Solved Scanner Appendix
CA Final Gr. I
(Solution of November - 2014)

Paper - 3 : Advanced Auditing and Professional Ethics

Chapter - 1 : Auditing and Assurance Standards & Guidance Notes
2014 - Nov [3] (d)
- Working papers are the property of the Auditor, and the Auditor should adopt reasonable procedures for custody and confidentiality of his working papers.
- He should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirement of record retention.
- Working papers should be properly filed, in order to ensure that they are easily retrievable.
- In case of recurring audits, some working paper files may be classified as permanent file or current file.
- Working papers of the Auditor constitute his property and should not be provided to client. However, the Auditor may at his discretion, if considered appropriate, make portion of or extracts from his working papers available to the client.

2014 - Nov [4] (b), (d)
(b) As per SRS 4410 - Engagement to compile financial information:
- A Chartered Accountant should mention in the report that they have not audited or reviewed these financial statements and accordingly express no opinion thereon.
- However, a compilation engagement carried out by the accountant does not relieve the management of their responsibilities towards the financial statements like ensuring the correctness of the financial statements.
- If the accountant becomes aware of information that is incorrect, incomplete or otherwise unsatisfactory, he or she should obtain additional or revised information. If the client refuses to provide that information, the accountant should withdraw from the engagement.
- So, contention of Z & Co. is not right. The accountant can withdraw from the engagement.

(d) As per SA - 550 Related Parties, In relation to related party transactions the Auditor shall ensure the following:

- Whether related parties are properly identified accounted and disclosed as per financial reporting framework.
- Identifying fraud risk factors relating to related parties transactions.
- Ensuring that the financial statements are true and fair.
- The auditor shall perform the following procedures in relation to the related party transaction :
  - (a) Verify the internal controls in relation to related party transactions.
  - (b) Understand the business rationale, terms of contract and accounting with respect to Related party transactions.
  - (c) Compare the transactions of related parties with market rates, other transactions, etc.
  - (d) Obtain expert opinion if need be.

The auditor shall obtain a management representation that all the related party transactions are properly approved, accounted and disclosed in the financial statements and are executed at Arm's-Length price.

2014 - Nov [5] (c)

(i) Reporting to shareholders

- As per Sec. 227(2) the auditor shall report to the members of the company on the accounts examined by him and on every Balance Sheet and profit & loss account and every other document declared by the Act to be part of, or annexed thereto laid before the company in General meeting during the tenure of his office.
- Reporting to those charged with governance.
- Generally it includes the management of the company.
  As per SA 260 the auditor should consider audits matters of governance interest that arise from the audit of financial statement and communicate them to those charged with governance.
- The auditor also report the weakness in the internal control system to those charged with governance which is not in case of reporting to the shareholders.

(ii) Audit Qualification

- The auditor shall express a qualified opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive to the financial statements or the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements. If any could be material but not pervasive.

- Emphasis of matter.
  If the auditor consider it necessary to draw user's attention to a matter presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to user's understanding of the financial statements, the auditor shall include an Emphasis of matter paragraph in the auditor's report.
- Provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements.

Chapter - 2 : Accounting Standards & Schedule III

2014 - Nov [1] {C} (a)

→ As per AS 10 - The cost which is directly attributable to the acquisition or installation of the fixed cost should be capitalised.

→ In the present case company has paid detention charges. As detention charges are not directly attributable to the acquisition or installation of fixed asset .

→ Detention charges should be charged to P&L account and not capitalised.

→ So, accounting treatment given by the company is wrong The auditor should qualify his report.

2014 - Nov [3] (a)

- As per clause 4(ix) statutory dues of CARO, 2003 the auditor should report whether the company is regular in depositing undisputed statutory dues.
- If it is disputed then the forum where the dispute is pending should also be mentioned.
- A show cause Notice generally contains the requirements of the assessing officer, However normally mere issuance of a SCN by the concerned department should not be construed to be a demand payable by the company.
- So in the present case levy of a sum of ₹ 25 lakhs shall not be reported as outstanding statutory dues.
- So, there is no need to report.

2014 - Nov [7] (d)

1. **Intangible Asset**
   - An Intangible Asset is an identifiable non - monetary asset without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose.
   - So main features of identifiable, non - monetary asset And without physical substance.
   - Intangible assets must have the characteristics of an assets i.e. Future economic benefits and Reliability measured.

2. **Intangible Item**
   - An Intangible item is an identifiable non - monetary item without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose.
   - So, intangible items are those items which does not have the following characteristics i.e. Future economic benefits and Reliable measured.

