confirmations". Auditors assumption without sufficient and appropriate audit evidence signifies that he is also guilty under Clause 7 & 8 of Part I of Second Schedule (primarily) to the Chartered Accountants Act, 1949. Also discuss the involvement of audit risk under SA 315 and materiality under SA 320 and Schedule III requirements – similar question discussed in the Class as well.

- (ii) Advise as a statutory auditor under CARO & other allied provisions as per the Co. Act, 2013, for 2015-2016: (8 Marks)

1. Compute the amount of reserves under CARO, 2016:

Particulars as per Sch. III	Case 1	Case 2	Case 3
▪ General Reserves	10	10	10
▪ Revaluation Reserves	5	5	5
▪ Sinking Fund	2	2	2
▪ Securities Premium A/c	4	4	4
▪ P & L (Dr.) [Hint: P & L Account (Dr.) Balance shall be adjusted against total reserves even if the resulting figure is negative figure]	(15)	(18)	(22)
▪ Discount on issue of Debentures [Hint: discount of issue of debentures to be adjusted to extent of Securities Premium Account]	1	1	1
▪ Reserves under CARO, 2016	? = Rs. 5	? = Rs. 2	? = Rs. (2)

2. ABC Private Limited has furnished the following information for the financial year 2015-2016:

- (i). Paid up Share capital [since incorporation till 2015-2016 = Rs. 48 Lakhs];
(ii). Reserves and Surplus [2015-2016 = Rs. 4 Lakhs];
(iii). Bank Overdraft [2015-2016 = Rs. 80 Lakhs];
(iv). Loan from NBFC [2015-2016 = Rs. 25 Lakhs];
(v). Operational Revenue [2015-2016 = Rs. 1.5 crores];
(vi). Non-operational Revenue of Interest Income [2015-2016 = Rs. 0.1 crore]
- (a). Advise whether CARO, 2016 is applicable on the company for the financial year 2015-2016. Would yours answer be different if PQR Limited is a subsidiary of ABC Private Limited.
(b). Would yours answer be different if PQR Limited is a holding company for ABC Private Limited.
(c). Would yours answer be different of PQR Limited had been PQR (P) Limited.

Hint: CARO, 2016 is not applicable on ABC (P) Limited despite the total loan from Bank and NBFC being more than Rs. 1 Crore, because ABC (P) Limited is a small company in terms of section 2(85) of the Co. Act,

