

CA-INTERMEDIATE
GROUP II – PAPER 6
ADVANCED AUDITING AND PROFESSIONAL ETHICS
SERIES - 3 (May 2020)

BATCH : ALL
Time Allowed: - 3 Hours

Date : 25.03.2020
Maximum Marks: 100

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Division "A"
All Questions are compulsory.

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1. OPE Ltd issued a prospectus in respect of an IPO which had the auditor's report on the financial statements for the year ended 31 March 2019. The issue was fully subscribed. 2
- During this year, there was an abnormal rise in the profits of the company for which it was found later on that it was because of manipulated sales in which there was participation of Whole-time director and other top officials of the company. On discovery of this fact, the company offered to refund all moneys to the subscribers of the shares and sued the auditors for the damages alleging that the auditors failed to examine and ascertain any satisfactory explanation for steep increase in the rate of profits and related accounts.
- The company emphasized that the auditor should have proceeded with suspicion and should not have followed selected verification. The auditors were able to prove that they found internal controls to be satisfactory and did not find any circumstance to arouse suspicion.
- The company was not able to prove that auditors were negligent in performance of their duties.
- Which of the following is correct?**
- (a) The stand of the company was correct in this case. Considering the nature of the work, the Auditors should have proceeded with suspicion and should not have followed selected verification.
 - (b) The approach of the auditors looks reasonable in this case. The auditors found internal controls to be satisfactory and also did not find any circumstance to arouse suspicion and hence they performed their procedures on the basis of selected verification.
 - (c) In the given case, the auditors should have involved various experts along with them to help them on their audit procedures. Prospectus is one area wherein management involves various experts and hence the auditors should also have done that. In the given case, by not involving the experts the auditors did not perform their job in a professional manner. If they had involved experts like forensic experts etc, the manipulation could have been detected. Hence the auditors should be held liable.
 - (d) In case of such type of engagements, the focus is always on the management controls. If the controls are found to be effective then an auditor can never be held liable in respect of any deficiency or misstatement or fraud.
2. CA Sameer, after developing the audit strategy for Menka Ltd., develops an audit plan but finds a need to revise the materiality levels set earlier and therefore a deviation from the already set audit strategy is felt necessary. In this case, he should 2
- (a) Continue with the Audit Plan without considering the Audit Strategy
 - (b) Drop the audit and withdraw from the engagement
 - (c) First Modify the audit strategy and thereafter prepare the audit plan according to the modified strategy.
 - (d) Devise a new audit plan and then, change the strategy as per the Revised Plan.

3. KJ Private Ltd has a business of pharmaceuticals and has an annual turnover of INR 1,500 crores. During the last few years, considering the environment in which the company operates, its profit has reduced and is still falling. Hence the management has been looking at various ways to cut the costs. AD & Associates are the statutory auditors of the company and RM & Associates are the internal auditors of the company. Initially the company did not want to appoint any internal auditors to save costs, however, at insistence of the statutory auditors, the company appointed the internal auditors. During the course of the statutory audit for the financial year ended 31 March, 2019, the statutory auditors requested for the detailed working papers of the internal auditors which the internal auditors refused. However, the statutory auditors told the management if the same are not provided then they would qualify their report. In this situation, please advise which of the following would be correct.
- (a) The statutory auditors should review the detailed working papers but they cannot qualify their report on this ground.
- (b) The statutory auditors may review the detailed working papers and even after that they may qualify their report.
- (c) The statutory auditors are not required to go to the extent of review of detailed working papers of internal auditors.
- (d) The statutory auditors may review the detailed working papers of internal auditors but for that purpose they would require prior approval of the ICAI.
- 2
4. While conducting the current year audit of Finco Ltd, the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements. This misstatement was related to recognition of research and development expenditure. The provisions of Ind AS 38 Intangible Assets relating to capitalisation of development expenditure was not applied properly. On this, unmodified opinion had been previously issued. The current auditor verified that the misstatement had not been dealt with as required under Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Accordingly, the current auditor will:
- (a) Express a qualified or an adverse opinion in the auditor's report on the current period financial statements modified with respect to the corresponding figures included therein.
- (b) Express an unmodified opinion in the auditor's report on the current period financial statements since it was related to the prior year.
- (c) Express a qualified opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
- (d) Express an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
- 2
5. Honeywell Ltd, a listed company pays its key managerial persons the remuneration in excess of the limits which have been prescribed under 197 of the Companies Act, 2013 without obtaining the necessary approvals from the regulatory authority. In this circumstance, the auditor while reporting under CARO 2016, is required to state:
- (a) Name of the managerial persons to whom the remuneration has been paid in excess of limits and the amount involved.
- (b) Name of the managerial persons to whom the remuneration in excess of limits are paid and the steps taken by the company for securing refund of the same.
- (c) The maximum remuneration payable and amount paid in excess of the maximum remuneration to the managerial persons.
- (d) The amount involved and steps taken by the company for securing the refund of the same.