Chapter - 3 : Audit Strategy, Planning Programming & Techniques
2014 - Nov [1] {C} (b)

→ AS per para 4(ii) a of CARO, physical verification of inventory is the responsibility of the management. Hence, management should verify all material items at least once in a year and more often in appropriate cases. The auditor should satisfy himself that the physical verification of inventories has been conducted at Reasonable intervals by the management and that there is adequate evidence on the basis of which auditor can arrive at such a conclusion.

→ Also as per SA-501, the auditor is required to comment on the reasonables and adequacy of the inventory verification procedures followed by the management.

→ In case inventory is material to the financial statement, the auditor should attend physical inventory counting unless it is impractical due to nature and location of inventory. If he is unable to do that than he should observe the same.

→ Certificate from the management does not receive the auditor from his duties. However if management is representation is reliable than it's ok but if the same is inconsistent with other audit evidence than the auditor shall perform audit procedures to attempt to resolve the matter.

→ So, in the present case the auditor is not right in his/her approach.

2014 - Nov [2] (c)

→ Methods of sampling

(1) **Random sampling-**This method of sampling is easy to operate types (a) simple Random or (b) stratified random.

(2) **Interval sampling-** samples following an interval will be selected types (a) Block sampling or (b) cluster sampling

(3) Monetary unit sampling/value weighted selection (i.e. selecting high value items for verification)

(4) **Haphazard selection -** This is a Non-statistical method of sampling, by which auditor selects the samples by his own choice.

Chapter - 4 : Risk Assessment and Internal Control

2014 - Nov [1] {C} (c)

→ As per SA-450 evaluation of misstatements identified during the audit. The Auditor has to consider the impact of identified mistakes/misstatement on the audit. Whether on the basis of these identified misstatements the original audit programme needs modification.

→ There may be some mistakes which were identified and colleted during the audit process by the auditor but remain uncorrected, the auditor has to evaluate the impact of these uncorrected misstatement on the financial statements.

→ The auditor have to determine whether uncorrected misstatements are material, individually or when considered together with other misstatements accumulated during the audit.

→ The auditor shall communicate with those charged with governance. Uncorrected misstatements and the effect that they, individually or in aggregate may have an opinion in the auditor's report.

→ The auditor shall request a written representation from management and where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole.

2014 - Nov [2] (a), (d)

(a) → The auditor should identify and assess the risks of material misstatements at the
- Financial statements level
- Relevant assertion level

→ Risks of material misstatement at the financial statement level refers to risks that relate previously to the financial statements as a whole and potentially affect many assertions.

→ Assertion level - In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, and disclosure of the various elements of financial statements and related disclosure.

→ After identifying the above risks the auditor should determine overall response to address the risk of material misstatement the auditor should design and perform further audit procedures to response to those risks.

→ The auditor's overall responses to address the assessed risks of material misstatement at the financial statement level may includes.

— Emphasizing to the audit team the need to maintain professional skepticism in gathering and evaluating audit evidence.

— The auditor may also make general charges to the audit procedures as an overall response.
— Consider seeking more extensive audit evidence from substantive procedures
— Modify the nature of audit procedures to obtain more pervasive audit evidence.

(d) → Inherent risk means the risk that there will be material error in accounting process wherever no related controls.
Misstatement can result from errors or fraud.
→ The auditor should perform the following risk assessment procedures to obtain an understanding of the entity and its environment including its internal control.
- Inquiries of management and others within the entity
- Analytical procedures
- Observation and inspection
- Discussion among the engagement team

→ The auditor understands of the entity and its environment consists of the understanding of the following factors.
— Industry, regulatory and other external factors
— nature of the entity selection and application of accounting policies
— objectives and strategies and the related business risks
— Internal control etc.

Chapter - 5 : Audit under CIS Environment
2014 - Nov [2] (b)

→ In a CIS Environment also, the basic audit objective is to provide a competent, independent opinion as to whether the financial statements show a true and fair view of the state of affairs of an entity.

(1) **Evidence collection:** The nature of evidence collected by the auditor is based on the type of controls that he audits. The attributable factors includes new controls, fast changing controls, difficulty in understanding controls, and diversified controls.

(2) **Evidence Evaluation:** An error in a CIS environment has serious implications, than in a manual environment due to these factors. In a shared data environment, a single input transaction may update multiple data items used by multiple users, which may be difficult to understand.
- Errors in computer system tend to be deterministic.
- Errors are generated at high speed and the cost, time and effort to correct and re-run program may be high.

→ Thus, internal controls that ensure high quality computer systems should be designed

→ Implemented and operated upon. For evaluation of controls, auditors need to understand whether a control is functioning reliably or multi-functioning, and traceability of control strength and weakness through the system.

