Practice Paper by FCA Kamal Garg [www.kgma.in]

1. As a Statutory Auditor, how would you deal with the following (***any four***)?

(a) Mr. Rajesh is appointed as the auditor of NOIDA Travels Ltd. with audit fees of Rs. 35,000. He purchased air ticket from Delhi to Kolkata and back for Rs. 18,000 from the client for his personal work and the amount remains unpaid at the end of the year as it is a general practice of the client to give credit to all. Mr. Rajesh claims that he does not incur any disqualification as contained in Section 226(3) of the Companies Act. Would your answer be different if his spouse's brother would have purchased such ticket who is a director in the subsidiary of NOIDA Travels Ltd. (5 Marks)

(b) PQR Limited is an Indian registered public company engaged in development of IT products. It is in the process of raising additional financing from foreign investors, primarily from the United States. As a part of its financial disclosure strategy, it intends to voluntarily provide the Audit Committee's report to the Board in our annual report. This is in line with their aspiration to set benchmarks and adopt global best practices in financial reporting that our potential US investors will be comfortable with. You are requested to provide a template of the same which we could use as a starting point. (5 Marks)

(c) JFK Private Limited is a start-up company operating in the space of online gift market. As part of its financing strategy the company raised equity capital from a set of strategic investors in November, 2012. This included an amount of Rs. 25 lakhs received from a Non-Resident Indian. The amount of money received was credited to share application money account pending its allotment. Subsequently, due to certain differences between the promoters and the NRI investor that included various issues apart from valuation, the shares were not allotted. Now the promoters are in the process of settling the differences with the NRI investor amicably and the company is pretty confident of resolving the matter and allotting the shares to the NRI investor, who the company believes is important for certain strategic business relationships that the investor will bring to the table. However, since the number of days from the date of receipt of share application money has exceeded 180 days during the quarter ended June 30, 2013, the company has made an application to the RBI seeking permission to allot the shares. The permission from the RBI was awaited as of the first quarter ended June 30, 2013. Since the company prepares quarterly financial statements and circulates the audited statements to its investors as part of the shareholder agreement, we believe that the same should be disclosed under the head "Equity" in the balance sheet under Revised Schedule VI, as we are confident of getting the clearance from the RBI. We seek your expert opinion on this matter. (5 Marks)

(d) ITL Limited is an Indian listed company engaged in the business of manufacture of healthcare products and provision of healthcare services. As part of our operations, we enter into contracts with vendors to purchase goods and services. Such contracts, *inter alia,* include contracts that are cancellable without penalty and others that are cancellable with contractual provisions for payment of damages/penalty for cancellation. The agreements and purchase orders include items that may be capitalized or charged off as revenue expenditure. Consequent to the migration of financials to the revised format prescribed by Schedule VI of the Companies Act, the company had disclosed all purchase commitments that were cancellable under the caption "Contingent liabilities and Commitments" at the value of such contracts as per the advice of the statutory auditors. During the current year, the internal auditors have remarked in their interim report to the board of the necessity to have a clear cut policy and guidelines in this area in the accounting manual. In the absence of clear definitions and disclosure requirements in Schedule VI as well as the ambiguity in the Guidance Note on Revised Schedule VI issued by the Institute of Chartered Accountants of India, the Company is unable to come out with clear cut rules for collating the data to disclose under the caption - "Commitments". Give your expert opinion on the following aspects:

(*a*) What contracts/agreements/purchase orders need to be included under "commitments"?, and

(*b*) How the value of the contract needs to be measured for the purpose of disclosure? (5 Marks)

(e) ABC Limited is an Indian Information Technology Services listed company and derives its revenues primarily from the export market. The company recently had a change in senior management and the Board has also undertaken a number of strategic initiatives that include cost management initiatives. As part of one such initiative, the Board has taken a decision to remove poor performing employees from its ranks both in India and abroad. The company has a target of terminating the services of 1,500 employees. Out of this target, the company has identified approximately 800 employees based on their performance appraisal records and the balance will be identified through a process involving the human resources function and the delivery and functional department heads. This exercise is planned to be completed by end of March, 2014 and the company has also decided to avail of the services of a HR consulting firm in order to provide outplacement services to the affected employees. The outplacement services include counselling the impacted employees, helping them develop a CV and assist them in getting placement in other organizations. The cost of this entire exercise is budgeted and signed by the Board and includes the following expenses – (a) notice pay and severance pay for

1,500 employees both in India and abroad (per-capita costs is relatively higher for the onsite employees), (b) relocation costs from onsite to India for certain Indian employees deputed abroad, and (c) outplacement fees. The outplacement fee is a fixed fee per affected employee and it is optional for an employee to avail of such service.