6. You are the audit senior in charge of the audit of Swandive Co, and have been informed by your audit manager that during the current year a fraud occurred at the client. A payroll clerk sets up fictitious employees and the wages were paid into the clerk's own bank account. This clerk has subsequently left the company, but the audit manager is concerned that additional frauds have taken place in the wages department. Which of the following audit procedures would be undertaken during the audit of wages as a result of the manager's assessment of the increased risk of fraud? 2
- (1) Discuss with the payroll manager the nature of the payroll fraud, how it occurred and the financial impact of amounts incorrectly paid into the payroll clerk's bank account.
 - (2) Review the supporting documentation to confirm the total of the fraudulent payments made and assess the materiality of this misstatement.
 - (3) Review and test the internal controls surrounding setting up of and payments to new joiners to assess whether further frauds may have occurred.
 - (4) Review the legal action taken by the management against the payroll clerk who was involved in the fraud and see whether he is punished for his actions.
- (a) Audit procedures 1,2,3
 - (b) Audit procedures 2,3,4
 - (c) Audit procedures 1,3,4
 - (d) Audit procedures 1,2,4
7. AJ Private Ltd. was incorporated on 21 March, 2018 and has limited operations. However, the capital induction in the company was huge because it would be capital intensive. The company is in the process to set up a plant in Karnataka which should be completed by 31 May, 2019. The company's management prepared its financial statements for the year ended 31 March, 2019. The auditors were also called to start the work in April 2019. The auditors would be able to complete their work by 31 May, 2019 and accordingly would issue their audit report by 1st week of June, 2019 as per the plan agreed with the management. The auditors have some observations related to preparations of financial statements which are not in compliance with Schedule III and most importantly the point related to capitalization of the plant as Property, Plant and Equipment in the financial statements for the year ended 31 March, 2019. Please suggest which of the following statements would be correct. 2
- (a) The compliance of Schedule III shall start from 1 April 2019 for this company as per Companies Accounts (Amendment) Rules 2016.
 - (b) The compliance of Schedule III shall start from first financial period, however, some exemptions would be applicable as per Companies Accounts Rules 2014.
 - (c) There should be full compliance of Schedule III and plant should be kept as CWIP as per Schedule III.
 - (d) There should be full compliance of Schedule III and plant should be shown as PPE as per Schedule III.
8. The Board of Directors of Young Ltd., a listed company, appointed Mr. Old, a Cost Accountant (not in practice), to conduct internal audit of the functions and activities of the company. The job of Mr. Old would be of an independent management function, involving a continuous and critical appraisal of the functioning of the company with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the company, including the entity's strategic risk management and internal control system. However, some of the officers of the company are against the appointment of a Cost Accountant who is not in practice as an internal auditor. State whether those officers are correct or not in their view point by referring the provisions of the Companies Act, 2013? 2

- (a) The view point of the officers are correct because as per section 138 of the Companies Act, 2013, the internal auditor shall be a chartered accountant.
- (b) The view point of the officers are correct because as per section 138 of the Companies Act, 2013, the internal auditor shall a cost accountant in practice.
- (c) The view point of the officers are correct because as per section 138 of the Companies Act, 2013, the internal auditor shall be an employee of the company.
- (d) The view point of the officers are not correct because as per section 138 of the Companies Act, 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board

9. Which of the following is correct :

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- (a) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
- (b) The auditor shall assemble the audit documentation in an audit file and shall not complete the administrative process of assembling the final audit file.
- (c) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis before the date of the auditor's report.
- (d) The auditor shall not assemble the audit documentation in an audit file.