→ So with increasing complexity of computer systems and control technology, it is becoming more and more difficult for the auditors to evaluate the consequences of strength and weaknesses of control mechanism for placing overall reliability on the system.

Chapter - 6 : The Company Audit

2014 - Nov [1] {C} (d)

→ As per SA- 250 Compliance with the laws and regulations by the entity- Responsibility of prevention of non-compliance of laws and regulations and detection thereof is not of the auditor. The responsibility of the auditors is to plan and perform the audit, recognizing that the audit may reveal the conditions or events that could lead to questioning whether an entity is complying with laws and regulations.

→ The auditor's responsibility is restricted to the extent that he should design his audit procedure in such a copy that the audit procedure may reveal the conditions which lead to questioning the entity about the compliance of laws and regulations.

→ For non-compliance the auditor should consider possible effect on financial statements.

→ It auditor concludes that the non-compliance has material effect on the financial statement the auditor should express qualified or an adverse opinion as appropriate.

→ In exceptional cases, the auditor may consider whether unless prohibited by laws or regulation withdrawal from the engagement in necessary when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances.

2014 - Nov [3] (c)

- If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall issue a Disclaimer opinion.
- If the auditor concludes that the possible effects on the financial statements of undeleted misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation the auditor shall resign from the audit. If resignation from the audit before issuing the auditor's report is practicable or possible, disclaim an opinion on the financial statements.

- If the auditor resigns before resigning the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

Chapter - 9 : Audit Report

2014 - Nov [3] (b)

- When the prior period financial statements are materially misstated the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which qualified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion.
  (I) In this case if provision for doubtful debts is not made than auditor would give a qualified opinion as last year
  (ii) If the company makes adequate provision for doubtful debts than there is no question to make a opinion qualified.

2014 - Nov [4] (a), (c)

(a)

•		(₹ in lakhs)
(a)	Paid up capital	₹ 35
(b)	Revaluation Reserve	₹ 12
(c)	Capital Reserve	₹ 10
		₹ 57
	Less: P & L (Dr.) balance	(₹ 12)
		₹ 45 lakhs

- Debit balance of profit & loss account can be reduced only against the balance of Revenue Reserve.
- As Aggregate of paid up capital and reserve doesn't exceed ₹ 50 lakhs CARO, 2003 is not applicable to the company.

(c)
- As per Clause 4 (xi) of CARO, 2003, auditor report whether the company paid the principal and interest dues to Financial Institutions, Banks or Debentureholders without default. In case of default, the period and amount of default shall be reported.
- So, the auditor should report the period and amount of all defaults existing at the Balance Sheet date where a default has been made good by the company during the accounting period covered by the auditor's report. The Auditor should state in his Audit report the fact of default having been made good.

- Dues to Financial Institutions would include the principal as well as any interest on any kind of dues payable to them.
- In the present case default amount will be reported as follows:

  "The company has defaulted in repayment of dues to Banks. However, the company has made good the default but after the balance sheet date".

Chapter - 12 : Audit of General Insurance Company

2014 - Nov [5] (b)

Claim provisions

- **Claims status reports:** Examine whether the claims status reports is complete as to material facts, to take a fair view of the provision made.
- Provision created by the company can be cross checked with reference to the claim files, that the amount of provision is not in excess of sum insured; ensure that survey fee, other direct expenses, salvage values are included while providing for claims, Average clause is applied when it is under insured by parties.
- Examine the reasons for carrying the provisions in the books in respect of claims which are filed long before and there has been no further communication.
- Verify whether provision has been made only for such claims that the company is legally liable after ascertaining that the risk was covered by the policy and the policy was in force and the claim did not arise during the period the company was not supposed to cover the risk also examine and ensure that no contingent liability is carried in the books in respect of any claim for policies issued.

Chapter - 13: Audit of Co-operative Societies

2014 - Nov [7] (b)

- As per Sec. 5 of Co - Operative Society Act,1972, no member, other than a Registered society shall-
  (a) Hold more than such portion of the share capital subject to a maximum of 1/5th, as prescribed by the rules, or
  (b) Have or claim any interest in the share of the society exceeding ₹ 1,000.

Chapter - 15: Audit under fiscal Laws

2014 - Nov [5] (a)

- As per Sec. 40A(3) payments exceeding ₹ 20,000, otherwise than by account payee cheques or bank drafts is disallowed.
- However, if an assessee makes payment of two different bills at the same time in cash or by bearer or crossed cheque Sec. 40 (A)(3) is not applicable even if the aggregate payment is more than ₹ 20,000. This is because of the fact that Section 40A(3) is applicable only in respect of an "expenditure" which is in of ₹ 20,000.

