# Gurukripa's Guideline Answers to Nov 2010 Final Exam Qns Advanced Auditing & Professional Ethics (New Syllabus)

Question No.1 is compulsory **(4 X 5 = 20 Marks).**
Answer **any five** questions from the **remaining six** questions **(16 X 5 = 80 Marks).**

Question 1: Comment on the following. 4 X 5 Marks = 20 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | A Co. Ltd has not included in the Balance Sheet as on 31–03–2010, a sum of Rs.1.50 Crores being amount in the arrears of Salaries and Wages payable to the Staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30–04–2010. The Auditor wants to sign the said Balance Sheet and give the audit report on 31–05–2010. The Auditor came to know the result of the negotiations on 15–05–2010. | **Issue 1:** The obligation requires a Provision for Outstanding Expenses under **AS–29**. **Issue 2:** The facts have become known to the Auditor before the date of issue of the Audit Report and before the date the Financial Statements are issued, under **SA–560.** The Auditor should request the Management to create provision for Rs.1.50 Crores. If not done, he should qualify his Audit Report. **Refer Page 29.11 Q.19 Padhuka's AS Book and Page 92 Para 6–9 Padhuka's SA Book** |
| (b) | B Co. Ltd is engaged in the business of developing mass scale housing projects including development of small commercial complexes. The Flats / Commercial Spaces are booked by the public and are allotted by way of Allotment Letter to each Allottee. Major construction activities pertaining to Buildings are undertaken after allotment is over. After completing the construction, possession of Flats / Commercial Spaces is given to Allottees by executing legal document. The CEO of the B Co. says that AS–7 is not applicable to the Company. | The Company is **not a Contractor**, but operating only on "**own account**" basis. Hence, AS – 7 is not applicable. However, AS–9 and AS–2 will be applicable. **Refer Page 7.1 Q.2 of Padhuka's AS Book** |
| (c) | In the Notes to Accounts of C Co. Ltd as on 31–03–2010, Note No. 11 states that – "Certain Machinery items are lying at Customs Warehouses and Company has paid Rs.900 Lakhs up to 30–06–2009 as Detention Charges, out of which a sum of Rs.580 Lakhs is written back during the year 2009–10, based on settlement with the concerned authorities in respect of a major spares of Machinery. For the remaining Machinery items, negotiations are pending and a provision of Rs.44 Lakhs is made. As such, total amount of Rs.364 lakhs paid / provided on account of Detention Charges have been capitalized and included in the Fixed Assets / Capital Work in Progress. The Management is of the view that these expenses are directly attributable to the acquisition of the related Fixed Asset." | Detention Charges cannot be capitalized, and Company's accounting treatment is wrong. The Auditor should qualify his report. **[AS – 10]** |
| (d) | During the course of audit of D Co. Ltd, you as an Auditor have observed that Inter–Corporate Deposit of Rs.50 Lakhs has been overdue. D Co. Ltd have disclosed this in the Notes to Accounts Note No.15 in Schedule No.21 stating that "Rs.50 Lakhs is overdue from XYZ Co. Ltd and the said Company is in the process of liquidation. Management is taking steps to appoint the Liquidator". | Since amount is not realizable in full, a provision should be made in the accounts. Mere disclosure is not sufficient. **[AS – 29 and SA–560]** |

Question 2: Comment with reference to the CA Act, 1949 and Schedules thereto. 4 X 4 Marks = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | PQR and Associates, CAs, have their Website and on the letterhead of the Firm, it is mentioned that "Visit our Website". In the website, the nature of assignments handled, names of prominent Clients and Fees charged is also displayed. **[Refer Page No.16.19, Point 3(i) and Page No.16.20, Point 5(b) Similar to N 02]** | Mentioning website name in Letterhead is permissible. In the website, nature of assignments can be given, but giving names of Clients and fees charged is not permissible. Hence, CA Firm is **guilty** under **Clause 6** of Part I First Schedule. |

