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FOR CA FINAL EXAM PREPARATION

CA Final 2022 Suggested Answers · Paper 3 Advanced Auditing and Professional Ethics (Old Scheme)

EXAM	YEAR	TYPE
CA Final	2022	Suggested Answers

SUBJECT
Paper 3 Advanced Auditing and Professional Ethics (Old Scheme)

DATE
May 2022

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

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

*Answer any **four** out of remaining five*

Question 1

(a) *PQR & Associates, Chartered Accountants, is a partnership firm having 3 partners CA P, CA Q and CA R. PQR & Associates are appointed as Statutory Auditors of ABC Limited, a listed entity for the financial year 2021-22 and CA P is appointed as Engagement Partner for the audit of ABC Limited. Before issuing the Audit Report of ABC Limited, CA P asked CA R to perform Engagement Quality Control Review and is of the view that his responsibility will be reduced after review by CA R. Whether the contention of CA P is correct? What are the aspects that need to be considered by CA R while performing Engagement Quality Control Review for audit of financial statements of ABC Limited?*

(5 Marks)

(b) *JKL Limited is engaged in the business of Construction and real estate having various projects across states. M/s YT & Co, Chartered Accountants have been appointed as Statutory Auditors. Audit Team from M/s YT & Co for audit of JKL Limited comprises of CA Z-Engagement Partner, CA Q, a paid assistant and 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is a managing partner. The engagement team discussed that SA 315 and SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the JKL Limited's related party relationships and transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant Standard on Auditing.* ***(5 Marks)***

(c) *Beta Hotel operates in an automated environment and uses application softwares for front desk, Guest reservations, Restaurant and kitchen orders and billing for which CA Anil has been appointed as an auditor. Guide CA Anil the various key aspects that needs to be considered by him while understanding of the automated environment of the Company in accordance with SA 315. Is he required to document the same? If yes, illustrate by giving one example.* ***(4 Marks)***

Answer

(a) **As per SQC 1,** "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the review does not reduce the responsibilities of the engagement partner. Hence, contention of CA. P that after engagement quality control review by CA. R, his responsibility will be reduced, is not correct.

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However, CA. R needs to consider the following aspect while performing Engagement Quality Control Review for audit of financial statements of a listed entity ABC Ltd.:

1. The engagement team's evaluation of the firm's independence in relation to the specific engagement.
2. Significant risks identified during the engagement and the responses to those risks.
3. Judgments made, particularly with respect to materiality and significant risks.
4. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
5. The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
6. The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
7. Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
8. The appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.

(b) **As per SA 550 "Related Parties",** the engagement team discussion that SA 315 and SA 240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.

Accordingly matters that are to be addressed in the discussion by CA Z among the engagement team include:

1. The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).
2. An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
3. The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special-purpose entities for off-balance sheet transactions, or an inadequate information system).

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4. The records or documents that may indicate the existence of related party relationships or transactions.

5. The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of relevant controls.

6. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:

   (a) how special-purpose entities controlled by management might be used to facilitate earnings management.

   (b) how transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

(c) Understanding and Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

1. The applications that are being used by the company;

2. Details of the IT infrastructure components for each of the application;

3. The organisation structure and governance;

4. The policies, procedures and processes followed;

5. IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230. The illustration below is an example of how an auditor can document details of an automated environment:

Application	Used for	Database	Operating System	Network	Server and Storage
SAP ECC/ HANA	Integrated application software	Oracle 19c	HP-UX	LAN, WAN	HP Server and NAS
REVS	Front Desk, Guest Reservations	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD
KOTS	Restaurant and Kitchen Orders	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD

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BILLSYS	Billing	Oracle 12c	Windows 2016 Server	Packaged Software	HP Server Internal HDD

Question 2

(a) *Mr. K has been appointed as statutory auditor of SK Limited for issuing an audit opinion on financial statements and internal controls over financial reporting (ICFR) for the year ended March 31, 2022 under the Companies Act, 2013. Guide Mr. K to prepare a checklist in the form of questions for testing internal control over cash and bank balances. When forming an opinion on ICFR is it necessary for Mr. K to test the transactions only at the balance sheet date?* ***(5 Marks)***

(b) *Jam Private Limited was engaged in business of manufacture of Cycles. CA Roy was appointed as a Statutory Auditor of the Company for the financial year 2021-22. During the year under audit, Jam Private Limited obtained working capital facilities from ABC Bank Limited for ₹10 crore hypothecating the Stock of goods as primary security. On inquiry CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited and the details of submission of quarterly stock statement are as follows:*

