

Mock Test Paper - Series I: September, 2024

Date of Paper: 13th September, 2024

Time of Paper: 2 P.M. to 5 P.M.

FINAL COURSE: GROUP I

**PAPER-3: ADVANCED AUDITING, ASSURANCE AND
PROFESSIONAL ETHICS**

ANSWERS

Part I: MULTIPLE CHOICE QUESTION

1. (c)
2. (a)
3. (b)
4. (d)
5. (b)
6. (c)
7. (d)
8. (b)
9. (a)
10. (c)
11. (d)
12. (a)
13. (b)
14. (c)
15. (a)

Part II - DESCRIPTIVE QUESTION

1. (a) M/s Dharam & Associates are unable to obtain sufficient appropriate audit evidence about the financial information of a joint venture investment that represents over 89% of the group's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are both material and pervasive to the consolidated financial statements. Therefore, the statutory auditor should issue a disclaimer of opinion.

The relevant extract of the Disclaimer of Opinion paragraph and basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We were engaged to audit the accompanying consolidated financial statements of Spice Ltd., (hereinafter referred to as the "Holding Company") and its subsidiaries (the Holding Company and its subsidiaries together referred to as "the Group), which comprise the

consolidated balance sheet as at March 31, 2024, the consolidated statement of Profit and Loss, (consolidated statement of changes in equity) and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the “Consolidated Financial Statements”).

We do not express an opinion on the accompanying consolidated financial statements of the group. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

Basis for Disclaimer of Opinion

The Group’s investment in its joint venture Croptop Ltd. company is carried at ₹ 120 crore on the Group’s consolidated balance sheet, which represents over 89% of the Group’s net assets as at March 31, 2024. We were not allowed access to the management and the auditors of Croptop Ltd., including audit documentation of auditors of Croptop Ltd. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group’s proportional share of Croptop Ltd.’s assets that it controls jointly, its proportional share of Croptop Ltd.’s liabilities for which it is jointly responsible, its proportional share of Croptop Ltd.’s income and expenses for the year, (and the elements making up the consolidated statement of changes in equity) and the consolidated cash flow statement.

- (b) SA 505, “External Confirmations”, states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

In the instant case, GST registrations of 38 concerns have been cancelled in the year 2023-24. It indicates that businesses at those addresses were closed. Further, there are no fresh registrations pertaining to the PANs of these parties. However, the auditor sent external confirmation requests in March 2024, which were duly responded. It raises questions on the reliability of responses received.

SA 500, “Audit Evidence” indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include:

- Was received by the auditor indirectly or
- Appeared not to come from the originally intended confirming party.

Keeping in view the circumstances described in the given situation, there is a risk that the response has not come from the originally intended confirming party. Unreliable responses may indicate a fraud risk factor that requires evaluation.

- (c) In the given case, the auditor has come to know the legal claim against the company before the issuance of the audit report. It has also come to his knowledge that the management of the company has agreed to an out of court settlement of ₹ 4 crore.

This is an example of a subsequent event between the date of the financial statements and the date of the auditor's report. It provides evidence of conditions that existed at the date of the financial statements and requires adjustment in financial statements.

Further as per SA 560, "Subsequent Events", the auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, "Written Representations" that all the events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

CA Shobit should ensure that appropriate adjustments and disclosures are made by the management. In the absence of the same, he should consider the impact of the said event and report accordingly.

2. (a) Audit procedure to verify Current Accounts and Saving Accounts are:

- Verify on a sample basis current account and saving accounts opened during the year for adherence to KYC norms. Verify that saving accounts are opened in name of individuals, HUF, some approved institutions like trusts, educational institutes etc. Remember that saving accounts are not opened for business or professional concern. The business transactions are carried in current accounts which can be opened for all kind of customers like companies, individuals, partnership firms etc.
- Verify the balances in individual accounts on a sample basis.
- Check the calculations of interest on a test check basis. Remember that no interest is paid generally on current accounts by banks.
- Examine whether the procedure for obtaining balance confirmation periodically has been followed consistently. Examine, on a sampling basis, the confirmations received.
- Ensure that debit balances in current accounts are not netted out on the liabilities side but are appropriately included under the head 'advances'.
- Inoperative accounts (both current and saving) are a high-risk area of frauds in banks. As per RBI guidelines, a savings/ current

account should be treated as inoperative/dormant if there are no transactions in the account for over a period of two years. Verify on a sample basis some of inoperative accounts revived/closed during the year. Ensure that inoperative accounts are revived only with proper authority. In this regard, cases where there is a significant reduction in balances of such accounts as compared to previous year, examine authorisation for withdrawals.