| | Question | Hint and Reference |
|---|---|---|
| (b) | Mr. B is a practising Chartered Accountant holding a valid Certificate of Practice. He accepted the appointment as Director of the Green World Co. Ltd. Mr. C, a Partner of Mr. B is Statutory Auditor of the said Company. | CA holding COP can be a Director (other than MD or WTD). However, he cannot be a Director, if he or his Partner(s) is Statutory Auditor of that Company. Hence, B is **guilty** under **Clause 11** of Part I First Schedule. **Page No. 16.34, Q.No.55 Point 1** |
| (c) | YKS & Co, a Proprietary Firm of Chartered Accountants was appointed as Concurrent Auditor of a Bank. YKS used his influence for getting some cheques purchased and thereafter failed to repay the Loan / Overdraft. | Y is **guilty** u/s 22 for **Other Misconduct** and also under Part IV of First Schedule. **Refer Page No.16.7, Q.No.18, Point 8 Page No.16.8, Q.No.19** |
| (d) | Mr. Mohan is a practising Chartered Accountant. He issued a Certificate of Consumption which did not reflect the correct factual position of the consumption of Raw Material by the concerned entity. It is found that the Certificate is given on the basis of data appearing in the minutes of meeting of the Board of Directors. | Issuing Certificate without proper verification of records constitutes **misconduct** under **Clauses 2, 7 & 8** of Part I Second Schedule. **Refer Page 16.50 T S Vaidyanatha Iyer & Page 16.51 P U Patil** |

Question 3: 4 + 4 + 8 = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | XYZ Ltd appoints you as the Auditor of the Company. You observe that the Previous Auditors A & Co. resigned. Also the Balance Sheet as at 31–03–2010 shows an Audit Fee Payable of Rs.25,000. What precautions you will take before commencing the audit work? | **Refer Page No.2.12 Q.No.26, Page No.16.28 Point 4 & 6, and Page No.16.21, Q.No.52 Point 1** |
| (b) | While doing audit, Ram, the Auditor requires reports from experts for the purpose of audit evidence. What types of Reports / Opinions he can obtain and to what extent he can rely upon the same? | **Refer Page No.109 Q.No.2 & 3 of Padhuka's SA Book, SA–620** |
| (c) | Different types of controls which operate over data moving into, through and out of the Computer. Auditor is required to review such controls. Comment. | **Refer Page No.11.14 Q.No.21** |

Question 4: 6 + 5 + 5 = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | Mr. Ram, a relative of a Director was appointed as an Auditor of the Company. Comment. | Ram should not accept the appointment if his Relative Director has **substantial interest**. **Refer Page No.16.60 Point No.4** |
| (b) | Mr. X, Director of ABC Ltd, made a Purchase Contract for Rs.10,00,000 with the Company. Comment. | Sec.297 and CARO Clause 4(v) are applicable. **Refer Page No.3.2 Q.No.3** |
| (c) | PQR Ltd, a Listed Company and having an Average Annual Turnover of more that Rs.5 Crores has no Internal Audit System. Give your views. | Having Internal Audit System is not mandatory. Auditor has to report facts under CARO. **Refer Page No.4.9, CARO Clause 4(vii)** |

Question 5: 6 + 5 + 5 = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | "Examination of Overdue Debts, Audit Classification of Society, and reporting the infringement of provisions of the Act are the special features of audit of a Co–Operative Society." Do you agree? | **Refer Page No.10.8, Points 1, 10 and 8** |
| (b) | Mr. R, the Tax Auditor finds that some payments inadmissible under Section 40A(3) were made, and advised the Client to report the same in Form 3CD. The Client contends that cash payments were made since the other parties insisted upon the same and did not have Bank Accounts. Comment. | If Form 3CD contains incomplete or false information, the Tax Auditor should give **Adverse Opinion** in Form 3CA/3CB. **Refer Page No.8.4 Q.No.8 Points 2, 4 & 6** |

| | Question | Hint and Reference |
|---|---|---|
| (c) | Your Client is contemplating taking over a Manufacturing Concern and desires that in the course of Due Diligence Review, you should specifically look for hidden liabilities and over valued assets, if any. State in brief the major areas you would examine for the above. | **Refer Page No.14.24 Q.No.41** |

Question 6: 6 + 5 + 5 = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | While doing the audit, X, the Statutory Auditor of ABC Ltd observes that certain Loans and Advances were made without proper securities, certain Debtors and Creditors were adjusted inter–se, and Personal Expenses were charged to revenue. Comment. | Inquiry u/s 227(1A) Clauses (a), (b) and (e) is required. **Refer Page No.4.5 Q.No.7 and 8** |
| (b) | XYZ, a manufacturing unit does not accept the recommendation for improvements made by the Operational Auditor. Suggest an alternative way to tackle the hostile management. | **Refer Page No.12.9 Q.No.19 Similar to M 96, M 04** |
| (c) | "Corporate Accountability and Civil and Criminal Penalties for White Collar Crimes." Comment on the major provisions of Sarbanes Oxley Act. | **Refer Page No.13.20 Q.No.2, Points VIII and IX** |

