

**MOCK TEST PAPER 2**  
**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. (a)
2. (b)
3. (d)
4. (d)
5. (d)
6. (c)
7. (b)
8. (a)
9. (a)
10. (a)

Questions (11-20) carry 2 Marks each

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

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

1. (a) **Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists:** As per SA 720, "The Auditor's Responsibility in Relation to Other Information", descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other items that may be included in the other information.

The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

**Auditor's duties with regard to reporting in the given case are given hereunder:**

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", if the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

- (i) Agrees to make the correction, the auditor shall determine that the correction has been made; or
- (ii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

- (b) In the given case, Abhinandan & Co. was appointed as an auditor of Nandan Ltd., operating in Telecom sector. The Company paid the license fee on its core business revenue whereas Government required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that Nandan 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 Saaransh Ltd.

As such, the financial statements of Saaransh Ltd. for the FY 2022-23 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 Saaransh 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 Saaransh Ltd. as at March 31, 2023, 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**

Saaransh 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) **Using the work of an Auditor's Expert:** As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert.

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

In the instant case, Mr. J, Mr. I and Mr. N, jointly appointed as auditors of JIN Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on was found faulty. Further, Mr. N is not in agreement with this report, therefore, he submitted a separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. J, Mr. I and Mr. N, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

Mr. J, and Mr. I will be held responsible for gross negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. N will not be held liable for the same due to separate opinion expressed by him.

- (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 Anant allowed CA Vasu (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 Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA Vasu 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 ₹ 2,00,000 for his association out of gratitude.

Thus, in the present case CA. Anant 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 Vasu to practice in his name as Chartered accountant and CA Vasu is neither in partnership nor in employment with CA. Anant.

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. Nemi, contractor dealing in food catering, flower decorating and light decorating activities, received in cash ₹ 1,85,000 for food catering and ₹ 1,25,000 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) **Failure to Obtain Information:** Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that if a Chartered Accountant in practice fails to obtain sufficient information to warrant the expression of an opinion or his exceptions are sufficient material to negate the expression of an opinion, the chartered accountant shall be deemed to be guilty of a professional misconduct.

In the instant case Mr. Vishal, a practicing Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e., by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printer's bills and by not caring to ascertain how many copies were sold and paid for.

The chartered accountant should not express his opinion before obtaining the required data and information. As an auditor, Mr. Vishal ought to have verified the basic records to ensure the correctness of circulation figures.

**Conclusion:** Thus, in the present case Mr. Vishal will be held guilty of professional misconduct as per Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

4. (a) **As per Para 10 of Ind AS-27 on "Separate Financial Statements"**, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either at cost or in accordance with Ind AS 109.

In the given situation, Chandanbala Ltd. has valued the investments in subsidiaries at cost.

**Ind AS 36 "Impairment"** deals with impairment of investments in subsidiaries accounted for at cost under Ind AS 27. **As per Para 9 of Ind AS 36**, an entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. It implies that impairment indicators for investment in subsidiaries is to be assessed by Chandanbala Ltd. individually for each investment and not as group of investment.

As provided, net worth of two of the subsidiaries of Chandanbala Ltd. have been eroded by 31<sup>st</sup> March 2023 and chances of recovery is bleak. This implies that the indicators of impairment in value of investment in those two subsidiaries exist on reporting date.

Therefore, Chandanbala Ltd. should provide for the impairment in the value of investment in those two subsidiaries despite of the fact that the investments in other three subsidiaries did not suffer any impairment.

- (b) **CA Nabhiray 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 in writing.

- 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.

(c) **Mr. Sheetal was discharged insolvent: Disabilities for the Purpose of Membership** : Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period.

In addition, failure on the part of a person to disclose the fact that he suffers from any one of the disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council.

In the given case, it is clearly stated that Mr. Sheetal was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. Sheetal has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.

5. (a) As per SA 570, "Going Concern", loss of a major market or a key customer is one of the operating indicators that may cast significant doubt on the company's ability to continue as a going concern.

