

**MOCK TEST PAPER 1**  
**FINAL COURSE: GROUP – I**  
**PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS**  
**SUGGESTED ANSWERS/HINTS**

**DIVISION A - MCQs (30 Marks)**

Questions no. (1-10) carry 1 Mark each and Questions no. 11-20 carry 2 Marks each.

1. (c)
2. (d)
3. (a)
4. (d)
5. (b)
6. (d)
7. (b)
8. (c)
9. (a)
10. (d)

Questions (11-20) carry 2 Marks each

11. (a)
12. (c)
13. (c)
14. (a)
15. (b)
16. (d)
17. (a)
18. (c)
19. (b)
20. (b)

**DIVISION B - DESCRIPTIVE QUESTIONS (70 Marks)**

1. (a) In the given question, Chandra & Co. did not apply audit procedures to ensure that opening balances had been correctly brought forward. A complaint was filed against the auditors in this context. As per Standard on Quality Control (SQC) 1 “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”,
  - (i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:
    - (a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
    - (b) Allegations of non-compliance with the firm’s system of quality control.

- (ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.
  - (iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.
  - (iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.
  - (v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.
- (b) In the given case, Sumati & Co. was appointed as an auditor of Mati Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that Mati Ltd.'s profit and loss account reflected a loss due to that provision. As an auditor evaluation would be done as under:

For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

- (i) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
  - (ii) Whether the significant assumptions used by management are reasonable.
  - (iii) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.
  - (iv) If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.
- (c) In the present case, there exists a material uncertainty that cast a significant doubt on the company's ability to continue as going concern and the same is not disclosed in the financial statements of Shreyansh Ltd.

As such, the financial statements of Shreyansh Ltd. for the FY 2020-21 are materially misstated and the effect of the misstatement is so material and pervasive on the financial statements that giving only a qualified opinion will be insufficient and therefore the statutory auditor of Shreyansh Ltd. should issue an adverse opinion.

The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

#### **Adverse Opinion**

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of Shreyansh Ltd. as at March 31, 2021, and of its financial performance and its

cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

#### **Basis for Adverse Opinion**

Shreyansh Ltd. has faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. Due to such event it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statement and notes to the financial statements of the company do not disclose this fact.

2. (a) An Indian company, Prabhu Ltd., listed on stock exchange entered into various related party transactions.
- (i) The report shall be signed either by the compliance officer or the chief executive officer of the listed entity.
  - (ii) (a) The company shall disclose the policy on dealing with related party transactions on its website and a web link thereto shall be provided in the Annual Report.
    - (b) The listed entity shall disclose the transactions with any person or entity belonging to the promoter/ promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.
  - (iii) (a) Yes, disclosures of related party transactions on consolidated financial statements are required to be made by the listed entity within 30 days from the date of publication of its standalone and consolidated financial results for the half year.
    - (b) The listed entity shall disclose related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website. Provided that a 'high value debt listed entity' shall submit such disclosures along with its standalone financial results for the half year
- (b) **Various Risk:** Businesses today operate in a dynamic environment. The volatility, unpredictability and pace of changes that exist in the business environment today is far greater than in the past. Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because of this dynamic environment the associated risks to business have also increased and companies have a need to continuously manage risks.

Examples of risks include:

- Market Risks;
  - Regulatory & Compliance Risks;
  - Technology & Security Risks;
  - Financial Reporting Risks;
  - Operational Risks;
  - Credit Risk;
  - Business Partner Risk;
  - Product or Project Risk;
  - Environmental Risks.
- (c) Clause (1) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he

allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.





The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner, or his employee and would work under his control and supervision.

In the instant case, CA Subahu allowed CA Bahu (who is a newly qualified CA professional with COP) to sit in his office for 6 months, and allowed him to provide tax consultancy independently to his firm's clients, filing of some IT and GST Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA Bahu was only reimbursed with his usual expenses and was not paid any salary or share of profit for the same. However, after the end of agreed period he was given a lump-sums of ₹ 2,50,000 for his association out of gratitude.

Thus, in the present case CA. Subahu will be held guilty of professional misconduct as per Clause (1) of Part I of First Schedule to the Chartered Accountants Act, 1949 as he allowed CA Bahu to practice in his name as Chartered accountant and CA Bahu is neither in partnership nor in employment with CA. Subahu.