	<p>2013. CARO, 2016 will always be applicable on ABC (P) Limited if it is (i) holding; or (ii) subsidiary, of PQR Limited - see discussion for Private Companies and Small Companies in yours Class Notes Had the company been PQR (P) Limited, then ABC (P) Limited will lose its status of a small company u/s 2(85) and CARO, 2016 will become applicable because ABC (P) Limited is a normal private company which is having total loan from Bank and NBFC being more than Rs. 1 Crore.</p> <p>3. During the course of audit of D Co. Ltd. (incorporated 6 years back) whose net worth is eroded, you as an auditor have observed that during 2015-2016, an inter-corporate deposit of Rs. 50 lakhs has been overdue. The company has defaulted in depositing PF and ESI dues to the labour department. The D Co. Ltd. has disclosed this in the notes to Accounts Note No. 15 in schedule no. 21 stating that '<i>Rs. 50 lakhs is overdue from XYZ Co. Ltd. and the said company is in the process of liquidation. The management is taking steps to appoint the liquidator</i>', and it was duly emphasised by the auditor in his audit report for 2015-2016. The said sum remained overdue even the in current year and liquidator was thus appointed at the instructions of the High Court. The company has also borrowed a term loan of Rs. 10 crores for purchasing plant and machinery. Advise about the reporting requirements as a statutory auditor.</p> <p>Hint: The statutory auditors need to consider the reporting for the following in his audit report:</p> <ul style="list-style-type: none"> • Reporting under Clause 3(iv), 3(v), 3(vii), 3(ix) and 3(xiii) of the CARO, 2016 [assumed that companies are related]; • Impact of Labour Laws in accordance with SA 250 issued by ICAI; • Impact on going concern appropriateness in accordance with SA 570 issued by ICAI; • Reporting of mitigating factors (if any) through Emphasis of Matter Paragraph; • Reporting about comparative position for the unresolved overdue debt position even in the current year [in accordance with the principles of SA 710] • Reporting about adverse impact u/s 143(3) of the Companies Act, 2013. [See Guidance Note discussed in the Class]
7. (a)	<p>(i) The auditor identified certain uncorrected misstatements during the course of audit examination. He wants to communicate this fact to the Client but is skeptical to develop some strained relations with him. Enumerate the matters which may result in such strained relationship and how he should deal with such uncorrected misstatements. (3 Marks)</p> <p>Hint: As per Engagement and Quality Control Standards issued by ICAI in relation to audit materiality and evaluation of misstatements, the auditor should consider the implications of the misstatement in relation to other aspects of the audit, particularly, the reliability of management representations. Further, in such circumstances, the auditor should consider requesting the management to adjust the financial information or consider extending his audit procedures. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate. In the instant case, the auditor has detected the material errors affecting the financial statements; the auditor should communicate his findings to the management on a timely basis, consider the implications on true and fair view and also ensure that appropriate disclosures have been made. As per SA 330, once audit risk is being assessed and identified, then auditor should consider the following to deal with such audit risk:</p> <ol style="list-style-type: none"> 1. Emphasizing the need to maintain professional skepticism [Refer SA 200R]; 2. Assigning more experienced staff/ experts [Refer SA 620]; 3. Incorporating unpredictability about further audit procedures to be performed (i.e.: surprise checks); 4. Widening the scope of audit 5. Changing the nature, timing and extent of audit procedures [Refer SA 520] <p>As per SA 240, the following factors may result in strained relations between auditor and the management:</p> <ol style="list-style-type: none"> a) Denial of access to records, facilities, etc for seeking evidence; b) Undue time pressures to resolve complex issues; c) Complaints by management about conduct of audit team; d) Key IT & other operational areas, systems etc. denied to be accessed; e) Unwillingness by management to permit auditor communicate to those charged with governance; <p>Tolerance of violations of entity's code of conduct</p> <p>(ii) What are the major sources of obtaining information about the client's business including assessment of appropriateness of going concern and what factors influence the application of analytical procedures in an audit of financial statements? (3 Marks)</p> <p>Hint:</p>

	<p>As per SA 315, knowledge of business can be obtained through following sources:</p> <ul style="list-style-type: none"> • Previous experience with entity & industry; • Discussions with directors/ customers/ suppliers/ internal audit personnel/ legal advisors, etc.; • Visits to entity premises; • Industry or Entity publications, for example, surveys, annual reports, etc. <p>The appropriateness of going concern assumption can be assessed in light of following indications:</p> <p>a) <i>Financial indications</i> such as negative net worth, adverse financial ratios, relying upon short term funds for long term projects, entering into scheme of arrangement with various lenders, etc.;</p> <p>b) <i>Operating indications</i> such as high labour turnover, loss of major market share, difficulties in obtaining raw material supplies, etc.;</p> <p>c) <i>Other indications</i> such as changes in Govt. policies, pending litigations and claims, etc.</p> <p>Further, the auditors also need to examine the mitigating factors, i.e., those compensatory factors that make the severity (i.e. harshness or inappropriateness) of going concern assumption as less severe.</p> <p>SA 520 states that analytical procedures (such as ratio analysis, etc.) can be influenced by:</p> <ul style="list-style-type: none"> • nature of available information; • materiality of items involved; • sources of available information; • reliability of available information; • knowledge of the business; and • comparability of available information
(b)	<p>In respect of members of stock exchanges advise about:</p> <p>(i). Types of margins; and</p> <p>(ii). Types of books of accounts to be maintained;</p> <p>(iii). Contents of audit report; and</p> <p>(iv). Investigation by SEBI</p> <p>Hint: Direct theory question. Refer Class Booklet</p> <p style="text-align: center;">Or</p> <p>As an internal auditor for a large manufacturing concern, you are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.</p> <p>Hint:</p> <p>The Internal Audit Programme in connection with Plant and Machinery and Tools and dies may be on the following lines:</p> <p>(i) <i>Internal Control Aspects:</i> The following may be incorporated in the audit programme to check the internal control aspects:</p> <p>(a) Maintaining separate register for hired assets, leased asset and jointly owned assets.</p> <p>(b) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.</p> <p>(c) All movements of assets are accurately recorded.</p> <p>(d) Authorisation be obtained for –</p> <p>(i) a declaring a fixed asset scrapped.</p> <p>(ii) selling a fixed asset.</p> <p>(e) Check whether additions to fixed asset register are verified and checked by authorised person.</p> <p>(f) Proper recording of all additions and disposal.</p> <p>(g) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.</p> <p>(h) Regular review of adequate security arrangements.</p> <p>(i) Periodic inspection of assets is done or not.</p> <p>(j) Regular review of insurance cover requirements over fixed assets.</p> <p>(ii) <i>Assets Register:</i> To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.</p> <p>(iii) <i>Cost Report and Journal Register:</i> To review the cost relating to each plant and machinery and to verify items which have been capitalised.</p> <p>(iv) <i>Code Register:</i> To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.</p> <p>(v) <i>Physical Verification:</i> To see physical verification has been conducted at frequent intervals.</p> <p>(vi) <i>Movement Register:</i> To verify (a) whether a Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.</p>

