Gurukripa's Guideline Answers to May 2014 Exam Questions
CA Final ADVANCED AUDITING AND PROFESSIONAL ETHICS

Q.1 is compulsory **(4 × 5 = 20 M).** Answer **any 5** Qns from **remaining 6** Qns **(16 × 5 = 80 M).** [Any 4 out of 5 in Q.7]

Note: Page Number Reference are from **"Padhuka's Students Handbook on Advanced Auditing – For CA Final"**
For Accounting Standards and Standards on Auditing, the corresponding Book and Page Numbers are indicated.

Question 1(a): AS – 29, SA – 706 – Contingent Liability Disclosure (5 Marks)

ABC Company files a law suit against Unlucky Company for ₹ 5 Crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the Notes accompanying its Financial Statements. As an Auditor of Unlucky Company, how will you deal with the situation?

Hint Answer	Reference
• Recognition criteria of Provisions as per AS–29 are not met. So, disclosure as **Contingent Liability is sufficient.**	• **Q.21 [P A/c –N 12] Page 29.10** of Padhuka's Students' Referencer for Accounting Standards
• However, the Auditor may include an **Emphasis of Matter Paragraph** if it is required so in his judgement.	• **SA 706, Para 6, A1 in Page 175** of Padhuka's Students' Referencer of Standards on Auditing
• Auditor should consider duties under SA–501 in relation to Litigation and Claims. [**SA–501, Para A.23, A.24**]	• **SA 501, Para A.23, A.24 in Page 89** of Padhuka's Students' Referencer of Standards on Auditing

Question 1(b): SAE – 3400 – Reporting on Projected Financial Statements (5 Marks)

T & Co. wants to issue a Prospectus, to provide potential investors with information about future expectations of the Company. You are hired by T & Co. to examine the Projected Financial Statements and give report thereon. What things you will consider before accepting the audit engagement, and what audit evidence will be obtained for reporting on Projected Financial Statements?

Hint Answer	Reference
• **Things to be considered:** (a) Intended Use, (b)Dissemination, (c) Nature of Assumptions, (d) Elements Included, (e) Period Covered, etc. • **Audit Evidence:** (a) Process Study & Reports, (b) Historical Data, (c) Examination Procedures by Auditor, (d) Management Representations, etc.	**Refer Para 17,18–25 of SAE 3400, Page 228**, of Students' Referencer on Standards on Auditing.

Note: Auditor may also consider the duties as per Guidance Note on Reports in Company Prospectus [**Page 22.35**]

Question 1(c): SA – 240, SA – 580, CARO – Fraud, Management Representations, etc. (5 Marks)

In the course of audit of K Ltd, its Auditor Mr. 'N' observed that there was a Special Audit conducted at the instance of the management on a possible suspicion of a fraud, and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the Special Audit Report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the Company. For this request also, the management remained silent. Please guide Mr. 'N'.

Hint Answer	Reference
• Clause 4(xxi) of CARO 2003, requires reporting on Fraud noticed / reported. • Access to Books of Accounts may include Special Audit Reports also. Not providing the Report to Statutory Auditor may constitute Limitation of Scope. • Written representations as required under SA 240, are to be obtained. If not, Auditor may give a Modified Report. • Reporting considerations under Para 18,19 of SA 580 shall apply.	**See Page 5.10, CARO Point 21** Also Refer Para 5–8, 39 of **SA– 240** Page 28,32 & Para 18 of **SA– 580** Page 132 of Students' Referencer on Standards on Auditing.

Question 1(d): SA – 505 – External Confirmation (5 Marks)

During the course of audit of Star Limited, the Auditor received some of the confirmation of the balances of Creditors outstanding in the Balance Sheet through external confirmation by negative confirmation request. In the list of Sundry Creditors, there are number of Creditors of small balances, except one old outstanding of ₹ 15 Lakhs, of whom, no confirmation on the credit balance received. Comment with respect to Standards of Auditing.

Hint Answer	Reference
Negative Confirmation is **not** acceptable for material Creditors. **Alternative Audit Procedures** to be performed to confirm the balances.	**SA–505** Para 15,12 in **Page 91** of Students' Referencer on Standards on Auditing.