10. _____ refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

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|-------------------------|---------------------------|
| (a) Audit documentation | (b) Audit File |
| (c) Audit Note Book | (d) Completion Memorandum |

Case Study 1

RS Ltd was set up by Raj and Shanti in 1992. Initially the name of the company was Rajeev Private Limited. The company is currently into the business of aviation. The company has its head office at Chennai. The company has been in the same business since its incorporation but over the years had to shut down its business 3 times due to operational inefficiencies and resultant losses.

In the year 2012, when the company restarted its operations after shutting that down third time, the company got funding from foreign investors. The management of the company increased its focus on the processes of the company and various checks and controls to improve the efficiency of the operations. This gradually resulted in improving the overall business culture of the company and gradually company started earning profits.

In the year 2016, the company got converted into public company and got its name changed to RS Ltd. After that the company also tried to get listed on the New York Stock Exchange but the market was not favourable and the company instead got listed in India.

The company kept increasing its focus on operational efficiencies which was also extended to all other processes of the company, most importantly, financial reporting which was not focused earlier by the management.

The company also appointed a large firm of Chartered Accountants, KB & Co, as its internal auditors, who have had specialization in the same sector so that they can help the company to fill the gaps in the processes, wherever required.

The company also appointed other consultants to improve on the operations and management functions.

During the financial year ended 31 March 2018, the internal auditors of the company raised some observations which were discussed in detail with the management, primarily because the management was not agreeing to some of the points of the internal auditors.

Subsequently in the financial year ended 31 March 2019, the management decided to set up its in-house internal audit function along with the CA firm, KB & Co. The idea was to do the work in-house and over the period, KB & Co can move out once the management is confident of the in-house internal audit function. Considering the above mentioned facts, please provide your suggestions in respect of the following:

11. The Standard Operating Procedures (SOP) for logistics process was not defined from the point of vehicle request received from the sales marketing department up to the bills verification. The management explained that part of this process was developed and remaining part was expected within next 3 months. 1
 - (a) This is more of a documentation and hence not relevant for the management.
 - (b) Auditor should highlight and report this matter in his report.
 - (c) The matter which is already under development should not be considered by the auditor.
 - (d) Management needs to demonstrate the development process further and get this issue closed.

12. It was noted that during a particular period, cash in hand balance was higher than actual cash requirement at some locations. Ratio of cash expenses to closing cash balance during that period ranged from 7 to 84 times. Further the insurance cover was also not taken for the cash in hand kept at some locations. The management explained that this occurred only during a specified period and the insurance coverage plan was in place for the next year. 1
 - (a) Auditor should report this matter in his report.
 - (b) The management needs to explain the amount involved and if that is low then the auditor should ignore this.
 - (c) The cash balance should not be looked at by the internal auditor as this is more relevant from financial reporting.
 - (d) Internal auditor should only report about not availability of the insurance coverage to the management.

13. On review of procurement process, it was observed that the system was not enabled to show pending delivery of same material while raising a subsequent purchase order and the guidelines were not defined for review of open purchase orders and long pending orders. 1

Management explained that this was due to lead time, locking in quantity/price, lead time to shipment, delays in delivery due to rake unavailability, failure of vendors to supply material as per timelines or quality etc and they will explore how system driven reporting can be done.

 - (a) This was an operational challenge and hence out of the purview of internal auditor.
 - (b) This related to some system constraints and hence may be ignored by the internal auditor.
 - (c) The internal auditor needs to highlight this in his report.
 - (d) The management should draw a proper plan to take care of this. In any case there doesn't appear to be any financial impact due eot this and hence the same should be ignored.