- (vii) *Assets Disposal Register*: To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.
- (viii) *Spare Parts Register*: To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.
- (ix) *Review of Maintenance*: To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.
- (x) *Review of Obsolescence*: To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.
- (xi) *Review of R&D*: To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

Or

Whether consolidation of financial statements is required for FY 2015-16 in case of A Pvt. Limited company not having a subsidiary but having an associate/joint venture companies (JVs)? Whether a company A Ltd. is required to consolidate its subsidiary which is a Limited Liability Partnership (LLP) or a partnership firm? Whether A Ltd. (an unlisted company) is required to prepare CFS in case B Ltd. (holding company of A Ltd) has prepared CFS and included the financial statement of A Ltd.?¹ (5 Marks)

Hint:

The requirement of preparation of consolidated financial statement (CFS) by companies not having subsidiary but having associate/JV comes from the AS Amendment Rules which have been notified by the MCA on 30th March, 2016. However, MCA *vide* General Circular 04/2016, dated 27.04.2016 has clarified that the AS Amendment Rules should be used for preparation of accounts for accounting periods commencing on or after the date of the notification. Therefore, the accounting period commencing after the date of the notification (*i.e.*, 30.03.2016) is 2016-17, the CFS should be prepared even by the companies not having subsidiary but having associate/JV from the financial year 2016-17 and onwards. It is pertinent to mention here that on 24.06.2016 *vide* Frequently Asked Questions (FAQs) regarding requirements to prepare CFS, ICAI also has clarified that even in case a company has no subsidiary but has associate/JV, CFS needs to be prepared for FY 2015-16.

Thus, in the first part of question the consolidation of financial statements is required in the instant case.

In the second part of question:

Yes, CFS must be prepared by A Ltd. for its subsidiary which is an LLP or partnership firm. Section 129(3), read with relevant rules thereof provides for the manner of consolidation of accounts pursuant to Schedule III of the Act, 2013 and the applicable AS. AS 21 defines subsidiary as an enterprise controlled by the parent. The term 'enterprise' includes a company and any enterprise other than a company. Therefore, LLPs and partnership firms are required to be consolidated. It is noted that under relevant Ind AS, *i.e.*, Ind AS 110, Consolidated Financial Statements provides that where an entity has control on one or more other entities, the controlling entity is required to consolidate all the controlled entities. Since, the word 'entity' includes a company as well as any other form of entity, therefore, LLPs and partnership firms are required to be consolidated. Accordingly, in the given case, A Ltd. is required to consolidate its subsidiary which is an LLP or partnership firm.

