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FOR CA INTERMEDIATE EXAM PREPARATION

CA Intermediate 2024 Suggested Answers · Paper 5 Auditing and Ethics

EXAM	YEAR	TYPE
CA Intermediate	2024	Suggested Answers

SUBJECT	DATE
Paper 5 Auditing and Ethics	May 2024

PAPER – 5 : AUDITING AND ETHICS

*Question No.**1** is compulsory.*

*Attempt any **four** questions from the remaining **five** questions.*

Question 1

(a) APR & Associates, a Chartered Accountant firm, are appointed as the auditors of Time Ltd. and Bakes Ltd. The volume and nature of business of both the companies are entirely different. CA R is the engagement partner for Bakes Ltd. CA P is the engagement partner for Time Ltd. CA R formulates an Audit Programme for conducting the audit of Bakes Ltd. He suggests CA P to use the same audit programme for Time Ltd. But CA P is of the opinion that this audit programme will not be useful for the audit of Time Ltd.

In light of the above, mention the matters that should generally be considered while preparing an Audit Programme. Is CA P correct in emphasizing for a different Audit Programme for Time Ltd.? ***(4 Marks)***

(b) ABC & Co. are in the business of manufacturing toys. The stock taking process has been done by the company as on 31.3.2024. The company has used FIFO method for valuation of its inventories. The cost of inventory as on 31.3.24 is ₹ 25,25,000/- and the net realizable value of the inventory on the same date is ₹ 25,24,000/-.

The cost of inventory includes the following:

(1) Material purchase cost - ₹ 25,05,000/-

(2) Allocated transport cost - ₹ 18,000/-

(3) Abnormal wastage - ₹ 2,000/-

The management seeks your advice in arriving at the value of inventory to be shown in the financial statements of the company. What should be the value of inventory in accordance with AS-2? ***(4 Marks)***

(c) Mr. Z, at the time of appointment as an independent director in EF Ltd. a listed company, came to know that the Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on internal controls for a listed Company. He wants to know the responsibilities as casted

under Companies Act, 2013 with regards to Internal Financial Control for (1) Directors (2) Independent directors and (3) Audit committee as per section 134(5)(e), 149(8) & 177(4) (vii) respectively of the Companies Act, 2013.

(3 Marks)

(d) CA B, an auditor, after the completion of busy audit season, was occupied in assembling of final audit files of one of his client. First of all, he started preparing various documents of that client and then kept those documents in various folders. He was preparing documents as well as audit file in paper form because he believed that it is mandatory. He could complete documentation as well as assembling of final audit file of that client after three months from the date of audit report. Generally, he retains audit file of the clients for 4 years from the date of audit report. Check the validity of the action of CA B. ***(3 Marks)***

Answer

(a) Following matters should be considered generally while preparing an Audit Programme:

(1) Stay within the scope and limitation of the assignment.

(2) Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.

(3) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.

(4) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.

(5) Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.

(6) Consider all possibilities of error.

(7) Co-ordinate the procedures to be applied to related items.

Evolving one audit programme- Not Practicable for All businesses: Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of

internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable.

In view of above mentioned provisions, CA. P is correct in emphasizing for a different audit programme for Time Ltd.

(b) Value of Inventory: Inventory to be recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories. Further, any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (e.g. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.

In the given situation, ABC & Co. is using FIFO method for valuation of its inventories. Further, cost of inventory as on 31.03.2024 is rupees 25,25,000 which includes material purchase cost of rupees 25,05,000, allocated cost of transport of rupees 18,000 and abnormal wastage of rupees 2,000. Net realizable value of said inventory is ₹ 25,24,000. In view of provisions of AS 2, cost allocated to transport for inventory is relating to bringing the inventory to the location, thus it will be added in cost of material. However, abnormal wastage of rupees 2000 should be excluded from cost of inventory.

Thus, cost of inventory will be ₹ 25,25,000 – ₹ 2,000 = 25,23,000 rupees and Net realizable value of inventory is ₹ 25,24,000.

For valuation in accordance with AS 2, "Inventory", lower of cost and net realizable value will be considered. Accordingly, ₹ 25,23,000 to be considered as value of inventory in the given situation.

