

**MOCK TEST PAPER - 1**  
**FINAL (OLD) COURSE: GROUP – I**  
**PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS**  
**SUGGESTED ANSWERS/HINTS**

**DIVISION A - MCQs (30 Marks)**

Questions no. (1-10) carry 1 Mark each and Questions no. 11-20 carry 2 Marks each.

1. (d)
2. (c)
3. (c)
4. (b)
5. (c)
6. (b)
7. (c)
8. (b)
9. (d)
10. (c)

Questions (11-20) carry 2 Marks each

11. (d)
12. (a)
13. (c)
14. (b)
15. (a)
16. (b)
17. (b)
18. (d)
19. (a)
20. (b)

**DIVISION B - DESCRIPTIVE QUESTIONS (70 Marks)**

1. (a) As per SQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”, review responsibilities are determined on the basis that more experienced team members, including the engagement partner, review work performed by less experienced team members.

In the given situation, Mr. Jay, engagement partner assigned review responsibilities to two of the engagement team members who were the most experienced team members.

While reviewing the work performed by less experienced members of the engagement team, both the more experienced Reviewers should consider whether:

- (i) The work has been performed in accordance with professional standards and regulatory and legal requirements.
  - (ii) Significant matters have been raised for further consideration.
  - (iii) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented.
  - (iv) There is a need to revise the nature, timing and extent of work performed.
  - (v) The work performed supports the conclusions reached and is appropriately documented.
  - (vi) The evidence obtained is sufficient and appropriate to support the report; and
  - (vii) The objectives of the engagement procedures have been achieved.
- (b)** As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In certain situations, the need for a detailed agreement in writing is required like -

- The auditor's expert will have access to sensitive or confidential entity information.
- The matter to which the auditor's expert's work relates is highly complex.
- The auditor has not previously used work performed by that expert.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.

- (c)** As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. 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.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

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. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

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.

2. (a) (i) As per Regulation 16(c) of the SEBI (LODR) Regulations, 2015, “material subsidiary” shall mean a subsidiary, whose income or net worth exceeds ten percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year. [Explanation- The listed entity shall formulate a policy for determining ‘material’ subsidiary.]

Regulation 24(1) of the SEBI (LODR) Regulations, 2015, provides that at least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

[Explanation- For the purposes of Regulation 24(1), notwithstanding anything to the contrary contained in regulation 16, the term “material subsidiary” shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year]

On the basis of above provisions, following information is tabulated as below:

Particulars	Share in Consolidated Income	Share in Consolidated Net Worth
Component ‘A’	11.67%	5%
Component ‘B’	3.33%	2.5%
Component ‘C’	23.33%	17.5%
Component ‘D’	21.67%	22.5%
Component ‘E’	6.67%	6.25%

It can be observed that Component ‘A’, Component ‘C’ and Component ‘D’, respectively, can be termed as “material subsidiary” as their shares in either consolidated Income or net worth exceeds 10%.

Further, at least one independent director from the board of directors of Triumph Ltd. shall be appointed or would have been appointed on the board of Component ‘C’ and Component ‘D’, respectively, as their shares in either consolidated income or net worth exceeds 20%.

- (ii) Generally, the financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi-location group audit. Such audits and audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components’ auditor.

Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”.

In the given situation, two out of seven components of Triumph Ltd. have remained unaudited where Component ‘F’ is material and Component ‘G’ is not material to the consolidated financial statements. Since Component ‘F’ is material, therefore, it may be assumed that reporting of Key Audit Matter in accordance with SA 701 is being done for Component ‘F’ and not for Component ‘G’.

Thus, in case of Component ‘F’, the Principal Auditor needs to consider its impact on the

auditor's opinion on the consolidated financial statements of the group, in terms of the principles laid down in SA 705, Modifications to the Opinion in the Independent Auditor's Report. Whereas in case of Component 'G', the principal auditor should make appropriate reporting under the "Other Matters" paragraph, pursuant to SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs, in the Independent Auditor's Report.

- (b) As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

Provided nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being MD or whole-time director) unless he or his partners is interested in such company as auditor.

The Ethical Standards Board (ESB) noted that Public conscience is expected to be ahead of law. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence. In the view of the above, the Board, via a clarification, decided that the auditor of a Subsidiary company cannot be a Director of its Holding company, as it will affect the independence of the auditor.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. 'acting as Recovery Consultant in the banking sector' is covered under general permission.