- So, in the present case payment exceeds the limit of ₹ 20,000 but each bill amount is less than ₹ 20,000. So, it will not be disallowed and as there will be any need to report in Tax Audit report.

Chapter - 16: Cost Audit
2014 - Nov [7] (e)
- Cost Audit is defined as the verification of cost accounts and a check on the adherence to the cost accounting plan. Hence, cost audit has two major activities, namely -
  (1) Verification of cost accounting records like the accuracy of cost accounts, cost reports, cost statements, cost data, costing techniques etc. and
  (2) Examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures, and objectives.
- The broad procedural aspects of cost audit includes conformity, applicability verification classification and allocation.
- There are two important phases of Cost Audit
  (1) **Efficiency Audit:** Efficiency Audit is directed towards measuring the execution of corporate plans.
  (2) **Propriety Audit:** It is concerned with the audit of such actions and plans of management, which have a bearing on.
- The finances and expenditure of the company.
- The purposes of Cost Audit may be classified into
  (1) Protective Purposes and
  (2) Constructive purpose
- Sec. 233B of the Companies Act stipulates cost audit for certain types of companies/Industries. The Government also orders the conduct of Cost Audit, from time to time, whenever it feels such type of audit is necessary for a particular Industry.

Chapter - 17: Special Audit Assignments
2014 - Nov [7] (a)
- Circuit Breaks are the price bonds that set the upper and lower limit within which a stock can fluctuate on any particulars day.
- SEBI has introduced MWCB at 10 : 15 : 20% of the movement in these indices, whichever is breached earlier. These Breakers provide the time to participants to react to the movement by way of the trading halt.
- The Trading halt on the exchange shall be as per following regulations

Duration of Trading halt

Time of movement	Movement in Index is 10%	Movement in Index is 15%
Before 1 p.m.	1 hour	2 hours
After 1p.m. but before 2.30 p.m.	½ hour	1 hour
On or after 2.30 p.m.	No Trading halt	For entire remaining period of the day

- If movement in the index is 20%, the Trading shall halt for remaining period of the day.

Chapter - 22 : Professional Ethics

2014 - Nov [6] (a),(b),(c),(d)

(a)
- As per clause 4 of part I of second schedule of the CA Act, 1949 , where a CA is Director of a company, the firm in which the said member is partner, should not express any opinion on its financial statements.
- There is no "expression of opinion" on financial statements in the given case, since the firm has been appointed to evaluate the costs of the various products manufactured by it for their information system, it can not be held liable for professional misconduct.

(b)
- Under clause (1) of part I of second schedule, a CA in practice is deemed guilty of professional misconduct, if the disclose information acquired in the course of his professional engagement, to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for time being in force.
- Guilty of Mr. Z divulging information obtained in the course of professional work is a breach of professional confidence even though the disclosure of information in the above case was under the impression that it will help the Nation to compete with other countries at the international level, this constitutes professional misconduct under clause (1) of part I of second schedule.

(c)
- Under clause (10) of part I of second schedule a CA in practice is deemed guilty of professional misconduct, if he fails to -
  (a) Keeps money of his client, other than fees or remuneration or money to be expended in separate banking account, or

(b) Use such money for the purpose for which they are intended, within a reasonable time.

- Member entrusted with monies belonging to his client, should deposit them in a separate banking account, and utilize them only in accordance with the client's instructions or for the purposes intended by the client, within a reasonable time.

  So, in this case M/s ABC is guilty of professional misconduct on the above principles.

(d)
- Regulation 47 of CA regulations, 1988 dealing with "premium from Articled clerks" reads as under : "No amount shall be charged from, or be payable by, an articled clerk or any other person on his behalf directly or indirectly, whether by way of premium or as loan or deposit or in any other form in connection with his engagement as an Articled clerk".
- Accepting a loan from the firm where an Articled clerk is interested will violate regulation 47, only if it can be proved that the engagement of Articled clerk is dependent upon this fact.
- In the present case an Articled clerk is having an indirect interest in the company.
- However, if the Articled clerk has already been engaged and his engagement is not related to the loan transaction, regulation 47 will not be attracted .
- Therefore, the CA will be guilty of professional misconduct under clause (1), if it is proved that the loan was related to the engagement of the Articled clerk.

2014 - Nov [7] (c)
- KYC means know your customers' code.
- It is really important to take care of customers' for the chartered accountant practice.
- A CA must have the knowledge of business of client, and its accounting systems.
- KYC helps to improve the work of a CA in practice.
- This is also necessary for the part of quality control procedures.
- A CA must have only a professional team for carrying out the work of client.
- If a CA takes care of KYC requirement in his practice than there are lesser chance of losing them. So, it is important for a successful practice.

FOR NOTES

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