

PAPER – 3: ADVANCED AUDITING, ASSURANCE & PROFESSIONAL ETHICS

Question No. 1 is compulsory.

Attempt any **four** questions from the remaining **five** questions.

Question 1

- (a) PQR Associates are the statutory auditors of a large un-listed company, which is engaged in manufacturing of auto components. Subsequent to re-appointment of auditors in the Annual General Meeting, the Company shared the appointment letter with PQR Associates, seeking acknowledgement and acceptance letter. CA. R is the engagement partner and is planning to issue the acceptance letter. During the current financial year, there was a search by the Income Tax authorities on the company, and certain accounting records were seized for verification. Based on the information available on social media, CA, R noted that the promoters' brother, is contemplating to contest in the ensuing elections, under the banner of a political party. One of the current senior engagement team manager, who has been doing the audit engagement till last year, has left PQR Associates and is planning to provide some accounting services to one of the associate companies. PQR Associates are yet to recruit another senior manager having adequate experience in the audits of clients engaged in automotive sector.

Elaborate the matters to be considered by PQR Associates with respect to acceptance & continuance of client relationships considering the above issues. **(5 Marks)**

- (b) Fancy Limited is a foreign company providing software support services having its Branch Office at Delhi. During the year 2023-24, Fancy Limited incorporated a subsidiary Nancy Private Limited in Gurgaon. For furtherance of objectives, Fancy Limited entered into a Business Transfer Agreement dated 5th October 2023 with Nancy Private Limited for transfer of all assets and liabilities along with the business of Delhi Branch to Nancy Private Limited on a going concern basis effective from 01st April, 2023. Further necessary approval from regulatory authorities is also received on 20th December, 2023 for such transfer. Fancy Limited promised that it shall provide continuing financial and operational support to Delhi Branch and further confirmed that any losses incurred post the date of transfer shall be borne by Fancy Limited.

During the year 2023-24, Delhi Branch of Fancy Limited have prepared its financial statements on the basis that the Branch Office does not continue to be a going concern and all its assets are carried in the books of accounts at the values likely to be recovered at the time of closure of operations, to the extent ascertainable at the time of preparation of the financial statements. Delhi Branch has incorporated above matter in detailed form in Note XX. to the financial statement.

You are the statutory auditor of Delhi Branch of Fancy Limited for the financial year 2023-24. According to you, Delhi Branch has correctly disclosed about the matter in Note XX to the Financial statement regarding management's intention to close the operations of the branch office. Further you have obtained sufficient appropriate audit evidence concerning audit and on the verge of finalization of audit report.

Draft a suitable opinion paragraph and basis thereof in the given case along with disclosure of Note XX with suitable place in audit report in terms of relevant auditing standard. **(5 Marks)**

- (c) Mr. BK has been engaged by XYZ Ltd. to report on summary financial statements derived from the financial statements audited by him in accordance with SAs. Mr. BK wants to determine whether the applied criteria are acceptable before accepting such assignment. Guide him the factors affecting auditor's determination of the acceptability of applied criteria as per relevant Standard on Auditing. **(4 Marks)**

Answer:**(a) Matters to be considered by PQR Associates with respect to acceptance & continuance of client relationships:**

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" a firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:

- Integrity of Client, promoters and key managerial personnel.
- Competence (including capabilities, time and resources) to perform engagement.
- Compliance with ethical requirements.

Matters to be considered as to integrity of clients:

- (1) The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- (2) The nature of the client's operations, including its business practices.
- (3) Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- (4) Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- (5) Indications of an inappropriate limitation in the scope of work.
- (6) Indications that the client might be involved in money laundering or other criminal activities.
- (7) The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

Matters to be considered to determine whether firm has the capabilities, competence, time and resources to undertake an engagement:

- (1) Firm personnel have knowledge of relevant industries or subject matters;
- (2) Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
- (3) The firm has sufficient personnel with the necessary capabilities and competence;
- (4) Experts are available, if needed;
- (5) Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
- (6) The firm would be able to complete the engagement within the reporting deadline.

(b) Draft of opinion paragraph and basis thereof along with disclosure of Note XX:

In the given case, Delhi Branch of Fancy Limited prepared its financial statements for the year 2023-24 using the liquidation basis of accounting, because Fancy Limited entered into a Business Transfer Agreement with Nancy private Limited for transfer of all Assets and Liabilities.