14. It was observed that the credit limit assessment was not being performed for all the customers which could result in possibility of credit being given to customers with weak financial credibility leading to bad debts/ financial losses to the company. 1

Management replied that they started the process of updation of credit limit in their ERP package which shall be completed in a month's time for major customers and for customers wherever temporary credit limit was defined. This would cover majority of exposure.

- (a) Since the management has already taken remedial action, the internal audit should drop this point.
 - (b) Since this matter related to financials, this should be covered by the statutory auditors and not the internal auditors.
 - (c) The management said that statutory auditors have also raised this point and hence internal auditors should drop this.
 - (d) Internal auditors should report this irrespective of the fact whether statutory auditors covered this or not.
15. The management's plan to phase out the CA firm by building up in-house internal audit team has been questioned by the statutory auditors saying this is not acceptable. 1
- (a) Statutory auditors are correct.
 - (b) Statutory auditors should observe this for a period and if that is working fine then they should have no concern regarding this.
 - (c) The management has a discretion regarding this and hence statutory auditors are not correct.
 - (d) The management should take approval from relevant authority like MCA and then statutory auditors would have to accept this.

Case Study 2

Setir Ltd is a company in which 59% of the paid up share capital is held by Punjab Government. The company is engaged in the business of providing consultancy services in relation to construction projects.

The Punjab Government is also planning to induct funds in the company in future, if required.

Nocri Ltd is a company controlled by Setir Ltd. The business of Nocri Ltd is construction and has an annual turnover of INR 2500 crores approx.

The audit of the financial statements of Nocri Ltd for the financial year ended 31 March 2019 got completed but Nocri Ltd observed that during the course of audit, there was lot of intervention of Comptroller & Auditor General of India, wherein C&AG was giving directions to the auditors on the manner in which audit should be conducted in respect of certain areas.

Further, it also received comments from C&AG on the audit report of the auditors. Nocri Ltd is seeking legal opinion to go against C&AG so that they can avoid unnecessary interference of C&AG and is also looking to have new auditors appointed by Nocri Ltd with whom they will have an engagement letter with the terms that those auditors don't accept any interference of C&AG which the existing auditors have not been able to avoid.

16. In this context, please advise which of the following should be correct? 1
- (a) The stand of the existing auditors should have been better i.e. not to accept any interference of C&AG.
 - (b) Management could have planned the audit work better by including the same terms in engagement letter with existing auditors instead of appointing another auditors.

- (c) C&AG involvement could have been accepted if this was the audit of Setir Ltd but not in case of Nokri Ltd and hence Nokri Ltd should also reach out to its parent company to get this resolved.
- (d) Stand of Nokri Ltd is wrong as the C&AG may get involved in the audit of Nokri Ltd.
- 17.** Auditor of government co. is appointed by :- **1**
- (a) Central government
(b) Members of the company
(c) Comptroller and auditor general of india
(d) None of these.
- 18.** CAG has power to order for supplementary audit in government co. within---- days from receipt of audit reports. **1**
- (a) 45 days (b) 30 days
(c) 60 days (d) 90 days.
- 19.** Term of CAG is :- **1**
- (a) 60 year old or 5 year whichever is earlier
(b) 65 year old or 5 year whichever is earlier
(c) 60 year old or 6 year whichever is earlier
(d) 65 year old or 6 year whichever is earlier
- 20.** CAG is appointed by:- **1**
- (a) Prime-minister of india (b) Cabinet-minister of india
(c) President of india (d) Member of Parliament india

Division "B"
Question No. 1 is compulsory.
Attempt any Four questions from the rest.