Period of Quarter	*Stock Value as per Books of Account as at the end of the quarter (₹ in crores)*	*Stock Value as per quarterly statement submitted to ABC Bank Limited as at the end of quarter (₹ in crore)*
Q1-2021-22	*11.50*	*14.00*
Q2-2021-22	*14.75*	*17.00*
Q3-2021-22	*11.50*	*14.00*
Q4-2021-22	*15.25*	*15.25*

The management of Jam Private Limited did not disclose the above variations in notes to accounts forming part financial Statements of the Company for the year 2021-22. The management replied that there are no variations as on the Balance sheet date and further they are of the view that stock statement furnished to bank is only a formality and computed arbitrarily only for the purpose of securing higher drawing power and hence statutory auditors need not be bothered.

Is the contention of the management valid? As a Statutory Auditor how CA Roy should deal and discuss the disclosure/reporting requirements if any, as per the Companies Act, 2013 and CARO, 2020. ***(5 Marks)***

(c) *CA Ravi, a practising Chartered Accountant, was proprietor of M/s Ravi & Associates. CA Ravi died on 15th September, 2020 due to cardiac arrest. Only family member left behind CA Ravi was his wife, Roohi. On 30th September, 2021, Roohi sold the practice of her husband to CA Balwan for ₹ 25 Lacs along with right to use the firm name i.e.,*

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M/s. Ravi & Associates and requested the Institute to consider the effect of such sale. Give your comments on the following issues with reference to the Chartered Accountants Act, 1949 and Schedules thereto:

(i) Whether Roohi can sell the practice to CA Balwan?

(ii) Can CA Balwan continue to practice as proprietor in name of M/s Ravi & Associates?

(4 Marks)

Answer

(a) In the given case of SK Limited, the appointed auditor Mr. K would prepare checklist for testing internal control over cash and bank balances. An illustrative set of questions to be answered by the audit staff is as follows:

Have you checked that the cashier -

(i) is not responsible for opening the incoming mails;

(ii) does not authorise any of the ledgers;

(iii) does not authorise any expenditure or receipt;

(iv) does not sign cheques;

(v) takes his annual leave regularly;

(vi) inks and balances the cash book every day;

(vii) verifies physical cash balance with the book figure daily at the end of the day;

(viii) prepares monthly bank reconciliation statement;

(ix) holds no other funds or investment;

(x) holds no unnecessary balance in hand;

(xi) does not pay money without looking into compliance with proper procedure and due authorisation; and

(xii) has tendered proper security or has executed a fidelity bond?

In the given situation, Mr. K is Statutory Auditor of SK Limited for issuing opinion on financial statements and internal control over financial reporting. He should surely test transactions during the financial year and not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher. From the discussion given above, it can be concluded that it would not be necessary for Mr. K to test the transactions only at the balance sheet date.

(b) As per clause (vii) of point Y of Schedule III to the Companies Act, 2013 - Division I - Financial Statements for a company whose financial statements are required to comply with the Companies (Accounting Standard) Rules, 2006, "where the company has borrowings from banks or financial institutions on the basis of security of current assets, it

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shall disclose the following :

(a) whether quarterly returns or statements of current assets filed by the company with banks or financial institutions are in agreement with the books of accounts.

(b) if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

Further, as per para 3(ii) (b) of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

The above clause requires CA Roy to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ₹ 5 crores in aggregate. Jam (P) Ltd. has been sanctioned working capital facilities/limit of ₹ 10 crores which is apparently in excess of ₹ 5 crores.

Secondly, whether the quarterly returns filed by the Jam (P) Ltd. company with ABC Bank Ltd. are in agreement with the book of accounts of the company.

According to the data given in the instant situation, it is clear that there are variations in Quarter 1, Quarter 2 & Quarter 3 requiring reporting under this clause because of difference in stock value as per Book of Accounts & Stock Value as per Quarterly returns submitted to ABC Bank Ltd.

Therefore, Contention of the management is not valid.

CA. Roy should report the differences as per the Companies Act, 2013 and CARO 2020 as follows:

	Stock value as per Book Accounts (₹ in Crore)	Stock value as per quarterly statement Submitted to ABC Bank Ltd. (₹ in Crore)	Variation
Q - 1	11.50	14.00	Excess reporting of stock to Bank by 2.50 crore
Q - 2	14.75	17.00	Excess reporting of stock to Bank by 2.25 Crore
Q - 3	11.50	14.00	Excess reporting of stock to bank by 2.50 crore

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(c) Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

It is being resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.