- (b) As per Part I 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, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice, under Clause (2); does not exercise due diligence, or is grossly negligent in the conduct of his professional duties, under Clause (7); or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, under Clause (8).

The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the management's representation.

In the instant case, the investment of ₹ 23 lakh appeared in the Balance Sheet of the company and was the same amount as in the last year. Later, it was found that the company's investments were only ₹ 76,000, but the value of investments was inflated for the purpose of obtaining higher amount of bank loan. Such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty.

Thus, in view of above, CA Aditya will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

- (c) **Key considerations that CA Kabir should address for effectiveness and security of the remote audits are:**

Feasibility and Planning

- Planning should involve agreeing on audit timelines, meeting platform (Zoom calls/ Microsoft Teams/Google Meet) to be used for audit sessions, data exchange mechanisms, any access authorization requests. Ensure feasibility is determining what

technology may be used, if auditors and auditees have competencies and that resources are available.

- The execution phases of a remote audit involve video/tele conferencing with auditees. The documentation for audit evidence should be transferred through a document sharing platform.

Confidentiality, Security and Data Protection

- To ensure data security and confidentiality, access to document sharing platform should be sufficiently restricted and secured by encrypting the data that is sent across the network. The information, once reviewed and documented by auditor, is removed from the platform, and stored according to applicable archiving standards and data protection requirements.

Auditors should take into consideration legislation and regulations, which may require additional agreements from both sides (e.g., there will be no recording of sound and images, or authorizations to using people's images). Auditors should not take screenshots of auditees as audit evidence. Any screenshots of documents or records or other kind of evidence should be previously authorized by the audited organization. In case of accessing the auditee's IT system auditor should use VPN (Virtual private network). VPN is a service which creates safe and encrypted online connections. It prevents unauthorized users to enter into the network and allows the users to perform work remotely.

Risk assessment

- The communication from auditor as well as auditees need to clear and consistent, and this becomes crucial during remote audit. The risks for achieving the audit objectives are identified, assessed and managed. The assessment if remote audit would be sufficient to achieve the audit objectives should be done and documented for each audit involving all members of the audit team and the audited organization representative.

3. (a) As per SA 320, "Materiality in Planning and Performing an Audit", when establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused

the auditor to have determined a different amount (or amounts) initially. If the auditor concludes a lower materiality for the same, he shall determine whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

In the given case, Deepti & Co., as an auditor has applied the concept of materiality for the financial statements as a whole. But they want to re-evaluate the materiality concept on the basis of additional information of import of machinery for production of new product which draws attention to a particular aspect of the company's business.

Thus, Deepti & Co. can re-evaluate the materiality concepts after considering the necessity of such revision.

- (b)** In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the audited balance sheet of the previous year to decide its principal business. The company will be treated as NBFC when
- (i) Financial assets of the company constitute more than 50 percent of the total assets (netted off by intangible assets) and
 - (ii) Income from financial assets of the company constitutes more than 50 percent of the gross income.

A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

In the given case of Singh Ltd, its financial assets are ₹ 374 Crore i.e., (₹ 61.75 + ₹ 312.25)

Total Assets (netted off by intangible assets) = ₹ 608 Crore

Income from financial assets = ₹ 68 Crore

Gross Income = ₹ 118.75 Crore

From the above, it can be concluded that financial assets of Singh Ltd. constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets of Singh Ltd. constitutes more than 50 per cent of the gross income. Hence, Singh Ltd. fulfills both the criteria to qualify as an NBFC.

Thus Singh Ltd. can apply for registration under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

- (c)** As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of the Chartered Accountant unless permitted by the Council so to engage.

