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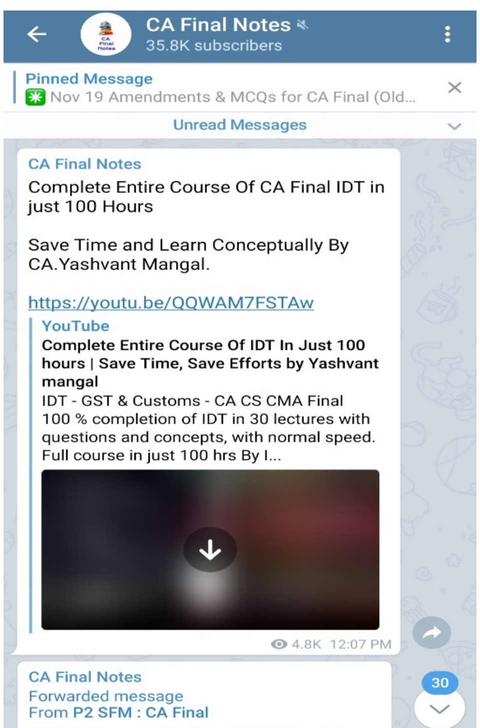

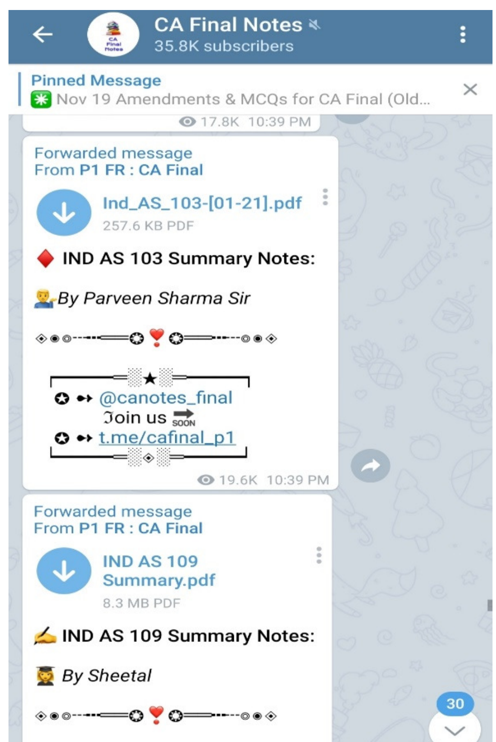

GRAPH PAPER IS ON THE PENULTIMATE PAGE

Book No. 1 (containing 28 pages)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

Final (new) - May 2019 Examination

Group No. I Paper No. 3

Subject Advanced Auditing and Professional Ethics

Number of Answer Books used : Main + 2 additional sheets

For use by ICAI only

801408

31 MAY 2019

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA MAY 2019

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Q.No.	To be ticked (✓) by the candidate against the Questions answered	Marks Awarded (to be filled by Examiner) a	b	c	d	e	Total
1	✓	3	3	1			7
2	✓	3	2	0			5
3	✓	3	3	4			10
4	✓	1	3	3			7
5							
6	✓	3	3	0			6
7							
8							
9							
10							
Total		13	14	8			35

Use only Blue / Black Ball Point Pen to write and shade the circles. AVOID RED PEN. Write the marks in the boxes before shading the respective circles.

Total Marks awarded

3 5

Total Marks awarded (in words) Thirty Five

Examiner's Signature

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INSTRUCTIONS TO THE CANDIDATE

nswers are not to be written on this page

hould be written in figures and words in the allotted space at the right hand corner of the nly and nowhere else including additional answer book/s and graph paper.

nber should be written in the box in numbers and darken the appropriate circles of the OMR on provided in the right hand corner of the cover page with **Black / Blue** ball point pen.

ill particulars such as name of Examination, Group No., Paper No. and subject at the appropriate space at the left hand upper corner.

4. Remove the Bar Code sticker of the particular paper from the Attendance sheet and affix the same on the box provided in the right hand corner of the cover page.

5. Since a machine will read the Roll no., please check and ensure that Roll number written in numbers, words and circles darkened are correct. In case any candidate fills this information wrongly, Institute will not take any responsibility for rectifying the mistake.

6. The answers should be written neatly and legibly

7. The answer to each question must be commenced on a fresh page and question number prominently written at the top of each answer. Alternatively, the question number should be distinctly written in the margin.