It further lays down that the sale is permitted subject to certain conditions like such a sale is completed/effected in all respects and the Institute's permission to practice in deceased's proprietary firm name is sought within a year of the death of such proprietor concerned. In respect of these cases, the name of the proprietary firm concerned would be kept in abeyance (i.e. not removed on receipt of information about the death of the proprietor as is being done at present) only upto a period of one year from the death of proprietor concerned as aforesaid.

In the given case, Mrs. Roohi, widow of Mr. Ravi, proprietor of M/s. Ravi & Associates, has sold the practice along with right to use the firm name after one year of his death for ₹ 25 lakhs. This sale is in effect the sale of goodwill.

From the discussion given above it can be concluded that:

(i) Mrs. Roohi cannot sell the practice of CA. Balwan with right to use the firm name.

(ii) CA Balwan cannot continue to practice in the name of the firm M/s. Ravi & Associates as a proprietor because the name of the firm M/s. Ravi & Associates would be kept in abeyance only up to a period of one year from the death of the proprietor.

Question 3

(a) M/s PQR Auto, a partnership firm, is engaged in manufacture of automobile spare parts having factory at Surat. CA S was appointed as the Tax Auditor of M/s PQR Auto for the Assessment Year 2022-2023. While carrying out the Tax Audit under section 44AB of the Income-tax Act, 1961. CA S observed following:

(i) Interest of ₹ 50,000 paid to Vendor X who was registered under MSME Act, 2006.

(ii) Interest payment ₹ 10,000 was incurred in relation to earning exempt interest income from Tax Relief bonds.

(iii) Sum of ₹ 1,00,000 was received from Mr. X, for sale of one plant and machinery. But due to non-compliance of one of the conditions as specified in the contract with Mr. X, M/s. PQR Auto forfeited ₹ 1,00,000 during AY 2022-23 as per forfeiture clause mentioned in the contract.

Guide CA S in reporting the above transactions under the relevant clauses in Form No. 3CD. ***(5 Marks)***

(b) TQR Limited is engaged in the business of garment manufacturing having registered office at Mumbai and branches across India. Mr. Shyam, one of the senior Managers was

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involved in creating false documents and legitimate documents were altered to support fictitious transactions. Consequently, the management appointed you to get forensic audit done based on the digital foot-print of transactions handled by Mr. Shyam. The use of sound techniques will enable to discover the defalcations on a timely basis. As a forensic auditor how will you deal and suggest Technology based/Digital forensic techniques.

(5 Marks)

(c) *CA K qualified as Chartered Accountant and started practice as proprietor in the name of M/s K & Associates in the year 2015-16. LST Limited, a listed entity, appointed M/s K & Associates as Statutory Auditor for the year ended 31st March, 2022. CA K signed the balance sheet of LST Limited for the year ended 31st March, 2022 on 14th May, 2022. M/s K & Associates never subjected themselves to the Peer Review process of the Institute since its inception of practice. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.* ***(4 Marks)***

Answer

(a) (i) As per Clause 22 of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to state the amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006. Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, in accordance with the provisions of this Act, shall not be allowed as a deduction for the purposes of the computation of income under the Income-tax Act,1961.

Accordingly, the CA. S is required to report the payment of interest of ₹ 50,000 to Vendor X who was registered under MSME Act, 2006 under clause 22 of Form 3CD of the Income-tax Act, 1961.

(ii) As per Clause 21(h) of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to report about the amount of deduction inadmissible in terms of section 14A Income-tax Act, 1961, in respect of the expenditure incurred in relation to income which does not form part of the total income.

Therefore, CA. S, the auditor is required to scrutinize expense accounts particularly interest account to check whether there is included any expense which is relatable to exempt income. He is also required to note down the amount and mention against the clause.

Thus, in the given situation, CA. S is required to report the same as per clause 21 (h) of Form 3CD of the Income-tax Act, 1961.

(iii) As per Clause 29(A) of Form 3CD of the Income-tax Act, 1961 of the Income-tax Act, 1961, the auditor is required to report,

(a) whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub section (2) of section 56 the Income-tax Act, 1961.

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(b) If yes, to provide the nature of income and amount thereof.