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- 1 State with reasons in brief whether the following statements are True or False. (Any Seven) 14**
- A.** "Substantive procedures" may be defined as audit procedures designed to evaluate the operating effectiveness of controls in preventing, detecting and correcting material misstatements.
- B.** General CIS controls may have pervasive effect on the processing of transactions in application system.
- C.** The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.
- D** Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.
- E** There is no relation between Inherent risk, Control risk and Detection risk.
- F** NGOs registered under the Companies Act, 2013 can maintain their books on either accrual or cash basis.
- G** The Managing Director of a company has shifted company's books of accounts from Registered office (Mumbai) to Corporate Office (New Delhi).
- H** The auditor will issue a disclaimer of opinion if he disagrees with the management with regard to the acceptability of the Accounting policies and the inadequacy of disclosures in the financial statements.
- 2A.** What are the provisions regarding appointment of auditors by rotation, after expiry of the term of the current auditor, that a company should consider? **4**
- B.** XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques. Advise the auditor in accordance with SA 530 **4**
- C.** The auditor of PQR LTD. is unable to obtain sufficient appropriate audit evidence and also auditor thinks that the possible effects of undetected misstatements on the financial statements would be both material and pervasive. The auditor perceives the situation involving multiple uncertainties there by the auditor concludes that it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements. **3**
- Advise and explain the type of opinion auditor would issue in the given circumstances. You are also required to explain the meaning of pervasive in this regard.
- D** "The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business" Discuss stating clearly the broad points you would be covering in framing plan to conduct audit in an efficient and effective manner. **3**

- 3A.** As an auditor, how would you consider the acceptance of a change in audit engagement? **4**
- B.** Is detection of fraud and error duty of an auditor? **4**
- C.** Section 73 of the Multi-State Co-operative Societies Act, 2002 discusses the powers and duties of auditors. According to this, every auditor of a Multi-State co-operative society shall have a right of access at all times to the books accounts and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi-State co-operative society or elsewhere, and shall be entitled to require from the officers or other employees of the Multi-State co-operative society such information and explanation as the auditor may think necessary for the performance of his duties as an auditor.
You are required to answer the inquiries an auditor would make under Section 73(2) **3**
- D.** The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, explain the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures. **3**
- 4A.** What is the purpose of a Letter of Engagement? What are the important contents of a Letter of Engagement? **4**
- B.** A person shall not be eligible for appointment as an auditor of a company where subsidiary or associate company or any other form of entity is engaged as on the date of appointment in consulting and specialized services as provided in Sec.144. Explain. **4**
- C.** Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence. However, which audit test to use, when and in what combination is a matter of professional judgement. Discuss stating the different ways testing is performed in an automated environment. **3**
- D.** Discuss the reporting requirements regarding Fixed Assets under CARO, 2016. **3**
- 5A.** With reference to SA 500, "Audit Evidence", discuss the different sources and their reliability, of audit evidence. **4**
- B.** At the time of scrutiny of General Ledger the Auditor observes that certain expenses essentially of a revenue nature are wrongly treated as capital expenditure. State examples of such expenses and the duties of auditor in this regard. **4**
- C.** The auditor evaluated, in respect of T Ltd., whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. **3**
Auditor's evaluation included consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.
Advise the qualitative aspects of the entity's accounting practices.
- D.** State the disadvantages of the use of an Audit programme. **3**
- 6A.** The auditor of PQR Ltd, a company engaged in the manufacturing of Auto parts obtains an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. **4**
Auditor is of the view that he requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process.
Advise explaining the meaning of control activities. Also identify and explain the control activities which are relevant to the audit.

- B.** Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain **4**

OR

On going through the financial statements of PQR Ltd, its auditors Kamal Gagan and Associates observed that company has taken Loans from banks and financial institutions. Further, the audit team discusses the following about Liabilities:

“Liabilities are the financial obligations of an enterprise other than owners’ funds. Liabilities include loans/ borrowings, trade payables and other current liabilities, deferred payment credits and provisions.

Verification of liabilities is as important as that of assets, for, if any liability is omitted (or understated) or over stated, the Balance Sheet would not show a true and fair view of the state of affairs of the company.”

Advise stating clearly the audit procedures generally required to be undertaken for verification of existence of Borrowings

- C.** Discuss the special points you would consider in the audit of club. **3**

- D.** In the case of a nationalised bank, the auditor is required to make a report to the Central Government. The report of auditors of State Bank of India is also to be made to the Central Government and is almost identical to the auditor’s report in the case of a nationalised bank. **3**

Explain what would the auditor state in his report.