8. The answer to each question in all parts should be fully completed in one page, or in a consecutive set of pages, before the next question is taken up.

9. Writing of Roll number in place/s other than the space provided for the purpose or writing distinguishing mark, symbols like "OM", "Sri", "Jesus", "786", etc., will tantamount to adoption of "unfair means"

10. Before submission of answer book to the invigilator after completion of the exam, take care to score out (X) blank pages, if any, that you might have left.

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Ques. 1 (a)

Ques. 1 (a)

As per SRE - 3400 " Examination of prospective financial information ", while reviewing the information and projections prepared by the management, the auditor should verify and examine the following :-

i) The assumptions i.e. the best estimate assumptions are reasonable and in line with the industry trends.

ii) The hypothetical assumptions used in the preparation of financial information are consistent with the historical financial statements.

iii) The projective financial information is prepared in all material aspects in accordance with the assumptions referred above.

iv) The entity has disclosed the assumptions in the information clearly describing as to whether the same is best estimate assumption or hypothecial assumption.

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v) The basis of information, forecast of data is disclosed and also the Same is reasonable.

vi) The auditor should also ensure that the assumption made are not prima facie biased or favourable to the entity or management.

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Ques. 1 (b)

Ques. 1 (b)

SA-299 " Responsibility of Joint Auditors".

The joint auditor may divide the work among themselve on the basis of asset / liabilities or Income / Expenditure or plant wise. An auditor is solely responsible for the work allocated to him. In respect of work which is not divided, they shall be jontly & severally responsible.

It is important to document to work divided among each other & get it signed by auditors & also to inform the client.

In given case, Dice Ltd appointed two firms as Joint auditor MN & Associates and PQ & Co. for conducting audit for the year ended 31st March 2019. The work of inventory valuation was alloted to MN & Associates and a major understatement in the value of inventory was not reported by him.

However in the given case, since there is no documentation between the Joint auditors for the work alloted it will be difficult for PQ & Co. to prove that MN Associate was responsible for this work.

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Firstly, solely MN & Associate will be held responsible for the misstatement occurred, however if PQ & Co. failed to prove the same then MN & Associate and PQ & Co. will be Jointly responsible for the mistatement due to no documentation for division of work.

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Ques. 1 (c)

Ques. 1 (c)

SA 210 "Agreeing the terms of Initial Audit Engagement".

In a case where after the acceptance of work by the auditor, management imposes certain limitation on the scope of the work due to which the auditor believes that this limitation will lead the auditor to disclaim the opinion, the auditor shall -

i) Inquire the management as to the reasons for such limitation and evaluate whether it is valid.

ii) The auditor shall evaluate whether there is any indication that makes the auditor aware about suspected fraud or error.

If auditor concludes that such limitation is unreasonable, the auditor shall ask the management of remove such limitation.

If the management refuses to remove the limitation, the auditor shall evaluate whether there are any alternative ways to obtain audit evidence and the impact of such limitation on audit procedures.

If he concludes that, it is impracticable to continue then:-

i) If not required by statute or regulation, he shall withdraw from the engagement.

ii) If it is not possible to withdraw then issue a adverse or disclaimer of opinion.

The auditor shall also consider the need to communicate the matter to those charged with Governance & shareholders through his report.

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Ques. 6 (a)

Ques. 6 (a)

Section 148 of the Companies Act, 2013 prescribes for cost audit of certain classes of companies as mandated by the Central Government.

However, there are few exceptions where such cost audit will not be required:

i) If a company is engaged in export business & its revenue from exports exceeds 75% of the total revenue.

ii) Entity is located in Special economic Zone.

iii) Entity / Company is engaged in generation of electricity for captive consumption through captive consumption plants.

In given case, Pearl Ltd is an exporter of precious & semi-precious stone. Its total turnover is ₹ 150 Crore & out of which ₹ 105 Crore is from export business which is 70% of total revenue.