The auditor is also required to obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year and examine whether any amount of such advances has been written back during the year and examine the basis of such write back to determine whether such write back was on account of an act of forfeiture. Further, the auditor is also required to verify the terms of contract to check the conditions to forfeit of such advance and such conditions have occurred, then should verify whether the amount has been actually forfeited.

Thus, same is required to be reported under clause 29(A) of Form 3CD of the Income-tax Act, 1961.

(b) **Technology based /Digital Forensics Techniques:** Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target company hard drives is a requisite facet of any modern forensic audit.

Before taking steps such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy.

Digital investigations can become quite complex and require support from trained digital investigators.

Many open-source digital forensics tools are now available to assist you in this phase of the investigation.

(i)	Cross Drive Analysis	(ii)	Live Analysis	(iii)	Deleted Files
(iv)	Stochastic Forensics	(v)	Steganography	(vi)	EnCase
(vii)	MD5	(viii)	Tracking Log Files	(ix)	PC System Log
(x)	Free Log Tools				

(c) Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available in general terms from the various pronouncements of the Institute is issued by way of Engagement and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers.

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Audit of Listed Companies: Pursuant to SEBI Notification, statutory audit of listed companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s. K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, CA K, the proprietor signed the balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. CA K would be held guilty of professional misconduct under clause (9) of Part I of Second Schedule of the Chartered Accountants Act, 1949. Also, CA K did not comply with the SEBI Notification which was required to be complied with.

Alternative Solution

Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of misconduct if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. It requires every member of the institute to act within the framework of the Chartered Accountants Act, 1949 and the regulations and guidelines made by Council thereunder.

The Statement on Peer Review shall be deemed to be a guideline of the Council under Clause (1) of Part II of Second Schedule to the Act and it is obligatory for the Practice Unit to comply with the provisions contained in this Statement.

As per the Statement every Practice Unit including its branches who has conducted Statutory Audit of Enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI(LODR) regulations, 2015, will be subject to Peer Review in accordance with this statement.

Audit of Listed Companies: Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, Mr K, the proprietor signed the Balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. Hence, CA K would be held guilty of professional misconduct under clause (1) of Part II of Second Schedule of the Chartered Accountants Act, 1949.

Question 4

(a) Comment on the following in the light of certificate of compliance of conditions of Corporate Governance to be issued under SEBI (LODR) Regulations 2015, for a Listed Company (one among the top 1000 listed companies) where the Board consists of 20 directors with a Non-executive director as its Chairman and further-

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(i) One Non-executive Director has attained the age of 70 years;

(ii) One of the Directors is a Director in eight other listed entities;

(iii) The Managing Director is serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a Stock exchange;

(iv) The Non-executive Chairman is the promoter of the Listed Entity which has nine Independent Directors;

(v) One Independent Director has been serving as Independent Director in eight listed entities of which equity shares are listed on a Stock Exchange. ***(5 Marks)***

(b) Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank for the financial year 2021-22. During the course of audit your audit team observed that a lump sum amount has been disclosed as Contingent Liability collectively though the components are correctly identified. In respect of contingent liabilities, the auditor is primarily, concerned with seeking reasonable assurance that all the contingent liabilities are identified and properly valued and the audit firm intends to obtain a representation from the 'management. Highlight the points/checklists that are to be covered in the management representation. ***(5 Marks)***

(c) XYZ Limited is manufacturer of soaps and cosmetics having business operations in Delhi. XYZ Limited is planning to expand its operations across India. Before expansion, the top management of XYZ Limited is willing to· appoint CA T for conducting Management Audit of XYZ Limited. However, the top management of XYZ Limited is afraid that Management Audit may lead to the breeding of antagonism on the part of the Company. The top management of XYZ Limited approached CA T and requested to explain them the causes of antagonism. Help CA T. ***(4 Marks)***

Answer

(a) (i) One non-executive director has attained the age of 70 years: The auditor should ensure that no listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy-five years. In the given situation, there is **no violation** of LODR 2015 for Non-executive director who has attained the age of 70 years.

(ii) One of the Directors is a Director in eight other Listed Entities: As per LODR 2015, a person shall not be a director in more than seven listed entities. In the given situation, there is **non-compliance** as one of the Directors is a Director in eight other listed entities which is exceeding the prescribed limit of seven entities.