The company intends to make a provision for the quarter ended September, 2013 for the notice and severance pay, cost of relocating staff from abroad to India before issuing termination notice and a provision for the outplacement fees, assuming 80% of the affected employees will opt for the service. The company also intends to communicate this as a restructuring provision along with the declaration of its results for the quarter ended September 30, 2013 as is the practice prevalent in corporate America. The company has documented this in accordance with Accounting Standard 29 covering provisions and restructuring, as this is a fundamental reorganization of the business. The Audit Committee of the Board has requested an independent external opinion on the veracity of the accounting treatment for this strategic initiative. (5 Marks)

2. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

(a) Mr. Rahul, a locally based Chartered Accountant, accepted the tax audit of ABC Limited at a fee lower than that charged by the previous auditor, who was stationed in another town and had to spend a lot of money on travel for which he did not charge separately. He also communicated to previous auditor (a CA Firm with 5 partners) through registered post acknowledgement due mode and the previous auditor advised him not to accept the audit as his audit fees is not paid by the company. The audit fee for the previous tax auditor was not paid by ABC Limited because their tax audit report was signed by some other partner of the firm instead of the partner who signed the letter of engagement. (4 Marks)

(b) The superannuation-cum-pension fund for the employees of a listed company was under a separate `trust'. Both the company and the trust were under the same management. The auditor, who was auditing the accounts of the company as well as the trust noted some irregularities in the operation of the trust and commented upon these irregularities in the confidential report given to the trustees, but did not mention about these irregularities in his report on the Annual accounts of the Trust. He also charged a statutory audit fees of Rs. 2.50 lacs from the company and Rs. 3.00 lacs as audit fees from the trust for the ensuing year under audit. (4 Marks)

(c) M/s XYZ a firm of Chartered Accountants received Rs. 2 lakhs in January, 2013 on behalf of one of their clients, who has gone abroad and deposited the amount in their Bank account, so that they can return the money to the client in July, 2013, when he is due to return to India. The firm, meanwhile, changed its stand and adjusted the amount with the audit fees and certification fees recoverable from client to the extent of Rs. 1.50 lakhs. (4 Marks)

(d) Mr. J.J. a practicing Chartered Accountant engages himself as part time finance manager of Quick Return Securities Limited. He is of the view that as both functions are independent, he need not take permission from the Institute.

Would your answer be different if he is appointed as a statutory auditor of Quick Return Securities Limited in which his father is the finance manager and he quoted his fees to be paid only if it earns profits from its portfolio management services. (4 Marks)

3. (a) Draft audit report u/s 227(3)(f) of the Companies Act, 1956 on the following 3 aspects in for XYZ Ltd. as on 31.3.2014:

(i) Where all directors have given written representations that they have not defaulted u/s 274(1)(g) of the Companies Act, 1956.

(ii) Where one of the directors, Mr. Flexible has failed to produce written representation that he has not defaulted u/s 274(1)(g) of the Companies Act, 1956.

(iii) Where on the basis of written representations received from the directors it is noticed that one of the directors, Mr. Rigid has defaulted in terms of Section 274(1)(g) of the Companies Act, 1956. (6 Marks)

(b) Draft a letter of engagement to carry out systems audit of a listed PSU subjected to review under Clause 41 of listing agreement, clearly stating within such letter of engagement the important characteristics of an effective system of Computer Audit Programme and the audit factors that should be considered while using the work of BPO units? (6 Marks)

(c) A CA firm is providing a range of services to individuals, partnership firms and companies that include statutory and internal audits. One of its clients has recently announced the launch of a real estate company with the objective of entering the villa and raw house segment in joint development with another leading real estate company. It has been approached to perform the functions of the internal auditor of the newly set-up company. Accordingly, it is in the process of compiling the internal audit manual and as part of this exercise and it seeks your inputs on the specific legislations that would be applicable to companies operating in the real estate segment which it can include as part of the Audit Manual. (4 Marks)

4. (a) Enumerate the main areas to be covered by the auditor in the case of energy and environment audit of an industrial unit. (4 Marks)

(b) State the salient features of the directions (questionnaire) to the auditors of Government companies issued by the Comptroller and Auditor General of India u/s 619(3) of the Companies Act, 1956 in relation to: (i) Assets and Investments, and (ii) Inventory and Contracting. Also examine the directors' responsibility, if any, when the statutory auditor as well as C&AG have issued qualified report for the Government Company. (4 Marks)