As per the Guidelines for Corporate Form of Practice, the Council has allowed the members in practice to hold the office of Managing Director,

Whole-time Director or Manager of a body corporate within the meaning of the Companies Act, 2013 provided that the body corporate is engaged exclusively in rendering Management Consultancy and Other Services permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard. The name of the Management Consultancy Company is required to be approved by the Institute and such a Company has to be registered with the Institute.

The members can retain a full-time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such management consultancy company. There will be no restriction on the quantum of the equity holding of the members, either individually and/ or along with the relatives, in such a company. Such members shall be regarded as being in full- time practice and therefore can continue to do attest function either in individual capacity or in Proprietorship/Partnership firm in which capacity they practice and wherein they are also entitled to train articled/audit assistants.

In the given case, CA Shubh, a Chartered Accountant specializing in Information Systems Audit and considered an expert in the field, was offered the position of Managing Director by ZX Limited, a management consultancy firm. He accepted the role without obtaining prior permission from the Institute of Chartered Accountants of India

From the above provisions, it can be concluded that the action of CA Shubh is valid.

- 4. (a) (i)** The auditor is required to report the transaction as per Clause (xv) of Paragraph 3 of the CARO, 2020 which states that whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.

Further, as per Clause (xiii) of Paragraph 3 of the CARO, 2020, auditor should report whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards.

In the given situation, Candy Ltd. has entered into non-cash transactions with one of the directors, Mr. Sidhant during the year, by transferring the property (by Mr. Sidhant) in favour of the Company in a deed of exchange of a site owned by the company.

Thus, the auditor is required to report the same as per Clause (xv) and Clause (xiii) of Paragraph 3 of the CARO, 2020.

- (ii)** As per clause (vii) (b) of Paragraph 3 of CARO,2020, the auditor is required to report where statutory dues have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the given situation, the survey team pointed out certain lapses regarding non-deduction of TDS and demand raised by DCIT(TDS). TDS dues are in the nature of statutory dues and the company has filed appeal against order of DCIT (TDS) raising a demand of ₹ 25 lacs with JCIT (Appeals). Therefore, these are in the nature of disputed statutory dues. Thus, it should be reported in accordance with Clause (vii) (b) of Paragraph 3 of CARO, 2020.

(b) As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of the Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

(A) every listed company;

(B) every unlisted public company having-

- (1) paid up share capital of fifty crore rupees or more during the preceding financial year; or
- (2) turnover of two hundred crore rupees or more during the preceding financial year; or
- (3) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
- (4) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

(C) every private company having-

- (1) turnover of two hundred crore rupees or more during the preceding financial year; or
- (2) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, XYZ Limited is a listed company. As per section 138 of the Companies Act, 2013, every listed company is required to appoint an internal auditor or a firm of internal auditors. Thus, in view of the above, XYZ Limited is required to appoint an internal auditor.

Further, MNM Limited is unlisted public company. The company is having ₹ 60 crore as equity share capital which is exceeding the prescribed limit of rupees fifty crore as per section 138. Thus, MNM Limited is required to appoint an internal auditor as per section 138 of the Companies Act, 2013.

GFG Limited is unlisted private company and having ₹ 70 crore as equity share capital, ₹ 180 crore as turnover and ₹ 80 crore loan from Bank and PFI. In view of provisions of section 138 of the Companies Act, 2013 discussed above, all the limits are below the prescribed limit for a private company. Therefore, GFG Limited is not required to appoint an internal auditor.

It can be concluded that XYX Limited and MNM Limited are required to appoint the internal auditor as per the provisions of the Companies Act, 2013 whereas GFG Limited is not required to do the same.

- (c) As per Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he does not exercise due diligence or is grossly negligent in the conduct of this professional duties.

In the given case, Pitch Private Limited requested CA Angad, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Ravi, one of the Director of Pitch Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Ravi was simply copied and pasted by another Director of Pitch Private Limited.

CA Angad, without verifying the genuineness of the Resignation Letter, digitally signed the Form and the said form was uploaded on the website of Registrar of Companies.

Due to forged resignation letter, the resignation of Mr. Ravi from directorship of the Pitch Private Limited had been occurred. It was noted that CA Angad had not taken any step to verify forged signature on resignation letter which anyone would have taken in normal circumstances.