In the given situation, M/s SS limited is a partly owned subsidiary of M/s HH limited. For the upcoming financial year, M/s DD & Co., Chartered Accountants, were appointed as the statutory auditors of SS limited. The CEO of the holding company was impressed with the knowledge and experience of Mr. D, one of the partners of the firm and hence, he offered Mr. D to take up the position of Director (not MD/ whole-time director) of HH limited. Further, Mr. D's friend approached him for an assignment for acting as a Recovery Consultant for a bank.

Therefore, in view of above in the given case, Mr. D should not accept the offer to be appointed as director of HH Limited. However, he can accept the assignment offered by his friend and can act as a recovery consultant for a bank.

3. (a) The appointment of statutory auditors in the General Insurance Corporation of India, and its subsidiaries and the divisions as well as other public sector Insurance Companies is made by the Comptroller and Auditor General of India, as in the case of other public sector undertakings. However, in the case of others, auditor is appointed at the AGM after ensuring that the auditor satisfies the compliance requirements with the relevant sections of the IRDAI Guidelines on Corporate Governance. These guidelines pose certain restrictions on the number of insurance companies a statutory auditor can audit. Currently, an auditor can conduct audit only for three insurance companies and not more than 2 life or 2 general. The Guidelines also mandate a mandatory joint audit for all insurance companies.

In the given case, R.O.K. & Co. is joint statutory auditor of Auspic General Insurance Co. Ltd. And of one another General Insurance Company. Accordingly, it can now, further, accept only one audit and that too of a Life Insurance Company only.

Further, TNK & Co. is joint statutory auditor of Auspic General Insurance Co. Ltd. as well as of one Life Insurance Company. Accordingly, it can now, further, accept only one audit of either a Life Insurance Company or a General Insurance Company.

(b)

Sr. No.	Query of Mr. Samay	Response to Query
1	What documents to be seen in case of loan given by the company in lieu of hypothecation of goods from lender as a security for the purpose of reporting as per clause (a) of section 143(1) of the Companies Act, 2013?	Mr. Samay should see deed of Hypothecation or other document creating the charge, together with a statement of stocks held at the balance sheet date in order.
2	What shall be the cost of Debentures and Bonus Shares sold by the company for which the cost is not ascertainable for the purpose of reporting as per clause (c) of section 143(1) of the Companies Act, 2013?	For Debentures sold: Where the cost of debentures sold is not ascertainable, the <b>book value</b> thereof at the date of sale may be treated as the cost for the purposes of this clause. For Bonus Shares sold: When bonus shares are received, the number of shares in the portfolio would be increased by the bonus shares while the cost of the total portfolio would remain the same as before. The result would be that the average cost per unit of the total holding would come down proportionately. The usual accounting practice for apportioning the cost of a part of the total holding on the sale thereof is to take it <b>at its average cost</b> .
3	Whether the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash for the purpose of reporting as per clause (f) of section 143(1) of the Companies Act, 2013?	The law on the subject has hitherto been that, where the consideration for the issue of shares is an adjustment against a <i>bona fide</i> debt payable in money on demand by the company, <b>the shares are deemed to have been subscribed in cash</b> (vide the decision in Spargo's Case – 1873, 8, Ch. A. 407). According to the legal opinion obtained by the ICAI, the expression "shares allotted for cash" may also include shares allotted against a debt. Therefore, in cases which are covered by the decision in Spargo's case, no comment is required by the auditor, even though the company may have in the Return of Allotment under Section 75, shown such shares as allotted against adjustment of a debt. Thus, the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash.

(c) **Making Roving Inquiries:** 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 judgement and may be able to command respect from their prospective clients.

In case of making an application for the empanelment for the allotment of audit and other professional work, the Council has opined that, "where the existence of such a panel is within the knowledge of the member, he is free to write to the concerned organization with a request to place his name on the panel. However, it would not be proper for the member to make roving inquiries by applying to any such organization for having his name included in any such panel."

Accordingly, Mr. Raja is guilty of misconduct in terms of the above provision as he has solicited professional work from the Finance Ministry, by inquiring about the maintenance of the panel.