Question 7: Write short notes on any four of the following – Any 4 X 4 Marks = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | Circuit Filters | **Refer Page No.F.33 in Fast Track Referencer N 07 Question** |
| (b) | Reversal of Income under Bank Audit | **Refer Page No.6.25, Q.No.38 Point A** |
| (c) | Guidance Note on Audit of Miscellaneous Expenditure (Revised) | **Refer Page No.18.9** |
| (d) | Verification of Outstanding Premium and Agent's Balances | **Refer Page No.7.12 Q.No.17** |
| (e) | Reconciliation of Cost and Financial Accounts | **Page No.5.31, Q.No.33** |

# Gurukripa's Guideline Answers to Nov 2010 Final Exam Qns Advanced Auditing (Old Syllabus)

Question No.1 is compulsory **(4 X 5 = 20 Marks).**
Answer **any five** questions from the **remaining six** questions **(16 X 5 = 80 Marks).**

Question 1: As an Auditor, how would you deal with the following situations? 4 X 5 Marks = 20 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | Mr. Honest, Director of Truth Private Ltd, is also a Director of another Company False Private Ltd, which has not filed Annual Returns and Accounts for the last three years, 2006–07, 2007–08 and 2008–09 with the Registrar of Companies. Truth Private Ltd passed the following resolution re–appointing Mr. Honest as Director of the Company at the Annual General Meeting held on 31–08–10. | Since the Defaulting Company False Pvt Ltd is only a Private Limited Company, Sec.274(1)(g) disqualification is not attracted. Hence, re–appointment of Mr.Honest by Truth Private Ltd is valid. **Refer Page No. 3.6, Q. No. 10, Pt. 2.** |
| (b) | 'A' Ltd has not made any provision in its accounts as regards losses sustained by its Subsidiary 'B' Ltd. However, it has credited to the Profit & Loss Account the dividend declared by its Subsidiary 'C' Ltd on its investments made in the Subsidiary. | **Issue 1:** It would be prudent to recognise the losses of Subsidiaries, to the extent the value of Investments is affected. **[AS – 13 read with EAC Opinion]** **Issue 2:** Dividends declared by Subsidiaries after B/s date, should not be included unless they are in respect of periods which closed on or before the B/s Date. **[AS – 5, SA–560 read with Note (f) of Schedule VI Part IA]** |
| (c) | XYZ Ltd purchased an Equipment at a price of $1,00,000 on 02–04–09, upon terms of credit that price should be settled within six months from the date of purchase. The Company capitalized the asset in terms of Indian Rupees at a rate of exchange prevailing as on date of purchase. When the liability is settled as per terms on 10–09–2009, it incurs an additional amount of Rs.3,50,000 due to exchange rate fluctuation on the date of settlement. The said sum is charged off to Profit & Loss Account. | **Issue 1:** Capitalising the Asset at the rate as on transaction date is correct as per AS–11. **Issue 2:** Debiting additional amount to P&L (due to settlement) is correct as per AS–11. [Note: However, option is available for capitalizing the same, vide MCA Notification dated 31.3.2009 on AS–11. |
| (d) | LMN Ltd has obtained Term Loan from Nationalized Bank amounting to Rs.10 Crores for purchase of Research and Development Equipments. Out of this, Company has utilized Rs.10 Lakhs towards purchase of Office Furniture and Car to be used by the Chief Executive Officer of the Company. | Non–Utilisation of Term Loan for specified purposes, should be reported under CARO Clause 4(xvi). **Refer Page No.4.10, Q. No. 15** |