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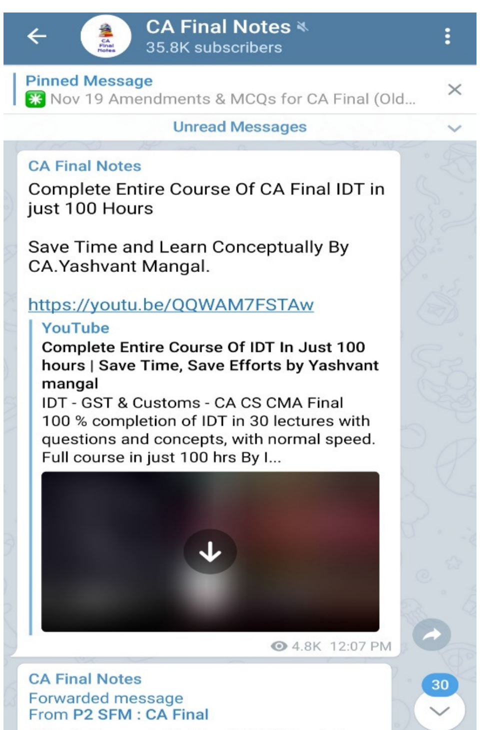

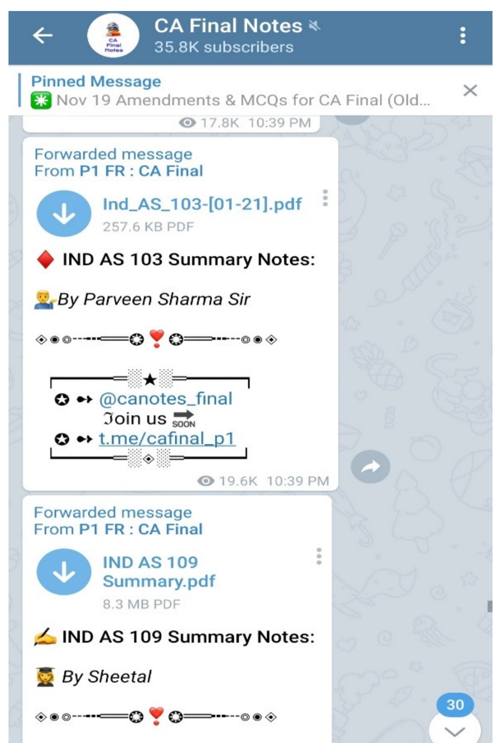

Since, in given case Pearl Ltd's revenue from export is less than 75% (only 70%), cost audit shall be mandatory for it.

Therefore, the contension of Pearl Ltd that its maximum revenue has been generated from export is not valid since it is not exceeded 75%.

Cost audit is applicable.

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Ques. 6 (b)

Ques. 6 (b)

As per Section 64, of the Insurance Act, 1938

No insurance company shall assume any risk in respect of any insurance contract on which premium is generally payable in india unless & untill the premium on such contract is received or guaranteed by the person or until & unless any advance premium has been paid by such person.

In given case, ABC Insurance Ltd insured a plant & machinery of M/s PQR Ltd on 01/10/2018 on which premium has been paid on 15/10/2018.

Fire broken out in the factory of PQR Ltd and the Plant & machinery got damaged on 10/10/2018. Now the company is filling a claim with Insurance company.

Since, premium on such contract was not paid till 10/10/2018, the

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Insurance company does not assume any risk till date & is under no obligation to pay the claim. Therefore, ~~PQ~~ ABC Insurance Co. Ltd should reject the claim of M/s PQR Ltd.

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Ques. 6 (c)

Ques. 6 (c)

As per clause 4 of Part 1 of Second Schedule to the Chartered Accountants Act, 1949, A chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he provides his opinion on the financial statements of an enterprise in which he, his firm or any of its partners or relative has a substantial interest. This restriction is not applicable on preparation of reports not issued to external entities & used for internal purposes.

In given case, CA Pant is the auditor of M/s Max Ltd where Son CA Sant has joined the firm of CA Pant for 6 month and has alloted a chamber and independently providing services to the client of the firm and filling return.

Therefore, CA Pant being Son of M/s Max Ltd and partner in the firm of CA Pant will affect the independence of the audit of M/s Max Ltd.

The fact that he was only getting re-imbursement of expense during the agreed period is irrelevant.

Therefore, CA Pant and also CA Sant shall be guilty of professional misconduct as per clause 2 of Part 1 of Second Schedule.

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Ques. 3 (a)

Ques. 3 (a)

The composition of board of an listed entity shall at all times consist of an appropriate combination of executive directors & non-executive directors.

The Board shall have minimum one women director and atleast 50% of the directors shall be non-executive directors.

~~The Board shall consist of minimum two third of independent directors.~~

1/3 of the total directors shall be independent directors, and if the Chairman of the board is an executive director or a promotor or a relative of promoter than minimum 1/2 shall be independent directors on the board.