(c) Khaas Aadmi Party, a political party registered with Election Commission of Indian, has received huge amount of contributions for funding its election contests. The Election Commission of India has appointed you to audit the political contributions received by the party. Draft the audit programme for such an audit. (8 Marks)

5. (a) Explain the common/ similar reportable elements in the CARO, 2003 and Form 3CD under Tax Audit reporting. (5 Marks)

(b) "The auditor should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity." Briefly state the matters to be included in such Communication including a situation where you noticed a misstatement resulting from fraud or suspected fraud during the audit and concluded that it is not possible to continue the performance of audit. (5 Marks)

(c) ABC Limited operates in the alcoholic beverages industry in India and derives revenues through business operations in the product segments comprising of liquor, glass and contracts. The company is listed on the Bombay Stock Exchange and presents consolidated financial statements to its shareholders in compliance with the listing agreement. As part of its foray into the real estate segment, the company had invested an amount of Rs. 50 crores along with other individual related parties three years back. The venture was structured as a partnership firm with ABC Limited sharing 75% in the profits and losses of the partnership firm and pro-rated representation on its governing body. The financial statements of the partnership firm have been reporting a non-material loss in each of the three years, primarily on account of administrative expenditure, as the partnership firm is still in the property development phase.

The company has been reporting the investment in the partnership firm as "Investments-long term" under the erstwhile Schedule VI and under "Non-current investments" under the revised version of Schedule VI. The investments have been accounted for at cost *less* provision for proportionate share in the losses of the partnership firm. This treatment has been followed both in the stand-alone as well as in the consolidated financial statements of ABC Limited. The statutory auditors are in agreement with this accounting treatment. The internal auditors have raised this as a non-compliance issue with the Board. Kindly provide your expert opinion on the appropriateness of the treatment of the investment by the company in the partnership firm engaged in real estate activity. (6 Marks)

6. (a) Explain the scope of concurrent audit of a bank, LFAR and Memorandum of Changes with reference to Reserve Bank of India guidelines. (4 Marks)

(b) (i) The auditor of the company requested one of its vendors to confirm the account balances due appearing in its books of account for a longer period of time. Despite several repeated requests the vendor did not reply and hence the auditor assumed that balances are not misstated and issued an unqualified audit report as not much of the audit risk is involved since these balances accounted only for 2% of the total net worth of the entity. (4 Marks)

(ii) Advise as a statutory auditor under CARO:

1. ABC Limited a listed company has taken one year short term loan of Rs. 15 lakhs from NBFC without getting authorisation from the finance manager and Rs. 45 lakhs as term loan from Punjab National Bank. These loans have been used for purchasing the plant and machinery worth Rs. 50 lakhs. The balance term loan was invested temporarily in high risk equity. A whistle blown fact was found that the term loans were obtained fraudulently by colluding with the lenders. (3 Marks)
2. During the course of audit of D Co. Ltd. (incorporated 6 years back) whose net worth is eroded, you as an auditor have observed that Inter Corporate deposit of Rs. 50 lakhs has been overdue. The D Co. Ltd. has 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. The management is taking steps to appoint the liquidator'*. Would your answer be different if D Co. Ltd. was incorporated only 3 years back. (3 Marks)
3. A company incorporated outside India having a share registration office at Mumbai contends that CARO is not applicable to it. (2 Marks)

7. (a) (i) The auditor and the client may have strained relations during the professional engagement. Enumerate the matters which may result in such strained relationship. (3 Marks)

(ii) What are the major sources of obtaining information about the client's business including assessment of appropriateness of going concern and what factors influence the application of analytical procedures in an audit of financial statements? (3 Marks)

(b) State the reporting responsibility(s) of an auditor in the context of non-compliance of Laws and Regulations in an audit of Financial Statement of Asset Management Companies. (5 Marks)

(c) Draft and audit programme for Service Tax and Prudential Norms audit in respect of NBFC engaged in the business of equipment leasing and borrowing & lending. (5 Marks)

8. Write short notes on ***any four*** of the following (4 Marks each):

(a) Option Share Capital

(b) Powers and duties of an auditors of a multi-state Cooperative Society

(c) Management Discussion and Analysis Report and material non-listed subsidiary under Indian SOX

(d) Submission of audit report u/s 219(1)(b)(iv) of the Companies Act, 1956

(e) Corporate Social Responsibility requirements for Depository Participants

(f) Broad objectives and types of reports in operational audit.

(g) Solvency Margin and Types of Re-insurance Contracts

(h) Management Bias