Question 2: Comment with reference to the CA Act, 1949 and Schedules thereto. 4 X 4 Marks = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | Mr. Moon is the Auditor of Sun Ltd, which has a turnover of Rs.100 Crores. The Audit Fee for the year is fixed at Rs.25 Lakhs. During the year, the Company offers Mr. Moon an assignment of Management Consultancy for a remuneration of Rs.50 Lakhs. | CA cannot accept assignments having fees higher than statutory audit of that Company. **Refer Page No. 16.61, Point 9(a)** |
| (b) | A Firm of CAs RJ & Co. was appointed by a Company to evaluate the cost of products manufactured by it for its information system. One of the Partners of the Firm RJ & Co. was a Non–Executive Director of the Company. | The CA Firm can be appointed. **Page No. 16.46, Situation (3) Same as N 01, N 04** |
| (c) | Mr. A, Chartered Accountant in Practice as a Sole Proprietor has no office near Egmore. Due to increase in professional work, he opens another office in Tambaram which is approximately 30 kms away from his existing office. For running the new office, he has employed a retired Income Tax Officer. | Exemption available for Office within 50 kms. **Refer Page No. 16.5, Q.No.8, Point 7** |
| (d) | A Partner of a Firm of Chartered Accountants during a TV Interview handed over a bio–data of his Firm to the Chairperson. Such bio–data detailed the standing with International Firm and also his achievements and recognition as an Expert in the field of Taxation. The bio–data was read out during the said interview. | **Refer Page No. 16.25 Situation (3) Similar to RTP, N 01.** |

Question 3: Comment on the following situations. 8 + 4 + 4 = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | The Auditors need not review accounting policies unless there is a change in the basis of accounting. Comment. | Auditor is bound to review accounting policies in accordance with following requirements –<br>• SA 200A – Para 2 & 4<br>• SA 315 – Para 11<br>• SA 260 – Para 12<br>• SA 501 – Para 33<br>• SA 580 – Para 9 & 11<br>• SA 720 – Directors Report Requirements |
| (b) (i) | 'A' Ltd having Fixed Assets at 10 different locations, in total valuing Rs.5,000 Crores, have been physically verifying the assets every third year. Auditor insists for yearly verification of the same. Comment. | While annual verification is impracticable, the verification programme should be such that all the assets are verified, atleast once in every 3 years. In such cases, the Auditor should report the fact, but if he is satisfied with the frequency of verification, he should make a suitable comment to that effect.<br>**Refer Page No.4.8 CARO Clause 4(i) read with ICAI Statement on CARO Para 4(i)(e)** |
| (b) (ii) | 'B' Ltd, manufacturing cycles, has 150 employees. Auditors observe that it has not registered itself for Provident Fund and ESI purposes, not remitting the dues in time and Auditor insists for qualifying the Report. Management contends that in the absence of registration it cannot be construed that the Company is in default of statutory dues on regular basis. Comment. | Non–compliance with EPF and ESI Statutes should be **reported** under CARO Clause 4(ix), and also as per SA–250 reporting requirements.<br>**Refer Page No.4.13, Q.No.23 CARO Clause 4(ix), and SA 250 Para 25 – 27** |

Question 4(a): Permissibility of Buy–back 8 Marks

The Company ABC Ltd has passed a Special Resolution at the Annual General Meeting held on 30–09–09 for buy back of Shares to the extent of Rs.12,50,000. The summary of Financial Position of ABC Ltd as on 31–03–09 is as under –

| | | | |
|---|---|---|---|
| Subscribed & Paid–up Share Capital | Rs.25,00,000 | Fixed Assets | Rs.40,00,000 |
| Reserves and Surplus | Rs.20,00,000 | Current Assets | Rs.12,00,000 |
| Current Liabilities | Rs.15,00,000 | Loans & Advances | Rs. 8,00,000 |
| Total | Rs.60,00,000 | Total | Rs.60,00,000 |

Comment whether the action of the Company is valid.

**Solution:** Permissible limit is only Rs.6,25,000 and not Rs.12,50,000. The following principles / ceiling limits apply –

- Buy–back should be or less than 25% of Total of Paid Up Capital & Free Reserves 25% of Rs.45,00,000 = Rs.11,25,000.
- Buy–back of Equity Shares in any Financial Year should not exceed 25% of Total Paid Up Equity Capital of in that Financial Year 25% x Rs.25,00,000 = Rs.6,25,000.

Question 4 (b): Disclosure under Schedule VI 8 Marks

PQR Private Ltd has prepared the Financial Statements for the year ended 31–3–10 and submitted the same to you for audit. Comment whether Sundry Debtors and Loans and Advances have been disclosed as required under Schedule VI of the Companies Act, 1956.