(c) Internal financial controls as per regulatory requirements: The Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls for a company. The term "internal financial controls" is used at some places in Companies Act, 2013 casting responsibilities as under: -

Relevant provision of Companies Act,2013	***Nature of Responsibility***
Section 134(5)(e)	In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls to be followed by the company and that such Internal financial controls are adequate and were operating effectively.
As per Section 149(8) of the Act	The company and independent directors shall abide by the provisions specified in Schedule IV which lays down the Code for independent Directors. As per this code, the role and functions of independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible.
Section 177(4)(vii) of the Act	Every audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include - evaluation of internal financial controls and risk management systems.

(d) Assembly of the Final Audit File:

Audit documentation may be recorded on paper or on electronic or other media. Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement. Hence the views of CA B that audit documentation should be maintained mandatorily in paper form is not correct.

The auditor shall prepare audit documentation on timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to

enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed. Completing the audit Documentation by CA B not on timely basis is not proper.

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. In the given situation, CA. B, after completion of audit season, is completing the audit file as well as assembling of final audit files of his client after three months of the date of audit report which is not valid as per SQC 1.

SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and Related Services", requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report. He retains audit file of the client for 4 years from the date of audit report is also non-compliance of SQC 1.

Question 2

(a) CA Q is the engagement partner for the audit of a Departmental store. As a part of the risk assessment procedure, he wants to make inquiries of the management and others within the entity. What kind of information can the auditor get by inquiring from the following?

(i) Internal audit personnel

(ii) In-house legal counsel

(iii) Marketing or sales personnel

(iv) Information systems personnel ***(4 Marks)***

(b) CA Z, the auditor of MNO Ltd., during the course of audit, assesses a risk of material misstatements regarding the litigations and claims involving the company. CA Z is not convinced with the management's explanations regarding the status of the litigations or claims. It is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general enquiry. The auditor sent a letter of specific enquiry requesting the

entity's external legal counsel to communicate directly with the auditor. List out the inclusions in the letter of specific enquiry.

In certain circumstances the auditor may judge it necessary to meet with entity's external legal counsel to discuss the likely outcome of the litigations or claims. What will be auditor's reporting responsibility if the management refuses to give permission to the auditor to communicate or meet with the external legal counsel? ***(4 Marks)***

(c) *JK Ltd. was having a 'Pager' manufacturing plant and looking at the demand it was of the view that the company will grow continuously in future. But, with the introduction of mobile phones in the market, the plant was shut down completely. The shareholders of the company were of the view that auditor failed to perform their duty and have not informed to them about the company's inability to continue its business, otherwise they might not have suffered the loss. List down the factors giving rise to the inherent limitations due to which auditor cannot provide a guarantee that the financial statements are free from material misstatement due to fraud or error.*

(3 Marks)

(d) *B Ltd. is a company manufacturing bed-sheets and pillow covers. They have appointed M/s C & Co., Chartered Accountants, as their auditors. The auditor is establishing audit strategy with his team members. As the work progressed, they came to know that the company has diversified its business and now they are also planning to manufacture wooden furniture. The auditor, in his professional judgement, considers this to be a significant factor in directing the engagement team's efforts. Give examples of factors that, in auditor's professional judgement, are significant in directing the engagement team's efforts.* ***(3 Marks)***

Answer

(a) Inquiries of Management and Others Within the Entity:

(i) Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.

(ii) Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract.

(iii) Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.

(iv) Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system-related risks.

(b) A letter of specific inquiry includes:

(i) A list of litigation and claims;

(ii) Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and

(iii) A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.

In certain circumstances**,** the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims. Further, if management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding, and the auditor is unable to obtain sufficient appropriate evidence by performing alternate audit procedures, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

Alternatively, if the auditor is able to perform alternate audit procedures and can obtain sufficient and appropriate audit evidence to resolve the issue, then he can give an unmodified opinion.

(c) Inherent limitations of audit: The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors: -

(1) Nature of financial reporting: Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

(2) Nature of Audit procedures: The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are *practical and legal* limitations on ability of auditor to obtain audit evidence. For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of *practical limitation* on auditor's ability to obtain audit evidence.

Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of *legal limitation* on auditor's ability to obtain audit evidence. Further, fraud may involve sophisticated and carefully organized schemes.

(3) Not in nature of investigation: Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

(4) Timeliness of financial reporting and decrease in relevance of information over time: The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it.

(5) Future events: Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

(d) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts: The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under: -

(i) Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control.