In the third part of the question:

MCA *vide* its circular dated 27th July, 2016 provided an exemption to a parent company from preparing consolidated financial statements if certain conditions prescribed thereof are fulfilled. The conditions are as follows:

"Provided further that nothing in this rule shall apply in respect of preparation of consolidated financial statements by a company if it meets the following conditions:—

- (iv) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company *and* all its other members, *including those not otherwise entitled to vote*, having been intimated in writing *and* for which the *proof of delivery* of such intimation is available with the company, *do not object to the company* not presenting consolidated financial statements;
- (v) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India, *and*
- (vi) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards."

In the present case, it is assumed that A Ltd. has intimated to the equity shareholders only. The aforesaid para is very clear to say, that the intimation shall be given to all the members, that is to say, intimation shall be given to equity as well as preference shareholders. A Ltd. has not given any intimation to its preference shareholders w.r.t. non-preparation of CFS. Thus, CFS must be prepared by A Ltd.

¹ This question is primarily meant for FR Paper. But considering the same cardinal feature in Auditing Paper, this question is relevant for this Paper too.

<p>(c)</p>	<p>Draft a general audit programme <i>including specifically</i> the programme for audit of Prudential Norms in respect of NBFC engaged in the business of equipment leasing and borrowing & lending. (5 Marks) [Hint: Discuss Prudential Norms (see class notes) plus the following: (i) Ascertain whether the NBFC has an adequate appraisal system for extending equipment leasing finance. (ii) Verify whether there is an adequate system in place for ensuring installation of assets and their periodic physical verification. In respect of some major transactions, an auditor should arrange for physical verification of the leased assets so as to dispel any doubts that equipment leasing finance was not extended without the corresponding assets being created. (iii) Ascertain whether the NBFC has an adequate system for monitoring whether the assets have been adequately insured against and regular maintenance of the leased assets is being carried out by the lessee. (iv) Verify the lease agreement entered into with the lessee in respect of the equipment given on lease.]</p> <p style="text-align: center;">Or</p> <p>Draft a limited review report pursuant to Clause 41 of the listing agreement, for ABC Limited, a listed PSU for the quarter ending on 31st December, 2016, for being submitted to the stock exchanges where it is listed. (5 Marks) Hint: Form of Unqualified Review Report REVIEW REPORT TO... We have reviewed the accompanying balance sheet of ABC Company as at December 31, 20XX, and related statement of profit and loss, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review. We conducted our review in accordance with the Revised Standard on Review Engagements (SRE) 2400, "Engagements to Review Financial Statements", issued by the Institute of Chartered Accountants of India (ICAI). This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provide less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion. Based on our review, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the Financial Reporting Standards.</p> <p>For ABC and Co., Chartered Accountants</p>
<p>8.</p>	<p>Write short notes on any four of the following (4 Marks each):</p> <p>(a) Role of Audit Committee in Corporate Governance [Hint: Direct theory question. See Class Booklet for Clause 49/ SEBI (LODR) Regulations, 2015]</p> <p>(b) Powers and duties vis-à-vis responsibilities of auditors of a multi-state Cooperative Society in a joint audit Hint: He shall have a right of access at all times to the books, accounts and vouchers of the Multi-State Co-operative Society whether kept at the head office of the Multi-State Co-operative Society or elsewhere and shall be entitled to require from the officers or other employees of the Multi-State Co-operative Society such information and explanation as the auditor may think necessary for the performance of the duties as an auditor. As per section 73(2) the auditor shall make the following inquiries:</p> <p>(a) Whether loans and advances made by the Multi-State Co-operative Society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi-State Co-operative or its members; (b) Whether transactions of the Multi-State Co-operative Society which are represented merely by book entries are not prejudicial to the interest of the Multi-State Co-operative Society; (c) Whether personal expenses have been charged to revenue account; and (d) Where it is stated in the books and papers of the Multi-State Co-operative Society that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.</p> <p>As per SA 299, each joint auditor is <i>solely responsible</i> for the work allotted to him. However, in the following cases the joint auditors would be <i>jointly & severally responsible</i>:</p> <p>i. Compliance and disclosure requirements as per some statute (for example, Bank audits) ii. Agreed amongst themselves to be jointly and severally liable iii. Collective decisions taken by them on any task</p> <p>Every joint auditor is having the right to issue his own individual report or one common report with other joint</p>

auditors. A Joint Auditor is not bound by the opinion of majority of other auditors. One joint auditor can rely upon the work of the other joint auditor and no further checking/ test checking is required to be done, unless there are suspicious grounds.