Balance Sheet of PQR Private Ltd as on 31–03–10

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| Share Capital: | | Fixed Assets: | |
| Authorised 1,00,000 Equity Shares of Rs.10 each | 10,00,000 | Gross Block | |
| Subscribed & Paid up 1,00,000 Equity Shares of Rs.10 each | 10,00,000 | Less: Depreciation | 25,00,000 |
| Reserves & Surplus: | | Current Assets, Loans & Advances: | |
| Profit & Loss A/c | 1,50,000 | Cash & Bank | 2,00,000 |
| Secured Loans: | | Sundry Debtors | 7,00,000 |
| Indian Bank (against hypothecation of Fixed Assets) | 20,00,000 | Loans & Advances | 2,50,000 |
| Current Liabilities & Provisions: | | | |
| Creditors for Trade | 5,00,000 | | |
| Total | 36,50,000 | Total | 36,50,000 |

**Solution:** **Refer Page No. 3.32, Annexure C & D.** Irregularities in the above disclosure are –

(a) Cash and Bank should be placed **after** Sundry Debtors.

(b) Details of Debtors viz. **Classification by Age, Nature and Party** is required to be given.

Question 5: 4 + 4 + 8 = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) (i) | For determining the liability for Gratuity, Actuary's Report is produced to the Auditor. On examination, the Auditor notices a serious wrong assumption in the Report. The Auditor challenges the Actuary's Report. Comment. | The Auditor must evaluate the reasonableness of Actuary's assumptions. **Refer Page No.111 Q.No.6 SA 620 of Padhuka's SA Book [Similar to M 00]** |
| (a) (ii) | The Loss as per Profit and Loss Account of a Limited Company is converted in to profits due to crediting of time–barred liability relating to the purchase of Plant & Machinery. Directors propose to declare dividend out of such profits. Comment. | Dividends cannot be declared out of such Capital Profits. **Refer Page No.3.25, Q.No.54 (Same as RTP)** |
| (b) | You have been approached by an organization to suggest a system where the user wants to access data immediately. What would be your suggestions if they want to process it after validation? | Appropriate User Access Controls and Input Controls should be in place. **Refer Page No.11.17, Q.No.25 & 26** |

Question 6: Comment on the following situations. 4 + 4 + 8 = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) (i) | ARG Bank has granted Loans to the extent of Rs.1500 Crores. 10 parties have not been repaying the Principal Amount and servicing the Interest for more than 36 months. During the year ended 31–03–10, it was found that two of the ten parties have paid Interest partly and the Bank has accounted full amount of interest accrued as income in respect of two parties – Comment. | Interest Recognition by the Bank is **not proper** in this case. **Refer Page No.6.23, Q.No.32, and Page No.6.25, Q.No.38 Point A2** |
| (a) (ii) | ARG Bank has paid money on the Drafts issued by other Branches. But later on it was found that this amount is shown under Suspense Account. Comment. | **Refer Page No.6.41, Q.No.62** |
| (b) | AB & Co. Chartered Accountants, was appointed to compile Financial Statements of Y & Co. a Firm, for Tax Audit purposes. During the course of work, the CA Firm has noticed that the Stock Valuation was grossly understated. When it was pointed out, the Management told that AB & Co. are not the Statutory Auditors of the Company and need not be concerned about valuation of Stock. Comment. | The Accountant shall intimate material mis–statement to Management, or else withdraw from the engagement. **Refer SRS 4410 Para 17 – 23 Page No.131 of Padhuka's SA Book** |

Question 7: Write short notes on any four of the following – Any 4 X 4 Marks = 16 Marks

| | Question | Hint and Reference |
|---|---|---|
| (a) | Other Misconduct | **Refer Page No.16.7, Q.No.18** |
| (b) | Rolling Settlement | **Refer Page No.9.6, Q.No.12** |
| (c) | Corporate Governance | **Refer Page No.13.1, Q.No.1** |
| (d) | Enquiry | **Enquiry u/s 227(1A): Refer Page No.5.13, Q.No.23**<br>**Enquiry as per SA: Refer SA 500 Page 58 of Padhuka's SA Book** |
| (e) | Reconciliation of Cost and Financial Records | **Page No.5.31, Q.No.33** |

STUDENTS' NOTES

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