Guideline Answers to May 2013 Exam CA Final Advanced Auditing and Professional Ethics

Question No. 1 is compulsory. Answer any 5 Questions from the remaining 6 Questions

1(a) The Balance Sheet of G Ltd as at 31st March 13 is as under. Comment on the presentation, in terms of Revised Schedule VI& Accounting Standards issued by NACAS. 5 Marks

Heading	Note No.	31st Mar 13	31st Mar 12
Equity & Liabilities			
Share Capital	1	xxx	xxx
Reserves & Surplus	2	0	0
Employee Stock Option outstanding	3	xxx	xxx
Share Application money refundable	4	xxx	xxx
Non – Current Liabilities			
Deferred Tax Liability (Arising from Indian Income Tax)	5	xxx	xxx
Current Liabilities			
Trade Payables	6	xxx	xxx
Total		**xxxx**	**xxxx**
Assets			
Non – Current Assets			
Fixed Assets – Tangible	7	xxx	xxx
CWIP (including Capital Advances)	8	xxx	xxx
Current Assets			
Trade Receivables	9	xxx	xxx
Deferred Tax Asset (Arising from Indian Income Tax)	10	xxx	xxx
P & L Debit Balance		xxx	xxx
Total		**xxxx**	**xxxx**

Hint – Refer Pg 18.49 – Guidance Note on Revised Sch VI

1. Share Capital and Reserves and Surplus should be disclosed under "Shareholders Funds" under "Equity & Liabilities".
2. "Share Application Money Refundable" is wrongly disclosed under the general heading "Equity & Liabilities". It must be specifically included and disclosed under "Other Current Liabilities".
3. Deferred Tax Asset should be disclosed as a Non – Current Asset. Deferred Tax Liability (on Indian Income Tax) and Deferred Tax Asset (on Indian Income Tax) can be mutually set off if there exists a right of set off, as per AS 22 on Accounting for Taxes on Income
4. Capital Advances is disclosed in CWIP (under Non-Current Assets). The same has to be disclosed under "Long Term Loans and Advances".
5. P&L Debit balance is wrongly disclosed in Current Assets. It has to be shown / reduced from "Reserves and Surplus" and the net balance has to be shown in outer column.
6. Employee Stock Option Outstanding should be classified under the heading "Reserves and Surplus".

1 (b) Z Ltd changed its employee remuneration policy from 1st April 2012, to provide for 12% Contribution to Provident Fund on Leave Encashment also. As per the Leave Encashment Policy,the Employees can either utilize or encash it. As at 31st March 2013 the Company obtained an actuarial valuation for the Leave Encashment Liability. However, it did not provide for 12% PF Contribution on it. The Auditor of the Company wants it to be provided, but the Management replied that as and when the employees availed leave encashment, the Provident Fund Contribution was made. The Company further contends that this is the correct treatment, as it is not sure whether the employees will avail leave encashment or utilize it. Comment. 5 Marks

Hint:Refer Padhuka's Students reference on Accounting Standards – AS 29& AS 15.The Company must provide for the additional expense relating to 12% Provident Fund Contribution.

1 (c) T Ltd. commenced its manufacturing activities from 1st April 2012. In the course of production, the Company generated certain by–products. As at 31st March 2013, the Company did not value the by–products considering the value as

insignificant. The Auditor of the Company is of the opinion that the by–products are inventory of the Company and it should be valued and brought into books of account. Comment. 5 Marks

Hint: Refer Padhuka's Students'Referencer on Accounting Standards AS–2 and EAC opinion thereon. By-products forms part of Closing Stock and must be valued in accordance with AS -2, even if value is insignificant.

1 (d) K Ltd., has 5 Subsidiaries as at 31st March 2013, and the Investments in Subsidiaries are considered as Long–Term and valued at cost. Two of the Subsidiaries' Net Worth eroded as at 31st March 2013, and the prospects of their recovery are very bleak and other three Subsidiaries are doing exceptionally well. The Company did not provide for the decline in the value of investments in Two Subsidiaries,because the overall investment portfolio in Subsidiaries did not suffer any decline, as the other three Subsidiaries are doing exceptionally well. Comment. 5 Marks

Hint:Refer Padhuka's Students' Referencer on Accounting Standards – 13 [Para 17-19, 32-33]

1. Carrying amount of Long Term Investments in Subsidiaries is determined on individual basis and set off / adjustment for decline / increase is not possible.
2. Permanent decline / reduction in value should be made for each investment individually.
3. Hence K Ltd should recognize permanent decline in value of the Investments in two subsidiaries whose Net Worth eroded.