- (c) Management Discussion & Analysis Report and material non-listed subsidiary under Indian SOX vs. Inconsistent information in Audit Report about such subsidiary [**Refer Clause 49/ SEBI (LODR) Regulations, 2015 Notes vs. SA 720**]
- (d) Submission of audit report u/s 136 read with 137 of the Companies Act, 2013 vs. Compilation of Proforma Financial Statements vs. Compilation of Financial Statements [**Refer Class Notes SA 810 vs. SAE 3420 vs. SRS 4410**]
- (e) Basic elements of Internal Audit Report vs. Directors' Report vs. Auditor's duty to verify the correctness of Directors' Report [**Refer Class Notes reference for SIA 4 vs. Section 134 vs. It's not a part of auditors' duty u/s 143 to verify the directors report. According to Section 143, the auditors are required to express their opinion on the profit and loss account and every document which is required to be annexed to the balance sheet, but the Boards' Report is not annexed, but is attached to the balance sheet**]
- (f) Auditors' certification about their appointment vs. Management's Certification vs. MSMED Reporting [**Refer Class Notes on Appointment of Auditors vs. SA 580 vs. MSMED Reporting as follows: MSMED (Micro, Small and Medium Enterprise Development) Act Reporting under Section 22; Every Buyer whose accounts are required to be audited under any Law shall be required to report following dues to MSMED Enterprises, in Notes to Accounts:**
 1. Principal;
 2. Interest;
 3. Interest paid u/s 18;
 4. Interest accrued and remaining unpaid present year;
 5. Of (4), Interest accrued and remaining unpaid in next year also
- (g) Comparatives vs. Subsequent Events [**Refer SA 710 and SA 560**]
- (h) Solvency Margin and Types of Re-insurance Contracts [**Refer Class Notes**]
- (i) Cases where fees can be charged by members in practice of percentage basis of other parameters. Can they exercise of lien if client has refused to pay the fees.

Hint: Lien cannot be exercised by virtue of ESB Clarification. The Supreme Court's decision in *R.D. Saxena v. Balram Prasad Sharma [2000] 7 SCC 264*, held that professionals cannot exercise lien of client's documents or books of account entrusted to them as these are not 'goods' (i.e., sale-able goods).

Regulation 192 of the Chartered Accountants Regulations, 1988 provides that:

(a)	in the case of a receiver or a liquidator, the fees may be based on a percentage of the realisation or disbursement of the assets;
(b)	in the case of an auditor of a co-operative society, the fees may be based on a percentage of the paid-up capital or the working capital or the gross or net income or profits;
(c)	in the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of the property valued;
(d)	in the case of certain management consultancy services as may be decided by the resolution of the Council from time to time, the fees may be based on percentage basis which may be contingent upon the findings, or results of such work;
(e)	in the case of certain fund raising services, the fees may be based on a percentage of the fund raised;
(f)	in the case of debt recovery services, the fees may be based on a percentage of the debt recovered;
(g)	in the case of services related to cost optimisation, the fees may be based on a percentage of the benefit derived; and
(h)	any other service or audit as may be decided by the Council.

- (c) **Quality Review Board of ICAI:** *Caution:* Do not confuse this with Peer Review Board

Under the provisions of the Chartered Accountants Act, 1949, the Board shall perform the following functions:-

- (a) to make recommendations to the Council with regard to the quality of services provided by the members of Institute;
- (b) to review the quality of services provided by the members of the Institute including audit services; and
- (c) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