(iii) The Managing Director is serving as Independent Director in Four listed entities of which one entity's equity shares are not listed on a Stock Exchange: Any person who is serving as a whole-time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities. For the purpose of above mentioned provision, the count for the number of listed entities on

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which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange. In the given situation, Managing Director has been serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a stock exchange. So it is not exceeding the prescribed limit of three entities, hence there is no violation of LODR 2015.

(iv) The Non-executive Chairman is the Promoter of the Listed Entity which has nine Independent Directors: The auditor should also verify that if the regular non-executive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors. In the given situation, Board consist of 20 directors with a Non-executive Director as its Chairman has 9 independent directors i.e., less than half of Board **is not in compliance with** the requirement of LODR, 2015.

(v) One Independent Director has been serving as Independent Director in Eight Listed Entities of which Equity Shares are listed on a Stock Exchange: A person shall not serve as an independent director in more than seven listed entities in case its equity shares are listed on a Stock Exchange. It may be noted that the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange.

In the given situation, there is **non-compliance** as one of the Independent Director has been serving as Independent Director in eight listed entities which is exceeding the prescribed limit of seven entities.

(b) Contingent Liabilities: In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should obtain representation from management that:-

(i) all off-balance sheet transactions have been accounted in the books of accounts as and when such transaction has taken place;

(ii) all off balance sheet transactions have been entered into after following due procedure laid down;

(iii) all off balance sheet transactions are supported by the underlying documents;

(iv) all year end contingent liabilities have been disclosed;

(v) the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/ expense and which, therefore, require creation of a provision/adjustment in the financial statements;

(vi) the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement;

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(vii) in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) and that no violation of section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; and

(viii) such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities.

Note: Students may be given due credit for any other relevant point quoted.

(c) CA. T as the management auditor, is expected to evaluate the effectiveness of controls, the auditees might fear that the management audit report may create their incompetent impression on the top management of XYZ Limited. Therefore, the management audit may lead to the breeding of antagonism on the part of the auditees. Causes of antagonism are as under:

i. Fear of criticism stemming from adverse audit findings.

ii. Fear of changes in day-today working habits because of changes resulting from audit recommendations.

iii. Punitive action by superiors prompted by reported deficiencies.

iv. Insensitive audit practices - reports which are overly critical, reports which focus on deficiencies only, the air of mystery cloaking some audits, and the perception that auditors gain personally from reporting deficiencies.

v. Hostile audit style - a cold and distant aspect is a lack of understanding of the auditee's problems, an absence of empathy, an air of smugness or superiority, an excessive concentration on insignificant errors, a prosecutional tone when asking questions, and a greater concern with parading defects than helping constructively to improve conditions.

Question 5

(a) You have been appointed as an auditor of Safe Life Insurance Company Limited. During the course of audit you come across several cases of lapsed policies. Management is flooded with complaints from Agents and Life Assured regarding Policy lapses and Revival. The policy lapsation is tracked over the PMS software. You are requested by the Management to explain in clear terms about Policy lapses and Revival. Also state your role as an auditor in verifying the same. ***(5 Marks)***

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(b) In exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006'. Elucidate the powers of Quality Review Board in discharging its functions. How the Quality Review Board would proceed in case it does not receive the information called for by it from any Company? ***(5 Marks)***

(c) CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s Delist Limited is a listed entity at National Stock Exchange and the financial statements are to be drawn up in compliance with Ind AS. M/s Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active and open market. CA Harry is concerned with identification and assessment of the risks of material misstatement for accounting estimates. Guide him with regard to the estimation making process adopted by management with reference to the relevant Standard on Auditing. ***(4 Marks)***

Answer

(a) Policy Lapse and Revival: "Lapse" is the discontinuance of the policy owing to non-payment of premium dues. In order to keep a life insurance policy "in force" the policy holder is required to pay premiums when due (either monthly/ quarterly/annual/bi-annual). If payment is missed, the insurer allows a period of 15/30 days from the premium due date for making the payment. This period is termed as "grace period". If the policy holder does not make the payment within the grace period, the policy gets "lapsed". Thus, a payment within the grace period is deemed to be a payment on the due date.

The terms and conditions of the policy stipulate that where the premium is not paid within the grace period, the policy lapses but may be revived during the lifetime of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy and that it would be better to take out a fresh policy.

The insurer should have taken persistent measures for monitoring receipt of renewal premium within the due dates. In case of most of insurers, policy lapsation is tracked over the PMS, wherein premium due dates are monitored by the system once initial data of the policy is entered in the system.