In the present case, Sudarshan Ltd. has a key customer in South Korea from which the demand for its products has ended on account of outbreak of war, subsequent destruction and government ban on import and export in South Korea. Further, the company has not yet identified new customers and is in the process of doing the same. As such, the identification of new customer is a material uncertainty that cast a significant doubt on the company's ability to continue as a going concern.

However, this matter is duly disclosed by the management of Sudarshan Ltd. in the financial statements for the year ended 31.03.2023.

As such, considering that the going concern assumption is appropriate but a material uncertainty exists with respect to identification of new customer, CA Prakash should:

- (1) Express an unmodified opinion and
- (2) Include in his audit report, a separate section under the heading "Material Uncertainty Related to Going Concern" to:
  - (i) Draw attention to the note in the financial statements that discloses the matters and
  - (ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Thus, CA Prakash should deal with this matter in his auditor's report in the above-mentioned manner.

- (b) False Declaration as Authorized Representative:** In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income Tax Act 1961.

Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

In the instant case, Mr. Bharat, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration, thus, he would be liable under section 278 of the Income Tax Act, 1961.

- (c) (i)** The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.

Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

- (ii)** There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.

- (iii)** The areas where due diligence may be undertaken are: -

- (1) Corporate restructuring.
- (2) Venture capital financing.
- (3) Public offerings.

- 6. (a)** In the given scenario, C&AG appointed a chartered accountant firm to conduct Performance Audit of OM Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit.

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is not performance audit in all aspects.

- (b) Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. Given below are examples of internal controls that are violated in the given situation:

In the instant case, S1 who is a peon opens all the mail and forwards it to the concerned person. Further, he does not have a signature book so as to check the signatures on important communications is not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.

All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery. In the given case, S2 has possession of all bank forms (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis.

Further, contention of bank that being a small branch with shortage of manpower they are not able to check the work and records on regular basis, is not tenable as such lapses in internal control pose risk of fraud.

The auditor should report the same in his report accordingly.

- (c) **Indications of Non-Compliance with Laws and Regulations : As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements"**, when the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations:

- (1) Payment of fines or penalties.
- (2) Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- (3) Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.



- (4) Purchasing at prices significantly above or below market price.
- (5) Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- (6) Unusual payments towards legal and retainership fees.
- (7) Unusual transactions with companies registered in tax havens.
- (8) Payments for goods or services made other than to the country from which the goods or services originated.
- (9) Payments without proper exchange control documentation.

**OR**

Rule 3 (1) of National Financial Reporting Authority Rules, 2018 inter alia, provides that the Authority (NFRA) shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate, namely: -

- (a) companies whose securities are listed on any stock exchange in India or outside India;
- (b) unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31<sup>st</sup> March of immediately preceding financial year;
- (c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of sub-section (4) of section 1 of the Act;
- (d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority by the Central Government in public interest; and
- (e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d), if the income or net-worth of such subsidiary or associate company exceeds twenty percent of the consolidated income or consolidated net-worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).

The Ministry of Corporate Affairs has vide their letter dated 30th January, 2019, has clarified to the Quality Review Board that in view of Sec.132 (2) of the Companies Act, 2013 r/w Rule 9(4) of NFRA Rules, 2018, the issue of QRB reviewing audits of the companies/bodies corporate specified under Rule 3 of the NFRA Rules, 2018 will only arise in case a reference is so made to QRB by NFRA, and not otherwise.

Considering the above, in the case of auditors of PQR Ltd., X insurance Ltd. and AB banking Company, NFRA has power to oversee quality of services of these audit firms. However, QRB can undertake review of the quality of services of auditors of AAZ Ltd.

Therefore, inclusion of names of auditors of PQR Ltd., X insurance Ltd. and AB banking Company in the draft panel for consideration by QRB is not proper.

Only the inclusion of the name of the auditor of AAZ Ltd in the draft panel is proper.