(ii) Significant industry developments such as changes in industry regulations and new reporting requirements.

(iii) Significant changes in the financial reporting framework, such as changes in accounting standards.

(iv) Other significant relevant developments, such as changes in the legal environment affecting the entity.

Question 3

(a) CA E is auditor of LM Ltd. Before commencing with current year's audit, he initiated planning for the audit. Planning includes the need to consider certain matters, prior to the identification and assessment of the risk of material misstatements. Enumerate such matters. ***(4 Marks)***

(b) The management of PQ Ltd. changed during the period under audit. Mr. G an auditor, at the time of receiving written representation on the management responsibilities from the management, was in a dilemma related to the date of and period(s) covered by the written representation. Further, new management was of the view that they can give written representation from the date they took over and not for the prior period when old management were managing affairs of the company. Guide the auditor & the management in this respect. ***(4 Marks)***

(c) *You are appointed as the auditor of a company manufacturing paints. The company has a robust system of internal control. Most of the controls in the company are automated and they are working effectively. However, in certain situations, manual elements in internal controls are more suitable. What are the circumstances where manual elements in internal controls may be more suitable?* ***(3 Marks)***

(d) *M/s PSR & Associates are the auditors of The Saturn Hotel, a chain of five-star hotels. Since the nature of their business is prone to frauds, the company has appointed internal auditors at various locations. The company has also devised a system of effective and efficient internal controls. The auditors, M/s PSR & Associates, want to use the work of the internal auditors. In order to ensure effectiveness, what kind of coordination should be there between the external auditor and the internal audit function?* ***(3 Marks)***

Answer

(a) Nature of Audit Planning- A Continuous and iterative process: Planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as: -

1. The analytical procedures to be applied as risk assessment procedures.
2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
3. The determination of materiality.
4. The involvement of experts.
5. The performance of other risk assessment procedures.

(b) As per SA 580, "Written Representations", the date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor's report.

Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated

as near as practicable to, but not after, the date of the auditor's report on the financial statements.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies. In view of above, management is required to provide the written representation for all the periods even when current management were not present during all periods referred to in the auditor's report.

(c) Manual elements vs automated elements in entity's internal control: Manual elements in internal control may be more suitable in the following circumstances:

- Where judgment and discretion are required.
- Large, unusual or non-recurring transactions.
- Circumstances where errors are difficult to define, anticipate or predict.
- In changing circumstances that require a control response outside the scope of an existing automated control.
- In monitoring the effectiveness of automated controls.

(d) As per SA 610, "Using the Work of Internal Auditors", coordination between the external auditor and the internal audit function is effective when, for example;

(i) Discussions take place at appropriate intervals throughout the period.

(ii) The external auditor informs the internal audit function of significant matters that may affect the function.

(iii) The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

Question 4

(a) *M/s KLM & Co. Chartered Accountants, a partnership firm, while designing tests of controls and tests of details in MN Ltd. has to determine the items for testing that can be effective in meeting the purpose of the audit procedure. For this, they decided to select specific items from a population. State the factors that can be considered by the audit firm for selecting specific items from a population and also state the specific items that can be included for such testing.* ***(4 Marks)***

(b) *Mr. L is a principal auditor of OP Ltd. There are several divisions of OP Ltd. that are audited by other auditors. State the procedures Mr. L should ordinarily perform to obtain sufficient and appropriate audit evidence that the work of other auditors is adequate for the principal auditor's purpose in the context of this assignment.* ***(4 Marks)***

(c) *LD Ltd. has given below loans to the following borrowers during the financial year 2023-24. Mr. B an auditor wants your guidance regarding additional regulatory information required to be provided under the Companies Act, 2013:*

Borrowers	***Maximum Loan granted during the year 2023-2024 (₹ in Lakh)***	***Outstanding Loan as at 31/03/2024 (₹ in Lakh)***
X (Promoter)	*20*	*15*
Y (Director)	*30*	*25*
Z (KMP)	*10*	*05*
A (Related Party)	*20*	*10*
Others	*80*	*65*
Total	***160***	***120***

(3 Marks)

SUGGESTED ANSWER

INTERMEDIATE EXAMINATION: MAY 2024

(d) XY and Associates are auditors of PQR Ltd., which provides electrical components on project basis. The purchases are huge and the auditor wants to make sure that all the purchases made during the period are recorded and there is no understatement or overstatement. For this purpose the audit team have performed procedures like cut-off tests, correct treatment of goods in transit, obtaining written representations and performing analytical procedures. What are the analytical procedures required to be performed to obtain audit evidence as to overall reasonableness of purchase quantity and price? ***(3 Marks)***

Answer

(a) The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include:

(i) the auditor's understanding of the entity,

(ii) the assessed risks of material misstatement, and

(iii) the characteristics of the population being tested.