Role of Auditor: The primary objective of the audit is to check and confirm that due dates are recorded and monitored properly and polices are marked as "lapsed" on non-receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy.

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(b) **Powers of Quality Review Board** : The Government of India has, in exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006'. To facilitate the discharge of its functions, Rule 6 of aforesaid rules provides:

i. on its own or through any specialized arrangement set up under the Institute, evaluate and review the quality of work and services provided by the members of the Institute in such manner as it may decide;

ii. lay down the procedure of evaluation criteria to evaluate various services being provided by the members of the Institute and to select, in such manner and form as it may decide, the individuals and firms rendering such services for review;

iii. call for information from the Institute, the Council or its Committees, Members, Clients of members or other persons or organizations, in such form and manner as it may decide, and may also give a hearing to them;

iv. invite experts to provide expert/technical advice or opinion or analysis on any matter or issue which the Board may feel relevant for the purpose of assessing the quality of work and services offered by the members of the Institute;

v. make recommendations to the Council to guide the members of the Institute to improve their professional competence and qualifications, quality of work and services offered and adherence to various statutory and other regulatory requirements and other matters related thereto.

In case, the Board does not receive the information called for by it from any company registered under the Companies Act, 2013, the Board may request the Central Government in the Ministry of Corporate Affairs for assistance in obtaining the information.

(c) As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", CA. Harry shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

The estimation making process adopted by the management including-

(1) The method, including where applicable the model, used in making the accounting estimates.

(2) Relevant controls.

(3) Whether management has used an expert?

(4) The assumption underlying the accounting estimates.

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(5) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and

(6) Whether and, if so, how the management has assessed the effect of estimation uncertainty.

Question 6

(a) CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India. Auditors are duly appointed for the subsidiaries and branches as well. With regard to the determination of materiality during the audit of consolidated financial statements, what should be the considerations of CA H? How he should deal in his report if there are observations (for instance modification and/or emphasis of matter in accordance with SA 705/706) made by component auditors? ***(5 Marks)***

(b) You are the team leader of 10 members for an audit of a Multinational Company. All the team members are concerned about audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned. In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard on Auditing. ***(5 Marks)***

(c) Mr. Sirish, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Information Technology. While delivering the speech, he told the audience that he is a Cybersecurity Expert and his firm provides services of cloud accounting, IT governance, risk compliance and information security at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of the audience he also distributed his business cards and telephone number of his firm to those in the audience.

Comment in the light of professional Code of Ethics. ***(4 Marks)***

OR

CA K, a Practising Chartered Accountant, was appointed as Authorized Representative by GKR Limited to appear before National e-assessment centre in the matter of its Faceless Income-tax proceedings for the Assessment year 2020-21. While preparing a reply in response to the notice for the Scrutiny Assessment, CA K observed that there were certain trade payables and loan creditors which were not in existence but was fabricated by the management of GKR Limited. Though CA K knew these accounts were fabricated, he still submitted those false accounts to the National faceless e-assessment centre. What are the liabilities of CA K under the Income-tax Act, 1961?

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Answer

(a) CA. H should consider the requirement of SA 600, "Using the Work of Another Auditor", if he decides to use the work of another auditor in relation to the audit of consolidated financial statements and he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

(i) The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.

(ii) The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.

(iii) The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 needs to be considered i.e. the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor".

(b) SA 230, "Audit Documentation", provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.

For example,

(i) the existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.

(ii) the existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.

(iii) An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.

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(iv) In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:

- For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
- Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".

(c) Using Designation Other Than a CA and Providing Details of Services Offered: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

In view of above, it is improper to use designation "Cybersecurity Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Cybersecurity Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also misconduct in terms of Clause (6).

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OR

(c) False Declaration as Authorized Representative: In connection with proceedings under the Income-tax Act 1961, a Chartered Accountant often acts as the authorized representative of his clients and attends before an Income-tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income-tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income-tax Act 1961.

Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

In the instant case, Mr. K, a chartered accountant was appointed as authorize representative by GKR Limited to appear before National E-Assessment Centre in the matter of its faceless Income-tax proceeding. While preparing a reply in response to the notice for the scrutiny assessment, CA. K, submitted false accounts to the National Faceless E-Assessment Centre, knowingly that certain trade payables and loan creditors accounts were not in existence and were fabricated by Management.

In view of above, CA. K would be liable under section 278 of the Income-tax Act, 1961.

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