3. (a) **Commission payable to Agents:** Insurance business is generally solicited by the Insurance agents. The remuneration of agent is paid by way of commission which is calculated by applying percentage to premium collected by him. Agency commission contributes towards significant portion of expenses incurred by the Insurance Commission. Commission is payable towards generation of new business and towards settlement of renewal premium

**Role of Auditor:** The Auditor during his review of Commission paid to Agents should mainly consider the following:

-  Review the system established by the Insurer with respect to calculation of commission to eligible agents accurately and processing the same in timely manner.
-  Review the commission payment system is in sync with the premium collection system.
-  Check whether commission paid is within the limit prescribed under Insurance Act.
-  Check whether commission is clawed-back on the cancelled policies.

- (b) Section 269ST provides that no person shall receive sum of ₹ 2 lakh or more a) in aggregate from a person in a day; or b) in respect of a single transaction; or c) in respect of transactions relating to one event or occasion from a person otherwise than by an account payee cheque or an account payee demand draft or by use of electronic clearing system through a bank account.

Further, the tax auditor has the responsibility to verify the compliance with the provisions of 269T of the Income Tax Act.

Furthermore, the tax auditor is required to report under Clause 31 (ba) particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, during the previous year, where such receipt is otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account:-

- (i) Name, address and Permanent Account Number (if available with the assessee) of the payer;
- (ii) Nature of transaction;
- (iii) Amount of receipt (in ₹);
- (iv) Date of receipt;

In the present case, Mr. Yuvi, contractor dealing in food catering, flower decorating and light decorating activities, received in cash ₹ 1,75,000 for food catering and ₹ 1,35,000 for flower

decoration from one NGO for holding one event, by way of cash which is exceeding prescribed amount of ₹ 2,00,000. Thus, tax auditor is required to report the same in compliance with Clause 31 (ba) of Form 3CD.

- (c) **Using Designation of Insolvency Professional:** As per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than 'Chartered Accountant' on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.

In the given situation, CA. Vardhman is a Chartered Accountant in practice. He is also empanelled as an Insolvency Professional (IP), accordingly, has mentioned the same on his visiting cards, letter heads and other communications also. As per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant empaneled as IP (Insolvency Professional) can mention "Insolvency Professional" on his visiting cards, letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause 7 of Part 1 of First Schedule to the Chartered Accountants Act, 1949. Thus, complaint of neighbor Mr. Tapas is not enforceable/ valid.

4. (a) **CA Sheetal has to ascertain whether the company has complied with the following aspects in relation to the activity of mobilization of public deposits:-**
- i. The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will have to increase/reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame and should ensure that the NBFC has informed about the same to the RBI inwriting.
  - ii. In the event of downgrading of credit rating below the minimum specified investment grade, a non-banking financial company, being an investment and credit company or a factor, shall regularise the excess deposit as provided hereunder:
    - a. with immediate effect, stop accepting fresh public deposits and renewing existing deposits;
    - b. all existing deposits shall run off to maturity; and
    - c. report the position within 15 working days, to the concerned Regional Office of the RBI where the NBFC is registered.
    - d. No matured public deposit shall be renewed without the express and voluntary consent of the depositor.

(b) **Steps to Prepare the Management Audit Report:**

**Planning the Audit Report** - Before starting the report, the auditor should ask himself, "What do I want to tell the reader about this audit?" The answer will enable him to communicate effectively.

**Supporting information** - The management auditor should supplement his report with appropriate audit evidence which sufficiently and convincingly supports the conclusions.

**Preparing draft report** - Before writing the final report, the auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his report. It would also indicate whether there is any superfluous information or a gap in reasoning.

**Writing and issuing the final report** - The final report should be written only when the auditor is completely satisfied with the draft report. The head of the management auditing department may review and approve the final report. Before issuing the final report, the auditor should discuss

conclusions and recommendations at appropriate levels of management. The report should be duly signed and dated.

**Follow-up of the audit report** - The management auditor should review whether follow-up action is taken by management on the basis of his report. If no action is taken within a reasonable time, he should draw management's attention to it.

**Action / Response of Management on Audit Report:** Where management has not acted upon his suggestions or not implemented his recommendations, the auditor should ascertain the reasons thereof. In cases where he finds that non-implementation is due to a gap in communication, he should initiate further discussions to bridge such gaps. The actions and responses to the Management Audit Report reflect management's attitude to the audit. In any case, the auditor to retain the usefulness of the audit function should ascertain from the management, preferably in writing, the reasons for non- implementation. It is possible that because of change in circumstances, the audit observation did not require any action on the part of the management. The auditor should satisfy himself on the appropriateness of such reasons as well to close the issue.

- (c) **Failed to Supply Information Called For:** As per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Thus, in the given case, Mr. Shanti has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant. Therefore, he is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

5. (a) **Implications of relatives' securities holding on the Appointment of the Auditor:** According to Section 141(3)(d)(i) of the Companies Act, 2013, read with Rule 10, an auditor is disqualified to be appointed as an auditor if the auditor or his relative holds securities or interest in the company of face value exceeding ₹ 100,000.