4. (a) (i) **Government Guaranteed Advance:** If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not invoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

- (ii) **The Audit Programme to Verify Advances against Life Insurance Policies is as under-**

- (i) The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer.
- (ii) The auditor should also examine whether premium has been paid on the policies and whether they are in force.
- (iii) Certificate regarding surrender value obtained from the insurer should be examined.
- (iv) The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

- (b) **Selection of Assurance Service Engagements for Review:** The Statement on Peer Review defines the scope of peer review which revolves around compliance with **technical, ethical and professional standards**; quality of reporting; office systems and procedures with regard to compliance of assurance engagements; and, training programmes for staff including articled and audit assistants involved in assurance engagements. The **entire peer review process is directed at the assurance services.**

Assurance Services means assurance engagements services as specified in the "**Framework for Assurance Engagements**" issued by the Institute of Chartered Accountants of India and as may be amended from time to time. Assurance engagements **does not include management consultancy** engagements or engagements solely to assist the client in preparing, compiling or collating information other than financial statements.

In the given situation, CA. Sudarshan is appointed as a peer reviewer for M/s Preet Associates, has asked for all management consultancy engagements and engagements solely to assist the client in preparing, compiling or collating information other than financial statements carried out by M/s Preet Associates for her peer review. In view of above, Peer Review of management consultancy engagements and engagements solely to assist the client in preparing, compiling or collating information other than financial statements at the time of execution step by **CA. Sudarshan is not correct as** management consultancy engagements and engagements solely to assist the client in preparing, compiling or collating information other than financial statements **are not covered** in the scope of Assurance engagement and Peer Review is directed at assurance engagement only.

(c) **Turnover limit for the purpose of Tax Audit:** The following points merit consideration as stated in the Guidance note on Tax Audit issued by the Institute of Chartered Accountants of India -

- (i) Price of goods returned should be deducted from the figure of turnover even if the return are from the sales made in the earlier years.
- (ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.
- (iii) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount.

Applying the above stated points to the given problem,

1. Total Turnover		524 Lac
2. Less –	(i) Goods Returned	20 Lac
	(ii) Special rebate allowed to customer in the nature of trade discount would be deducted	<u>5 Lac</u>
<b>Balance</b>		<b><u>499 Lac</u></b>

Since the aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount and aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment, limit for tax audit is five crore rupees. In the given situation, Abhinandan would not be required to get his accounts audited under section 44AB of the Income Tax Act, 1961 as Rs. 499 lac is below prescribed tax audit limit i.e. five crore rupees.

5. (a) As per section 27 of Chartered Accountants Act 1949, if a Chartered Accountant in practice or a Firm of Chartered Accountants has more than one office in India, each one of such offices should be in the separate charge of a member of the Institute. Failure on the part of a member or a firm to have a member in charge of its branch and a separate member in case of each of the branches, where there is more than one, would constitute professional misconduct. This condition applies to any additional office situated at a place beyond 50 kms from the municipal limits in which any office is situated.

However, exemption has been given to members in practicing in hill areas subject to certain conditions such as:

- Such member/ firm be allowed to open temporary offices in a city in the plains for a limited period not exceeding 3 months in a year.
- The regular office need not be closed during this period and all correspondence can

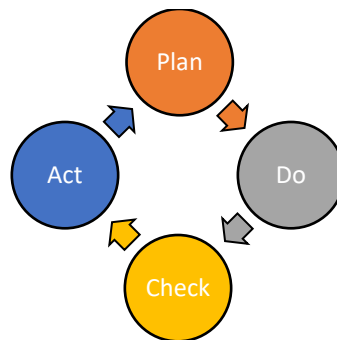
continue to be made at the regular office.

- The name board of the firm in temporary office should not be displayed at times other than the period such office is permitted to function.
- The temporary office should not be mentioned in letter head, visiting card, any other documents as a place of business of the member/ firm.
- Before commencement of every winter, it shall be obligatory on the member/firm to inform the Institute that he/it is opening the temporary office from a particular date and after the office is closed at the expiry of the period of permission, an intimation to that effect should also be sent to the office of the Institute by registered post.