Question 2: Give your comments with reference to Chartered Accountants Act, 1949 and Schedules thereto.

	Question	Answer	Marks
(a)	**Mr. A, a practicing Chartered Accountant, failed to return the books of accounts and other documents of a client despite many reminders from the client. The client had settled his entire fees dues also.**	Guilty. Pg 16.9, Q.23	**4**
(b)	**Mr. B, a practicing CA as well as a qualified lawyer, was permitted by the Bar Council to practice as a Lawyer also. He printed his visiting card where he mentioned his designation as Chartered Accountant and Advocate.**	Guilty. Pg. 16.40, Situation – 3, Pg 16.25, Q.46, Pt. 9	**4**
(c)	**Mr. C, a practicing Chartered Accountant, in the course of the audit of a Listed Company discovered serious violations of the provisions of the Companies Act, 1956, informed the Registrar of Companies out of public interest.**	Guilty. Pg. 16.44, Q. 70 (similar); Also refer the case Shree Indl Rubber Works P Ltd vs SR Khanna in Pg 16.44	**4**
(d)	**Mr. D, a practicing CA, did not complete his work relating to the audit of the accounts of a company and had not submitted his Audit Report in due time to enable the Company to comply with the statutory requirements.**	Guilty. Gross Negligence. Pg. 16.51, Refer the case LN Saxena& JM Chadha	**4**

Question 3: For answers– Refer Padhuka'sStudents' Referencer on Standards on Auditing

	Question	Hint	Marks
(a)	**In the course of audit of Z Ltd, its Auditor wants to rely on audit evidence obtained in the previous audit in respect of effectiveness of internal controls instead of re–testing the same during the current audit. As an Advisor to the Auditor, kindly caution him about the factors that may warrant a re–test of controls.**	SA 330, Pg 70, Para 13	**4**
(b)	**In audit plan for T Ltd, as the Audit Partner, you want to highlight the sources of mis–statements, arising from other than fraud, to your audit team and caution them. Identify the sources of mis–statements.**	SA 450 Pg 79, Para 4 [A1]; SA 240, Pg. 33, Para B[1] – any 4 points	**4**
(c)	**The Auditor of H Ltd wanted to obtain confirmation from its Creditors. But the Management made a request to the Auditor, not to seek confirmation from certain Creditors citing disputes. Can the Auditor of H Ltd accede to this request?**	SA 505, Pg 91, Q.5 [M 05 adopted]	**4**
(d)	**R & Co, a Firm of Chartered Accountants, have not revised the terms of engagements and obtained confirmation from the Clients, for the last 5 years, despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement.**	SA 210, Pg. 14, Para 14 – 17, A.28 – A.32.	**4**

Question 4 (a)

In the course of audit of Good Samaritan Bank as at 31st March 2013 you observed the following –

(i) In a particular account there was no recovery in the past 18 months. The Bank has not applied the NPA norms as well as Income Recognition Norms to this account. When queried, the Bank Management replied that this account was guaranteed by the Central Government,and hence these norms were not applicable. The Bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government? 5 Marks

Refer Pg. 6.24, Q. 33, Pt. 12, 13

(ii) The Bank's advanceportfolio comprised of significant loans against Life Insurance Policies. Write a suitable audit program to verify these advances. 3 Marks

Refer Pg. 6.34, Q. 52

Question 4 (b)

As at 31st March 2013, while auditing Safe Insurance Ltd, you observed that a policy has been issued on 25th March 2013, for fire risk favoring one of the leading corporate houses in the country, without the actual receipt of premium, and it was reflected as Premium Receivable. The Company maintained that it is usual practice in respect of big customers, and the money was collected on 5th April 2013. You further noticed that there was a fire accident in the premises of the insured on 31st March 2013, and a claim was lodged for the same. The Insurance Company also made provision for a claim. Please respond. 4 Marks

Following points require consideration in the above case –

1. Policy documents should not be issued unless the premium is collected –Ref Pg 7.5, Q. 9; Point 4(j)
2. Auditor to verify the legal liability for any provision created by the Insurance Company – Ref Pg 7.7, Q. 11, Pt. II (4)
3. The Auditor shall report that the fact of wrong accounting policy as per IRDA Regulations – Ref Pg 7.2, Q.3 [Pt 2(d)]
4. Reporting: After careful consideration of the above facts the Auditor may issue a modified report.