Specific items selected may include:

- **High value or key items:** The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic.
- **All items over a certain amount:** The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.
- **Items to obtain information:** The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

(b) The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

(i) Advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for

co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter -component transactions that may require disclosure and the time-table for completion of audit; and

(ii) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

(iii) The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor.

(c) As additional regulatory requirements, following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, Directors, KMPs and the related parties (as defined under Companies Act, 2013,) either severally or jointly with any other person, that are:

(a) repayable on demand or

(b) without specifying any terms or period of repayment.

Type of Borrower	**Amount of loan or advance in the nature of loan outstanding (₹ In Lakhs)**	**Percentage to the total Loans and Advances in the nature of loans (₹ in Lakhs)**
X (Promoter)	15	**12.5%** =15/120 X 100
Y (Director)	25	**20.833%** =25/120 X 100
Z (KMP)	05	**4.167%** =5/120 X 100
A (Related Party)	10	**8.333%** =10/120 X 100

(d) The auditor should perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include:

(i) **Consumption Analysis:** Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with

previous years with closing stock and ask for the reasons from the management, if any significant variations are found.

(ii) **Stock Composition Analysis:** Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.

(iii) **Ratios:** Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.

(iv) **Quantitative Reconciliation:** Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.

Question 5

(a) PQ & Co. want to diversify its business and for that purpose they want to raise money by issuing shares to the general public. The face value of the shares is ₹ 100 but the directors of the company propose to issue the shares at a discounted rate of ₹ 95/- so as to receive more response. The statutory auditor, however, objects to the same as it is not allowed as per the Companies Act, 2013. State the provisions of Section 53 of the Companies Act, 2013 with reference to shares issued at a discount and the consequences where the company fails to comply with the provisions of this section.

(4 Marks)

(b) HR & Associates are the auditors of a large manufacturing company. The company has recently invested huge amount in Property, Plant and Equipment (PPE) for its new unit. They have added many incidental expenses to the cost of PPE. The junior audit team members are not sure about which costs should be excluded from the cost of PPE. Give examples of costs that should not form part of costs of PPE. ***(4 Marks)***

(c) A professional accountant is expected to comply with the fundamental principles of professional ethics at all times. Explain which fundamental principle governing professional ethics is violated in the following situations?

(1) A chartered accountant in practice accepted the appointment as an auditor of a firm in which his sister was a partner.

(2) A chartered accountant in practice was approached by his friend to seek some insider information about a company, which was a client of the chartered accountant. He could not refuse his friend's request.

(3) A chartered accountant in practice failed to inform his client about the change in laws applicable to his client. ***(3 Marks)***

(d) You have been appointed as the statutory auditor of a limited company. The company is registered as a Nidhi company. What are the reporting requirements of a Nidhi company under the Companies Auditor's Report Order, 2020? ***(3 Marks)***

Answer

(a) Shares issued at a discount: According to Section 53 of the Companies Act, 2013,

(1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.

(2) any share issued by a company at a discounted price shall be void.

Notwithstanding anything contained in above sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

(3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

(b) Examples of costs that are not costs of an item of property, plant and equipment are:

(i) costs of opening a new facility or business, such as, inauguration costs;

(ii) costs of introducing a new product or service (including costs of advertising and promotional activities);

(iii) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(iv) administration and other general overhead costs.

(c) Fundamental Principles:

(1) **Objectivity:** The principle of objectivity requires that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity. Objectivity principle will be violated in the given situation where a chartered accountant in practice accepted the appointment as an auditor of a firm in which his sister was a partner.

(2) **Confidentiality:** Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships. Confidentiality principle will be violated in the given situation where a chartered accountant in practice could not refuse his friends requested to seek some insider information about a client company of the chartered accountant.

(3) **Professional Competence and Due care:** A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and act diligently and in accordance with applicable technical and professional standards. Professional Competence and Due Care principle will be violated in the situation where a chartered accountant in practice failed to inform his client about the change in laws applicable to his client.