Some New Questions to be prepared

1.	<p>Company X acquires Company Y, on June 2017. Pursuant to such acquisition the Company Y becomes 100% subsidiary of Company X. Company X and Company Y have March 31 as their financial year end for purpose of statutory reporting. During May 2017, the Company X was under planning to go for initial public offer and thus in accordance with the requirement of SEBI Regulation, the Company X has decided to prepare Proforma Financial Statements for purpose of its intended filing of the offer document in August 2017, which will include financial information for each of the 5 years ended March 31, 2017 in accordance with SEBI Regulations. Advise about the assurance reporting requirements to be followed by the statutory auditors of the company.</p> <p>Hint: Refer SAE 3420.</p> <ul style="list-style-type: none"> • Proforma Financial Statements are used in the offer documents to demonstrate the effect of a transaction on the financial statements of an Issuer company as if the transactions had occurred at an earlier date. • Accordingly, Company X would be required to present proforma balance sheet and present proforma Statement of Profit and Loss for year ended March 31, 2016 as if the acquisition was completed on March 31, 2016; • The approach selected should be clearly disclosed in the notes to the Proforma Financial Statements and the auditor should check that such approach is consistently applied over the reported years.
2.	<p>Distinguish between CDR, SDR, S4A schemes and Revised Framework for Stressed Assets and debt restructuring notified by the RBI.</p> <p>Hint: Refer class notes - direct theory question</p>
3.	<p>What are the various factors on which the choice of sample size is dependent. Is it mandatory for an auditor to do sample checking during audit examination.</p> <p>Hint: Factors:</p> <ol style="list-style-type: none"> 1. Materiality; 2. Nature/ size of business; 3. Complexity of transactions and expert's views, if any; 4. Integrity of management; 5. Tolerable misstatements 6. Sampling risk and resultant impact on overall audit risk, etc. <p>It is not mandatory for an auditor to do sample checking during audit examination but due to huge volume of data, vouchers, records, transaction and time constraint, it may not be possible to vouch and verify each and every item of total population and records. So for completing an audit in a time bound manner auditor might be required to do some sample checking. For this purpose ICAI issued SA 530 in relation to audit sampling which provides various methods of sampling and also provides proper manner of implementing the same during an audit. It should be noted that auditor's will remain responsible for the opinion expressed by them on sample basis of examination.</p>
4.	<p>What are the KYC norms to be complied with by a member in practice. What is the period for which working papers shall be retained by such member in practice.</p> <p>Hint: Refer chapter on Code of Ethics and SQC 1 in yours class notes - direct theory question</p>
5.	<p>What are the factors that require the auditors to:</p> <p>(a). Retest the internal controls</p> <p>Hint: The various factors are as follows:</p> <ul style="list-style-type: none"> • Professional judgement • Weak (i.e. deficient) control environment • Substantially the controls are manual rather than automated or the automated controls themselves are deficient • Frequent changes in employed personnel • Changes in business environment <p>(b). Review the materiality</p> <p>Hint: The various factors are as follows:</p> <ul style="list-style-type: none"> • Professional judgement of the auditor • Changes in assessment of audit risk and sampling risk • Changes in information or basis on which materiality was assessed earlier • Changes in size and nature of entity's operations • Changes in applicable FRF
6.	<p>What are the types of erroneous conclusions that may result due to sample checking. What methods shall be applied to make a sample selection</p> <p>Hint: Direct theory question from the Class Notes</p>

7.	<p>What are the factors on which the efficiency of internal check system depends.</p> <p>Hint: The various factors are:</p> <ul style="list-style-type: none"> • Efficient channel of communication • Job rotation at regular intervals • Usage of more of automated systems rather than manual systems • Daily deposit of cash in the Bank account • Segregation of job responsibilities and no single person being made responsible for multiple tasks
8.	<p>Indicate the control procedures which the auditor should adopt in applying CAAT (Computer Assisted Audit Technique) in an audit under CIS environment and in determining whether to use CAATs, what are the factors that a statutory auditor has to consider.</p> <p>Hint: Direct theory question from the Chapter on “Class Notes way of answering EDP Audit Questions”</p>
9.	<p>Describe the powers of investigation under the Companies Act, 2013 w.r.t. investigation of related companies etc. and investigation into ownership of the company.</p> <p>Hint: Direct question from the Class Notes – see Section 219 and 216 of the Companies Act, 2013.</p>
10.	<p>Describe forensic audit and the steps to carry out forensic audit.</p> <p>Hint: Direct question from the Class Notes</p>
11.	<p>Distinguish between audit of company and audit of LLP</p> <p>Hint: Answer to be developed from the class notes</p>