Question 4 (c)

While writing the audit program for tax audit in respect of A Ltd, you wish to include possible instances of Capital Receipt if not credited to Profit & Loss Account which needs to be reported under Clause 13(e) of Form 3CD. Please elucidate possible instances. 4 Marks

Refer Pg. 8.9, Clause 13 Pt. 5

Question 5 (a)

J Ltd is interested in acquiring S Ltd. The valuation of S Ltd is dependent on Future Maintainable Sales. As the person entrusted to value S Ltd, what factors would you consider in assessing the Future Maintainable Turnover? 4 Marks

Refer Pg. 14.6, Q. 11, pg. 14.23, Q. 40

Factors in evaluating Future Maintainable Turnover:

	Factor to be considered	Description	Effect on Future Turnover
1	Nature of Product	Turnover of the Products following a "life cycle" (e.g.pharma companies) is impacted by the stage in which they are in.	At the end of the product life cycle the future turnover might not be sustained.
2	Projection vsForecast	It is possible to justify the near future (forecast). However it is difficult to justify the turnover for a longer future (projection).	Farther the time period involved, the more it is difficult to justify the revenue projections.
3	Seasonality	Products catering to a particular season may not sustain theirsaleabilityafter the season.	Future Maintainable Turnover may not be possible in off-season periods.
4	Market competition	Products facing more competition (both local and foreign), will dilute the earnings per competitor	Higher the competition level, future sales becomes difficult to sustain.
5	Legal Regulations	Proposed legal regulations can create impact on future saleability of a product.	In case of adverse/ restrictive legal regulations, future turnoverwill be affected.
6	Company's past performance	The company's past revenues should be analyzed, to assess the trend of itsgrowth.	It is difficult to evaluate future turnover for newly incorporated Companies, companies with volatile turnover, etc.
7	Economic scenario	General economic scenario and the consumer's ability to buy the product may also be considered in the long run.	Turnover of Luxury items in a recessionary scenario, may not be predictable.

Question 5(b)

The Managing Director of X Ltd, is concerned about high employee attrition rate in his Company. As the Internal Auditor of the Company,he requests you to analyze the causes for the same. What factors would you consider in such analysis? 4 Marks

Refer Pg 12.34, Q 39

Hint: Info given in Pg 12.34, Q 39 can be summarized as follows:

1. Manpower Planning should be made to match with the appropriate work load per person
2. Personnel recruitement should ensure right man for the right job
3. Training programmes can be "on the Job" and "Exclusive programmes" which will ensure employee's productivity.
4. Incentive schemes will ensure low labour turnout
5. Work review mechanism should be proper. Communication of expectation and goals of the employees must be clear.
6. Leadership skills & the Level of Motivation must be ensured.

Question 5(c)

E & Co, a Firm of Chartered Accountants, requires your help in identifying the audit procedures that can be performed using CAATs. Please guide them. 4 Marks

Refer Pg. 11.23, Q. 36

Question 5(d)

As the Auditor of a large multi–locational Company, in the planning process, you are requested to identify the inherent audit risk at the account balance and class of transaction level. 4 Marks

Hint: Refer Padhuka's Students' Referencer on Standards on Auditing, SA 315, Pg. 59, Para 24-25, Pt 2, 3 & 4

Question 6(a)

H Private Ltd had taken Overdrafts from two Banks with a limit of ` 10 Lakhs each, against the Security of Fixed Deposit it had with those Banks and an Unsecured Overdraft from a Financial Institution of ` 9 lakhs. The said loans were outstanding as at 31st March 2013. The Paid-Up Capital and Reserves of the Company as at that date was ` 40 Lakhs and its turnover during the financial year ended on 31st March 2013 was ` 3 Crores. The management of the Company is of the opinion that CARO 2003 is not applicable to it because Turnover and Paid-Up Capital were within the limits prescribed and loans taken against the Fixed Deposit cannot be considered. The Company further contended that loan limit is to be reckoned per Bank or Financial Institution and not cumulatively. Comment. 4 Marks