Further the definition of relative also includes daughter and a daughter's husband. Both are covered in the definition of relative as defined by the Companies Act 2013.

Thus, the disqualifications will be applicable as the relative/s are holding securities of face value of more than ₹ 100,000 and market value is not important.

It is also to note that in the event of acquiring any security or interest by a relative above the threshold prescribed, the corrective action to maintain the limits as specified above can be taken by the auditor within 60 days of such acquisition or interest. The same has however not been done.

In the instant case, Daughter of Mr. *Shripal* purchased the securities on 10<sup>th</sup> September 2021 of face value of ₹ 45,000 and husband of daughter of Mr. *Shripal* purchased the securities on 10<sup>th</sup> of December, 2021 of face value of ₹ 90,000. Aggregating the value of holding of securities exceeds the limits mentioned in proviso to section 141(3)(d)(i) i.e. ₹ 1,00,000.

Further, corrective action taken by Husband of Daughter of Mr. *Shripal* on 18<sup>th</sup> February, is also not in accordance with prescribed grace period of 60 days.

Therefore, CA. *Shripal* will be disqualified for appointment as an auditor of Raja Ltd. as per section 141(3)(d)(i) and he shall vacate his office.

- (b) **Audit Programme of Movie Theatre Complex:**

- (i) Peruse the Memorandum of Association and Articles of Association of the entity.
- (ii) Ensure the object clause permits the entity to engage in this type of business.

- (iii) In the case of income from sale of tickets:
  - (1) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
  - (2) Verify the system of relating to online booking of various shows and the system of realization of money.
  - (3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
- (iv) Verify the **internal control system** and its effectiveness relating to the income from café, shops, pubs, game zone etc., located within the multiplex.
- (v) Verify the system of control exercised relating to the **income receivable from advertisements** exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
- (vi) Verify the system of collection from the **parking areas** in respect of the vehicles parked by the customers.
- (vii) In the case of **payment to the distributors** verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
- (viii) Verify the system of **payment of salaries and other benefits to the employees** and ensure that statutory requirements are complied with.
- (ix) Verify the payments effected in respect of the **maintenance of the building** and ensure the same is in order.
- (x) Verify the insurance premium paid and ensure it covers the entire assets.
- (c) **Over-Valued Assets:** In case of due diligence exercise, the area of analysis in order to ensure that the assets are not stated at over-valued amounts are:
  - Uncollected/uncollectable receivables.
  - Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
  - Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
  - Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
  - Litigated assets and property.
  - Investments carried at cost though realizable value is much lower.
  - Investments carrying a very low rate of income / return.
  - Infertuous project expenditure/deferred revenue expenditure etc.
  - Group Company balances not reconciled.
  - Intangibles having no relisable value.

6. (a) **Issues examined in Comprehensive Audit:** Some of the issues examined in comprehensive audit are-

- (i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?
- (ii) Have the accepted production or operational outputs been achieved? Has there been under utilisation of installed capacity or shortfall in performance and, if so, what has caused it?
- (iii) Has the planned rate of return been achieved?
- (iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
- (v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
- (vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?
- (vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?
- (viii) If the enterprise has an adequate system of repairs and maintenance?
- (ix) Are procedures effective and economical?
- (x) Is there any poor or insufficient or inefficient project planning?

(b) **Power of Tribunal in case Auditor acted in a Fraudulent Manner:** As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447 of the said Act.

It is hereby clarified that in the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

(c) **Data Mining Techniques:**

- i. Data mining technique is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns.
- ii. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud.
- iii. It explains various affinities, association, trends and variations in the form of conditional logic.



- iv. Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis.

In the given case of BMY Bank Ltd., CA Rajul appointed as forensic auditor for its borrower, AMISS Ltd, shall use above stated data mining techniques to identify any hidden patterns of information.

**OR**

- (c) While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence and avoid conflict of interest, the following eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment.

**For being a technical reviewer (TR):**

- He should not have disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him/her or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against him during last three financial years and/or thereafter.
- He or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have been the statutory auditor of the company, as specified, or have rendered any other services to the said entity during last three financial years and /or thereafter.
- He or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have had any association with the specified AFUR, during the last three financial years and /or thereafter.
- He should comply with all the eligibility conditions laid down for appointment as an auditor of a company u/s 141(3) of the Companies Act, 2013 which apply mutatis mutandis in respect of the review of the quality of statutory audit of the entity, as specified, so far as applicable.
- He does not belong to the city/region of head office of the AFUR.