Question 2(a)(b)(c)(d): CA Act and Professional Ethics **(4+5+3+4 = 16 Marks)**

Q.No.	Question	Hint Answer	Ref
2(a) 4 M	**Mr. 'E', a practicing Chartered Accountant, was requested by one of his Clients to prepare a projection for next five years and also a report on the same. Mr.'E' after having prepared the same stated in his report the sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts. He also stated that he does not vouch for the accuracy of the forecasts. Give your comments with reference to CA Act, 1949 and Schedules thereto.**	The approach is **correct.** There is no Professional Misconduct under Clause (3) of Part I of Second Schedule.	**Refer Page 20.46, Q.73**
2(b) 5 M	**Mr. 'A' is a practicing Chartered Accountant, working as Proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee, for taking care of routine matters of his office. During his absence, Mr. 'Y' has conducted the under mentioned jobs in the name of M/s A & Co.** **(i) He issued the audit queries to Client which were raised during the course of audit.** **(ii) He issued Production Certificate to a Client under Central Excise Act, 1944.** **(iii) He attended the Income Tax proceedings for a Client as Authorized Representative before Income Tax Authorities.** **Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s A & Co, and liability of Mr. 'A' under the CA Act, 1949.**	• Issue of Audit Queries & attending routine matters as Authorised Representative is **permissible.** • Issuing Production Certificate under Central Excise Act, constitutes **misconduct** for Employee CA, for contravention of ICAI Regulations. • Mr. A is guilty of Professional Misconduct under Clause (12) of Part I of First Schedule.	**Refer Page 20.41, Q.62, 63, and Page 20.3, Q.6, Point 2**
2(c) 3 M	**Mr. 'G', while applying for a Certificate of Practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business. Give your comments with reference to CA Act, 1949.**	Refer **K.S.Dugar Case**. G is guilty of **professional misconduct** under Clause (3) of Part II of Second Schedule.	**Refer Page 20.65, Q.93**
2(d) 4 M	**Mr. 'C', a Chartered Accountant, holds a Certificate of Practice while in employment also, recommends a particular lawyer to his employer in respect of a case. The Lawyer, out of the professional fee received from the employer, paid a particular sum as Referral Fee to Mr. 'C'. Give your comments with reference to CA Act, 1949.**	• Holding COP while in employment also, requires prior permission, else guilty of misconduct under Clause 11, Part I of First Schedule. • Fee Sharing attracts professional misconduct under Clause (2) of Part II of Second Schedule.	**Refer Page 20.41, Q.64 & Page 20.36, Q.57**

Question 3(a)(b)(c)(d): Company Audit, Audit Committee and Liabilities of Auditors **(4+4+4+4 = 16 Marks)**

Q.No.	Question	Hint Answer	Ref
3(a) 4 M	**A Ltd, is a Chennai based Company. The Total Turnover of the Company is ₹ 10 Crores for the year 2012–13. The Company has a Branch Office at an area which was recently affected by flood. The transportation services are not available due to destruction caused by flood. The Branch Office recorded turnover of ₹ 1,50,000 in the Financial Year 2012–13. No audit of the Branch has been carried out. The Statutory Auditor of the Company has made no reference of the above Branch in his report. Comment.**	• In the above case, Quantum of Branch Activity does not exceed ₹ 2 lakhs or 2% of Turnover. Hence, exempted from Branch Audit. • However, Statutory Auditor should expressly state the fact of exemption in his Report. • Also Auditor to report u/s 227(3) w.r.t. Branches not visited by him.	**Refer Page 2.20, Q.47, and Page 2.13, Q.29, Pt.4**

Q.No.	Question	Hint Answer	Ref
3(b) 4 M	**Mr. 'U', a respectable Chartered Accountant of international repute, was requested by one of the major corporates in India to join its Board and also a Chairman of Audit Committee. He expressed his apprehensions that he is not having the requisite experience. Mr. 'U' seeks your view on the responsibility of Audit Committee vis–à–vis the review of Financial Statements.**	Responsibility of Audit Committee includes areas of – (a) Internal Control / Audit, (b) External Audit, (c) Financial Reporting, (d) Others.	**Refer Page 17.4, Q.8**
3(c) 4 M	**For the year ended on 31st March 2014, P Ltd proposed to pay a dividend of 25% on its Equity Shares and it further proposed to transfer 20% of Net Profit for that year after Tax to its Reserves. Its Auditor objected to the same, stating that 10% is the maximum permissible limit to transfer to Reserves. Comment.**	Higher than 10% of transfer **permissible**, if prescribed 4 conditions are satisfied.	**Refer Page 3.14, Q.30**
3(d) 4 M	**In the assessment procedure of M/s Cloud Ltd, the Income Tax Officer observed some irregularities. Therefore, he started investigation of the Books of Accounts audited and signed by Mr. Old, a practicing CA. While going through the books, he found that M/s Cloud Ltd used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. The Income Tax Department filed a complaint with the ICAI saying Mr. Old had negligently performed his duties. Comment.**	• Refer **Commissioner of Income Tax vs G.M. Dandekar** Case. If the CA has exercised due care and diligence, no question of Negligence. • Guilty under Clause 7 of Part I of Second Schedule, in case of negligence.	**Refer Page 19.12, Q.15 and also Page 20.54, Q.81**