(d) Reporting requirements of a Nidhi Company under the CARO 2020: The auditor is required to report under clause (xii) of Paragraph 3 of CARO 2020:

(a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability;

(b) whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.

Question 6

(a) CA M is the engagement partner of the firm M/s Y2Z LLP and he is auditing the financial statements of a listed entity ABC Ltd. The audit firm has determined that an engagement quality control review is required for this assignment. Discuss the responsibilities of CA M as an engagement partner for engagement quality control review as per SA-220. ***(4 Marks)***

OR

(a) Sanskar Foundation is a Non-Governmental Organisation (NGO) for orphan children. They have received voluntary contribution of ₹ 50 lacs from the promoters, specifying that ₹ 20 lacs are towards the Corpus contribution and ₹ 30 lacs are towards Revolving fund. Explain the terms "Corpus contribution" and "Revolving fund". ***(4 Marks)***

(b) MNB bank advanced certain loans guaranteed by government. State the prudential norms for asset classification and income recognition of such loans. ***(4 Marks)***

(c) Mr. D an auditor, while auditing ACE Ltd., identified certain misstatements in relation to particular class of transactions and account balances. He had communicated same to those charged with governance and also taken written representation for the same. State the audit documentation required by the auditor regarding misstatements identified during the audit.

(3 Marks)

(d) JK Ltd. has opened a new manufacturing unit and for that they want plant & machinery. Since the capital outflow will be huge, they are considering of taking it on lease. They have approached several parties and have shortlisted one of them who is ready to give the plant on lease for 11 years, which is approximately the estimated economic life of the asset. As per the agreement, JK Ltd. will bear the insurance and maintenance expenses of the asset. Which kind of lease agreement have JK Ltd. entered into and what is the ownership status, the accounting treatment and the tax benefits of the same?

(3 Marks)

Answer

(a) Engagement Performance: As per SA 220, for audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

(i) Determine that an engagement quality control reviewer has been appointed.

(ii) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.

(iii) Not date the auditor's report until the completion of the engagement quality control review.

(iv) If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

or

(a) A contribution made towards the capital or the corpus of an NGO is known as corpus contribution. The donors are generally required to specify whether the donation/grant given by him shall form part of the corpus of the NGO. Such contributions are generally given with reference to the total funds required by an NGO.

The objective of a contribution or grant towards a Revolving Fund is to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects and then recover the loan so as to give temporary loans again and so on. However, any interest earned from the beneficiary on such temporary loans from the revolving fund could be either added back to the fund or credited to the Income and Expenditure Account depending on restrictions laid down by the authority providing the contribution (for the revolving fund) or by the rules and regulations laid down by the concerned NGO in this regard.

(b) Government Guaranteed Advances (In case of accounts overdue for more than 90 days): Central Government. Guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.

The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

Alternative Solution:

Government Guaranteed Advances (In case of accounts overdue for not more than 90 days):

Asset Classification: In case of advances guaranteed by both Central Government and State Government, they would be classified as Standard Advances in the following manner:

Classification of Advances	Particulars
Standard Regular	Accounts not overdue
Special Mention Accounts:	
1. SMA 0	Accounts showing stress signals
2. SMA 1	Accounts overdue between 31 to 60 days
3. SMA 2	Accounts overdue between 61 to 90 days

Income Recognition

Income would be recognised for all the accounts which are not overdue for more than 90 days, on accrual basis, in case of advances guaranteed by both Central Government and State Government.

(c) **Documentation regarding misstatements identified during audit:** The audit documentation shall include:

(i) The amount below which misstatements would be regarded as clearly trivial;

(ii) All misstatements accumulated during the audit and whether they have been corrected; and

(iii) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

(d) In the given situation, JK Ltd. has opened a new manufacturing unit and for that they want plant & machinery. They have taken the plant on lease for 11 years, which is approximately the estimated economic life of the asset. As per the agreement, JK Ltd. will bear the insurance and maintenance expenses of the asset.

Same will be considered as Finance Lease as per AS-19 since the lease term is for a major part of the economic life of the asset even if title is not transferred.

Status of Ownership: Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred.

Accounting treatment: Finance lease is treated like loan arrangement. Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.

Tax benefit: Lessee can claim both interest and depreciation expense as financial lease is treated like a loan.