Refer Pg. 4.13, Q. 29

Hint:

1. Applicability of CARO: Ref Q 20, Pg 4.11; Pvt Ltd Company must satisfy all the 3 conditions for claiming exemption.
2. Loan against FD: Ref Q 29, Pg. 4.13, Point 5(a); Amount outstanding must be considered fully (not net of FD).
3. Interpretation of the term "Loan from any Bank": Ref Q 30, Pg,. 4.14 (Total Outstanding balances with all Banks & FI to be considered, not individually i.e. 10 + 10 + 9 = `29 Lakhs >`25 Lakhs)
4. Conclusion: CARO is applicable to the above Company, since Loan condition relating to exemption is not satisfied.

Question 6(b)

XYZ Ltd has significant operations in a foreign country. Due to civil and political unrest in that country, physical verification of Inventory and Fixed Assets could not be carried out, and you are not in a position to obtain audit evidence through other audit procedures also. The value of Fixed Assets and Inventory forms part of 80% of the Asset Value of the Company. As the Auditor of XYZ Ltd,what factors do you consider in your reporting responsibility? Also draft a suitable report that will be incorporated in the Main Audit Report (Reporting under CARO 2003 need not be considered). 8 Marks

Hint: Refer Padhuka's Students' Referencer on Standards on Auditing for SA related page references.

It is clear that there is a limitation on the scope of audit. The same can be analysed under the following points:

S No	Ref	Pg Ref	Hint
1	SA 210	13, Para 7	If there is a limitation on scope imposed by the Management,before accepting the audit, the Auditor should not accept the appointment.
	SA 500	82, Para 6	Auditor should obtain sufficient and appropriate audit evidence.
2	SA 501	87, Para 6 & 7	If it is impracticable to be present at the time of Management's physical verification of stock, Auditor should (a) Physically verify the stock on an alternate date, or (b) Issue a Modified Opinion
3	SA 705	165, P. A8-A12	Of the 3 Types of "Limitations on Audit", the given case is one of "Limitations due to circumstances beyond the control of the Entity".
4	SA 705	166, Para A1	In case of material and pervasive limitation on scope, the Auditor shall issue a

			disclaimer of opinion.
5	Sec. 227(3)	4.1, Q.1, Pt. 4	Auditor should report "whether he has obtained proper information and explanations".
6	Reporting Format		Basis forDisclaimer of Opinion: Due to civil and political unrest in ……(country), physical verification of the company's Inventory and Fixed Assets could not be carried out. Hence,Closing Stock to the extent of value .... and Fixed Assets to the extent of .... are not verified by us. This constitutes 80% of the Total Value of the Assets of the Company. Disclaimer of Opinion: Because of the significance of the matters described in the Basis forDisclaimer ofOpinion Paragraph, we have not been able to obtain sufficient and appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Financial Statements.

Question 6(c)

R Ltd, as at 31st March 2013, defaulted in the repayment of interest and principal due to a Financial Institution. The due date was 28th February 2013. However, the defaulted amount was paid on 5th April 2013. The Company's Management is of the opinion that since the default is set right before the audit completion, these need not be reported in CARO 2003. Comment and draft a suitable report. **4 Marks**

Refer Pg. 4.33, Q.83 (Adopted)

Conclusion:The Auditor is required to report the period and amount of the default as on 31st March 2013.

Reporting Format:"The Company has defaulted in repayment of dues to Financial institution. Principal and Interest amounting to `............. became due on 28th February 2013, which are outstanding as on the date of Balance Sheet. Further, the Loan outstanding as on 31.03.2013 has been made good by the Company on 5th April 2013.

Question 7 – Write Short Notes on any four of the following (4 Marks each – 4 x 4 = 16 Marks)

(a) Restrictions on Investments of funds of a central co-operative society	Pg. 10.7, Q.8, Pt. 8
(b) Technical, Ethical & Professional Standards as per Statement on Peer Review	Pg. 17.9, Q. 16, Pt. 2; Pg. 17.12, Q. 19, Pt. 4
(c) Corresponding Figures	Pg. 180, Para 6, SA 710
(d) Permanent Consolidated Adjustments	Pg. 10.18, Q. 29, Pt.1
(e) Volatility Margin, its computation and its application	Pg. 9.3, Q. 4