Hence, CA Angad would be held liable for professional misconduct as per Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

5. (a) As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", the firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

In the given case, SPS & Associates, Chartered Accountants, statutory auditors of Grec Limited for the last two years, came to know that the company has expanded its operations into a new segment as well as in new country. SPS & Associates does not possess the necessary expertise for the same, therefore, SPS & Associates wish to withdraw from the engagement and client relationship. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.

If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with

governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.

Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.

Documenting significant issues, consultations, conclusions, and the basis for the conclusions.

SPS & Associates should address the above issues before deciding to withdraw.

- (b)** CA H should consider the requirement of SA 600, “Using the Work of Another Auditor”, if he decides to use the work of another auditor in relation to the audit of consolidated financial statements and he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

- (i) The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.
- (ii) The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.
- (iii) The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS.
- (iv) The principal auditor also obtains certain confirmations from component auditors like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements,

the principles of SA 600 need to be considered i.e. CA H (the parent auditor) should comply with the requirements of SA 600, "Using the Work of Another Auditor".

- (c) As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", when obtaining an understanding of the user entity in accordance with SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:
- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
 - (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
 - (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and
 - (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organization.

Based on above, while conducting the audit, CA Harish will assess the effect on the audit risk and take necessary steps.

6. (a) As per SAE 3400, "The Examination of Prospective Financial Information", when determining the nature, timing and extent of examination procedures, the auditor should consider matters such as:
- (i) the knowledge obtained during any previous engagements;
 - (ii) management's competence regarding the preparation of prospective financial information;
 - (iii) the likelihood of material misstatement;
 - (iv) the extent to which the prospective financial information is affected by the management's judgment;
 - (v) the sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;
 - (vi) the stability of entity's business; and
 - (vii) the engagement team's experience with the business and the industry in which the entity operates and with reporting on prospective financial information.
- (b) In the given situation, Shri Limited, a listed company, has installed pollution control equipment for processing the pollutants to keep the level

of pollution below the prescribed standard. The company managed to get pollution certificate by unfair means whereas breach of pollution control laws still continues. For arranging clearance certificate amount of ₹ 18.75 lacs had been incurred unlawfully. CA Gopal, Director Finance, came to know about these matters on review of the same during the period.

NOCLAR, under Code of Ethics, is applicable on professional accountants in service, and in practice. Among those in practice, it applies to Auditors, as well as professional services other than Audit.

It is applicable to Senior Professional Accountants in service, being employees of listed entities. Senior professional accountants in service ("senior professional accountants") includes directors.

NOCLAR takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.

As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted.

CA Gopal, Director-Finance is expected of taking the following action/responses:

- Obtaining an understanding of the Matter.
- Addressing the matter.
- Seeking advice.
- Determining whether further action is needed.
- Determining whether to disclose the matter to an Appropriate Authority.
- Imminent breach.
- Documentation.

- (c) The objective of the Due Diligence exercise will be to look specifically for any hidden liabilities or over-valued assets.

Example of Hidden Liabilities:

- The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.

- The company may have given “Letters of Comfort” to banks and Financial Institutions. Since these are not “guarantees”, these may not be disclosed in the Balance sheet of the target company.
- The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
- Tax liabilities under direct and indirect taxes.
- Long pending sales tax assessments.
- Pending final assessments of customs duty where provisional assessment only has been completed.
- Agreement to buy back shares sold at a stated price.
- Future lease liabilities.
- Environmental problems/claims/third party claims.
- Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
- Huge labour claims under negotiation when the labour wage agreement has already expired.
- Unresolved labour litigations.

OR

As per SA 810, “Engagements to Report on Summary Financial Statements”, when the auditor’s report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor’s report on the summary financial statements shall, additionally:

- (a) State that the auditor’s report on the audited financial statements contains an adverse opinion or disclaimer of opinion;
- (b) Describe the basis for that adverse opinion or disclaimer of opinion; and
- (c) State that, as a result of the adverse opinion or disclaimer of opinion, it is inappropriate to express an opinion on the summary financial statements.