In given case, M/s Real Ltd has total 9 directors on the board. Therefore, it is required to have minimum 5 of them as non-executive directors (50% of 9, rounded up).

If the chairman is non-executive director then atleast 3 independent directors (1/3 of 9) and if chairman is executive director then minimum 5 shall be independent directors (1/2 of 9). Also a position of One women director is compulsory.

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Ques. 3 (b)

Ques. 3 (b)

Banks have certain characteristics different from other commercial enterprises such as large custody of financial assets, risky assets, regulatory requirements etc and therefore require special audit consideration. The following pecularities may necessiate special audit consideration :-

i) Continous development of products & services which are unmatched by corresponding development in accounting and other matters.

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ii) The engagement of bank in the fully automated environment like net banking, online transactions, ATM services, etc which exposes a bank to various types of risk.

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iii) The transaction are initiated and completed by the customers themselves without any involvement of banking

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official.

iv) The transaction is initiated at one place, recorded at another place & yet get completed at another place.

v) The custody of large volume of financial assets and engagement in large volume of transactions on a daily basis.

vi) The bank involves a huge amount of credit risk due to large advances in its balance sheet which additionally require important considerations.

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Ques. 3 (c)

Ques. 3 (c)

Section 2 (2)(iv) of the Chartered Accountants Act, 1949

1 states that a member shall be deemed to be in practice he is renders "Other services" to the client. The term other services includes management consultancy services which are authorised by council for members.

Advisor and consultant to the public issue is one of the services included in management consultancy services but it specifically excludes portfolio management services, underwriting services.

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In present case, CA Natraj in practice accepted assignment as advisor and consultant to public issue by his client m/s Super Ltd along with underwriting of 25% shares at 1% commission.

Since, the council has only approved advisory & consultant services, CA Natraj can not underwrite shares on his own behalf.

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Further clause 1 of Part II of Second Schedule to the chartered Accountants Act, 1949 states that a member of Institute shall be guilty of professional misconduct if he contravenes any of the provision of this Act or regulations made there under or guidelines issued by council.

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Therefore, the view of CA Natraj is not tenable as management consultancy service do not include under writing services.

Therefore, he shall be deemed to be guilty of professional misconduct.

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Ques. 4 (a)

Ques. 4 (a)

To assess and evaluate the control environment as a part of his audit program. The standard operating procedure (SOPs) of assessment and evaluation of control are as follows-

i) Control enivironment: The auditor shall first evaluate the environment of the organisation and what controls are put in place by management to protect & safe gaurd its assets and preperation of financial statement on timely basis.

ii) Risk Assessment procedure: The auditor shall evaluate through understanding of the entity types of risk associated with the organisation in accordance with SA 315.

iii) Internal control systems: Evaluate whether there is an effective system of control i.e. design, implementation & maintenance of controls to address the areas of risk and potential errors / fraud.

iv) Controlling activities: The auditor shall verify the process by which the management or those charged with Governance controls the activities of various functions and systems running in the organisation and their operating effectiveness.

v) Monitoring Activities: Evaluate the process & procedure of monitoring the activities in the organisation and also the validity and compliance of laws, system and controls.

Ques. 4 (b)

Ques. 4 (b)

As per Section 141(3)(e) of the Companies Act, 2013 a person or his firm shall not directly or indirectly have any business relationship with the company, subsidiary company, holding company, associate company or subsidiary of such holding or associate company.

However, the person or firm is allowed to undertake -

i) He or it is allowed to render services which are allowed to be rendered by a CA in practice or

ii) enter into transaction with such companies in the ordinary course of business at Arm's length prices.

Otherwise he or it will be disqualified to be appointed as the auditor of such company.

In the given case, PQ & Co. is an audit firm with P & Q as partners. For financial year 2018-19 they have been appointed as the statutory auditors of Mango Orchards Hotel Ltd. The firm is regular customer of hotel and partners usually stay at the hotel in course of travelling for which payment are settled against bill raised quarterly by company.

If the transaction is at arm's length price in ordinary course of business then the audit firm shall not disqualified from appointment and vacation as per Section 141(4) shall not be required.

However, if the payment term of quarter is an additional benefit offered to the statutory auditors then it will be affecting their independence of mind and therefore will be disqualified from appointment and shall immediately vacate office.