Question 4(a)(b)(c): CARO, Consolidation of FS **(4+6+6 = 16 Marks)**

Q.No.	Question	Hint Answer	Ref
4(a) 4 M	**H Ltd granted Unsecured Loan of ₹ 1 Crore at 15% p.a. to two of its Subsidiaries during the Financial Year 2012–2013. Before the year–end, both the Companies repaid the loan. The management of H Ltd is of the opinion that since no balance is outstanding as on 31st March 2013, these Loans are not required to be reported in CARO 2003. Comment and draft a suitable report.**	Even transactions that have been squared up/ settled have to be reported. [See below for **Draft** Report]	**Refer Page 5.20, Q.49**
4(b) 6 M	**In the course of audit of Y Ltd, as the Auditor of the Company you observed the following:** **(i) The Company has advanced a Loan to a Firm in which a Director was interested, at a rate lower than the prevailing market rate, as well as there was no agreements on terms of repayment.** **(ii) There are certain transactions which ought to have been entered in the Register maintained u/s 301, were omitted to be entered.** **How Auditor will report in CARO 2003?**	• Prima facie, giving Loan to a Related Party Firm at below market rates & without repayment terms are prejudicial to the Company's Interest. • Omission of Items is required to be reported by the Auditor.	**Refer Page 5.8, Q.15 Pt.3 & Pt.5**
4(c) 6 M	**X Limited is the Holding Company of Y Limited and Z Limited. Explain the nature of Current Period Consolidation Adjustments which will be taken into account for the preparation of Consolidated Financial Statements.**	**See Point No. 2** of reference question.	**Refer Page 13.4, Q.9**

Q.4(a) Draft Report: 4 (iii): In respect of the loans, secured or unsecured, granted or taken by the Company to / from Companies, Firms or Other Parties covered in the register maintained under Section 301 of the Companies Act, 1956:

(a) The Company had given Unsecured Loan of ₹ 1 Crore each, to two Subsidiaries at 15% Interest p.a., which have been repaid during the year itself.

(b) In our opinion and according to the information and explanations given to us, the rate of Interest and other terms and conditions of loans given by the Company, are not prima facie prejudicial to the interest of the Company.

Question 5(a)(b)(c): Bank Audit, Insurance Audit, Guidance Notes **(5+6+5 = 16 Marks)**

Q.No.	Question	Hint Answer	Ref
5(a) 5 M	**Shy & Co. had been allotted the Branch Audit of a Nationalized Bank for the year ended 31st March 2014. In the audit planning, the Partner of Shy & Co. observed that the allotted branches are pre–**	**See Point No.2** of reference question.	**Refer Page 8.24, Q.33**

Q.No.	Question	Hint Answer	Ref
	dominantly based in rural areas and major portion of the advances were for agricultural purpose. He needs your assistance in incorporating the criteria prescribed for determination of NPA norms in respect of Agricultural Advance, in audit plan.	See **Point 11** of reference question	**Refer Page 8.24, Q.34**
5(b) 6 M	**M/s ABC & Co, a CA Firm, was appointed as the Auditor of 'Always Safe General Insurance Ltd.' Advise them how they will verify Outstanding Premium and Agents' Balances.**	See reference question.	**Refer Page 9.13, Q.22**
5(c) 5 M	**Good Bank Ltd, intends to advance to a customer, based on the Stocks and Receivables. It appoints you to conduct a periodical review of status of Stocks and Receivables of that Borrower. Please draft a suitable program of verification.**	See Guidance Note on Audit of A/cs of Non Corp. Entities (Bank Borrowers) **[Page 22.38 to 22.41]**	**Also see Page 8.36 & 8.39, Q.54, 60**

Question 6(a)(b)(c)(d): Govt Audit, Operational Audit, Investigation, Peer Review **(6+3+4+3 = 16 Marks)**

Q.No.	Question	Hint Answer	Ref
6(a) 6 M	**ABG &Co. a Chartered Accountant Firm, has been appointed by the C & AG for performance audit of a Sugar Industry. What factors should be considered by ABG & Co, while planning a Performance Audit of Sugar Industry?**	See reference question.	**Refer Page 6.15, Q.34**
6(b) 3 M	**Mr. 'P' has been appointed as Operational Auditor of M/s Books & Magazine Ltd, and observed a totaling error in an Invoice of ₹1,000. He has not taken care of the same, saying that this is out of scope of his work. Comment.**	Operational Audit focuses on **qualitative aspects** than accounting aspects. So, P's claim is **correct**. However, possibility of system error should also be considered by P.	**Refer Page 15.15, Q.26**
6(c) 4 M	**What will be your approach in Investigation under Section 235 and 237 into the affairs of the Company registered under Companies Act, 1956?**	See reference question.	**Refer Page 16.9, Q.17**
6(d) 3 M	**What are the areas excluded from the scope of Peer Reviewer?**	**See Point No. 2** of reference question.	**Refer Page 21.3, Q.5**

Question 7(a)(b)(c)(d)(e): Various Topics – Answer any four out of the following **(4 × 4 = 16 Marks)**

Q.No.	Question	Hint Answer	Ref
7(a) 4 M	**Write Short Notes on: Classification of Frauds by NBFC.**	See reference question.	**Refer Page 8.57, Q.90**
7(b) 4 M	**Write Short Notes on: Causes of Risk of Material Misstatement in CIS Environment.**	See Point 4,5,6	**Refer Page 14.11, Q.16**
7(c) 4 M	**Write Short Notes on: Evaluation of Inherent Risk at the level of Financial Statements.**	**SA–315**, See Point 3	**Page 60 of Students' Referencer on Standards on Auditing.**
7(d) 4 M	**Write Short Notes on: Objectives of Internal Check System.**	See reference question.	**Refer Page 1.6, Q.15**
7(e) 4 M	**Write Short Notes on : Tolerable Misstatement**	Definition as per **SA–530**	**Page 98 of Students' Referencer on Standards on Auditing.**