In the given case, Mr. Z has set up his regular office in the hill area of Kodaikanal, he decided to set up a temporary office in the nearby city Marudai, situated at about 100 kms from the main office. As planned, he took an office space on rent for the months of April, May & June. During these months, his regular office was not closed. Further he was in-charge for both the offices. In view of abovementioned criteria's, he is eligible to avail the benefits of the above exemptions. Also, it is given that the temporary office was open in Madurai for only 3 months and not beyond that. The fact that Mr. Z is in-charge for both the offices, the temporary office being set-up in the plains which is 100 kms away and the regular office kept open during the 3 months does not constitute any violation of the provisions of the Chartered Accountant Act. Assuming Mr. Z has informed the Institute regarding such temporary office in the prescribed manner.

Therefore, in the given case, no penal action needs to be taken on the basis of complaint registered by Mrs. A, as Mr. Z is not guilty of professional misconduct.

- (b) **The Operational Audit is not one-time activity.** It should be viewed as a continuous improvement cycle:



The continuous improvement cycle of Operational Audit can be depicted through Plan, Do, Check and Act diagram.

All the significant operations must be subjected to the scrutiny of operational audit, at least, once in three years. Therefore, the operational audit should be done in the current scenario. However, to deal with the employee hostility the participative approach of the audit should be adopted.

In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes a co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When the participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational

audit report. With this attitude of the auditor, it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor does not have to force any change on the auditee.

- (c) Section 2(45) of the Companies Act, 2013, defines a “Government Company” as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them.

In the given scenario, VM Ltd., a company wholly owned by Central Government was disinvested during the previous year, resulting in 45% of the shares being held by public. Since, shares were listed on the BSE therefore all the listing requirements were applicable.

Opinion of Finance Manager of the Company Mr. Gautam that since company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the Company and the C&AG will not have any role to play, is not correct as listing of company’s shares on a stock exchange is irrelevant for this purpose.

6. (a) In order to ensure that the manufacturing unit of SP Ltd. will be able to meet the cash requirements internally, one is required to verify:
- (i) Is the company able to honour its commitments to its trade payables, to the banks, to the government and other stakeholders?
  - (ii) How well is the company able to convert its trade receivables and inventories?
  - (iii) How well the Company deploys its funds?
  - (iv) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
  - (v) What is the investment pattern of the company and are they easily realizable?
- (b) **Audit Programme of Movie Theatre Complex:**
- (i) Peruse the Memorandum of Association and Articles of Association of the entity.
  - (ii) Ensure the object clause permits the entity to engage in this type of business.
  - (iii) In the case of income from sale of tickets:
    - (1) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly and accurately accounted.
    - (2) Verify the system relating to online booking of various shows and the system of realization of money.
    - (3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows in a day.
  - (iv) Verify the internal control system and its effectiveness relating to the income from café, shops, pubs, game zone etc., located within the multiplex.
  - (v) Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
  - (vi) Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.

- (vii) In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement, any payment of advance made to the distributor is also adjusted against the amount due.
  - (viii) Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.
  - (ix) Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.
  - (x) Verify the insurance premium paid and ensure it covers the entire assets.
- (c) **Basic Accounting Control Objectives:** The basic accounting control objectives which are sought to be achieved by any accounting control system are -
- (i) Whether all transactions are recorded;
  - (ii) Whether recorded transactions are real;
  - (iii) Whether all recorded transactions are properly valued;
  - (iv) Whether all transactions are recorded timely;
  - (v) Whether all transactions are properly posted;
  - (vi) Whether all transactions are properly classified and disclosed;
  - (vii) Whether all transactions are properly summarized.

**or**

**Consideration of Factors in Use of CAATs:** In determining whether to use CAATs, the auditor should consider the following factors:

- (i) **Availability of sufficient IT knowledge and expertise:** It is essential that members of the audit team should possess sufficient knowledge and experience to plan, execute and use the results of CAAT. The audit team should have sufficient knowledge to plan, execute and use the results of the particular CAAT adopted.
- (ii) **Availability of CAATs and suitable computer facilities and data in suitable format:** The auditor may plan to use other computer facilities when the use of CAATs on an entity's computer is uneconomical or impractical, for example, because of an incompatibility between the auditor's package programme and entity's computer.
- (iii) **Impracticability of manual tests due to lack of evidence:** Some audit procedures may not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.
- (iv) **Impact on effectiveness and efficiency in extracting a data:** It includes selection of samples, applying analytical procedures, time involved in application of CAAT, etc.
- (v) **Time constraints in certain data,** such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make arrangements for the retention of data required, or may need to alter the timing of the work that requires such data.