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Ques. 4 (c)

Ans- 4 (c)

As per Section 143(6)(a) of the Companies Act, 2013, Comptroller & Auditor General of India may order a supplymentary audit of the books of the Government entity by such person or persons as it may deem fit and for the purpose of such audit require information to be furnished to them by such persons as may be prescribed.

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Further Section 143(6)(b) provides that the on receipt of auditor's report and comment of C&AG, the company shall forward such report and comments to the all the person entitled like share holders, trustee of debentures or any other person who are eligible to be sent a report.

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Therefore, the contension of the directors of Sun light Ltd of not discussing the supplementary auditors report & comments of C&AG is not valid. And it is required to forward the Report to all eligible person and discuss the same ~~#~~ in the AGM on 01/09/2018.

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Ques. 2 (a)

Ques. 2 (a)

A per SA 620 - " Use of work of Auditor's expert ", the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay are as follows -

i) Competence : The auditor shall consider the competence of the person as whether he has requisite skills & professional knowledge required for the purpose of the work to be examined by him.

2) Capabilities: The auditor should also consider whether he is capable enough to use the required skill and knowledge in the area of work for which he is so engaged.

3) The auditor shall also consider that the expert is subject to any

Addl. Book No. 1

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
ADDL. BOOK

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Q. 2 (a)

Q. 2 (a)

professional on technical standards of which he is a member.

4) The auditor shall discuss with the expert the assumptions used by him in the work, also the areas where he was required to make significant judgements.

5) The auditor should also make an independent assessment of work and track the deviations occured between the work of expert and his assessment.

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Ques. 2 (b)

Q. 2 (b)

As per $\boxed{SA - 705}$ - " Modification in the opinion of Independent auditors ~~audit~~ report " , the auditor shall consider the need of modfying his opinion on the basis of audit evidence obtained regarding the matter.

In given case, ALM Associates has been appointed as auditors of M/s Harry Ltd which acquired 55% shares in M/s Sam Ltd on 15^{th} October 2018.

During the audit, ALM Associates found that the company has not prepared consolidated financial statements because on the date of acquisition the fair value of certain assets & liabilities has not been ascertained.

The opinion para shall be as follows -

In our opinion and on the basis of information given in basis for opinion para, we hereby give a adverse opinion in relation to the statement of Balance sheet, Statement of profit and loss, Statement of Cash flow statement and accompanying notes.

Basis for Adverse Opinion:

The company has not prepared consolidated financial statements as required by INDAS-110 and Schedule III due to non-availability of information about fair values of acquisition of subsidiary M/s Som Ltd. Due to non-inclusion of the subsidiary, the financial statements do not reflect a true & fair view in relation to the affairs of the company.

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Ques. 2 (c)

Ques. 2 (c)

As per SQC-1 " Quality control for audit firm ", the engagement partner shall ensure independence requirements & eliminate and reduce the same.

Some engagement specific safeguard which may be introduced in the work environment to ward off such threats are as follows :

i) The engagement partner shall obtain a declaration of independence from all the members in the engagement team about their relation with the auditee.

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ii) The ~~auditor~~ engagement partner shall also prepare policy on independence requirement which should be affirmed compliance by all the members in the firm and the engagement team.

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Addl. Book No. 2

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
ADDL. BOOK

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Ques. 2 (c)

Ques. 2 (c)

iii) The engagement partner shall also obtain declaration of independence on an yearly basis.

iv) The partner shall ensure that the breaches in respect of independence requirements and threats shall be immediately be communicated to the person responsible.

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v) The partner shall try to reduce the threat by way of adequate safeguards in the firm.

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OMR ANSWER SHEET

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Use Black Ball point pen to write in the Boxes

Roll Number	Paper No. (See reverse)	Paper Code	OMR Sheet No.
203578	3	WAH1	511268

Question Booklet Serial No.	Question Booklet Set No.
104393	A

Level of Exam

INTERMEDIATE ①
FINAL ●

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OLD ①
NEW ●

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1	A	●	C	D	16	A	●	C	D
2	●	B	C	D	17	A	B	●	D
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5	●	B	C	D	20	A	B	C	●
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10	A	B	●	D	25	A	B	C	D
11	●	B	C	D	26	A	B	C	D
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13	A	B	●	D	28	A	B	C	D
14	A	●	C	D	29	A	B	C	D
15	●	B	C	D	30	A	B	C	D

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