Auditor is permitted to issue an unmodified opinion on such financial statements, provided that the liquidation basis of accounting has been properly applied and that adequate disclosures are made in the financial statements.

SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report, requires the auditor to include an emphasis of matter paragraph when a matter that is appropriately presented or disclosed

in the financial statements is of such importance, in the auditor's professional judgment, that it is fundamental to users' understanding of the financial statements. If the auditor determines an emphasis of matter paragraph is appropriate, the emphasis of matter paragraph would state that the entity has changed the basis of accounting used to determine the amounts at which assets and liabilities are carried from the going concern basis to a liquidation basis.

Opinion

We have audited the standalone financial statements of Delhi Branch of Fancy Limited ("the Company"), which comprise the balance sheet as at March 31, 2024, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, give a true and fair view, in conformity with the accounting principles generally accepted in India, of the state of affairs of the India Branch Office of the Company as at March 31st, 2024 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the ICAI's Code of Ethics and the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note XX regarding Delhi Branch Office management's intention to close the operations of the Branch Office subject to regulatory approvals. Accordingly, the financial statements have been prepared on the basis that the Delhi Branch Office does not continue to be a going concern and provisions have been made in the books of account for the losses arising or likely to arise on account of closure of operations including the losses on the realizability of current assets. Our opinion is not modified in respect of this matter.

(c) Factors affecting auditor's determination of the acceptability of applied criteria:

SA 810 deals with the auditor's responsibilities when undertaking an engagement to report on summary financial statements derived from financial statements audited in accordance with SAs by that same auditor. Before accepting an engagement to report on summary financial statements, the auditor shall determine whether the applied criteria are acceptable. Applied criteria refer to the criteria applied by management in the preparation of the summary financial statements.

Factors affecting the auditor's determination of the acceptability of the applied criteria:

- (i) The nature of the entity;
- (ii) The purpose of the summary financial statements;
- (iii) The information needs of the intended users of the summary financial statements; and
- (iv) Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

Question 2

- (a) Happy Hospital is a very renowned hospital for Orthopedic Surgeries Mumbai having sophisticated infrastructure. Happy Hospital has started using a novice system which includes complete record of Indoor Patient i.e. their diagnosis, their treatment, their medications, their billings, and receipts thereon which is developed and managed by CT Contractors. CA Z is a statutory auditor of Happy Hospital. CA Z came to know about this system while auditing. CA Z is concerned whether the controls at CT Contractors Associates are operating effectively or not. For this purpose, CA Z demanded from CT Contractors, an assurance report from a practicing chartered accountant about their opinion on the description of CT Contractor's system, and the effectiveness of the control. Which type of report should be obtained by CA Z in terms of relevant Standard on Auditing? What aspects are to be considered by CA Z in using such assurance report as audit evidence that controls at CT Contractors are operating effectively? **(5 Marks)**
- (b) In terms of subsection 114 of Revised code of Ethics, a professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as result of professional and employment relationships. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in knowledge that the information will not be disclosed to a third party. In this context, enumerate the circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate. In deciding whether to disclose confidential information what are the points that should be kept in the mind of professional accountants? **(5 Marks)**
- (c) The management of High Limited is concerned with the reporting requirement cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 for the financial year 2023-24 with regard to the Audit Trail (edit log). Audit trails may be enabled at the accounting software level depending on the features available in such software or same may be captured directly in the database underlying such accounting software. Consequently, the management of the company approached CA J and asked him to suggest them list of internal controls which may be required to be implemented and operated to demonstrate that the Audit trail (or Edit Log) feature was functional, operated and was not disabled. Help CA J. **(4 Marks)**

Answer:

- (a) **Type of Assurance Report to be obtained from Auditor of Service Organisation:**

SA 402 "Audit Considerations relating to an Entity using a Service Organisation" deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organisations.

In the given case, CA Z (User Auditor) demanded from CT Contractors (Auditor of Service Organisation) an assurance report about their opinion on the description of CT Contractor's system, and the effectiveness of the control.

As per SA 402, when the user auditor's risk assessment includes an expectation that controls at the service organisation are operating effectively, the user auditor shall obtain audit evidence about the operating effectiveness of those controls by obtaining a **Type 2 report, if available**.

Aspects to be considered in using Type 2 report as audit evidence that controls at Service Organisation are operating effectively:

If, the user auditor plans to use a Type 2 report as audit evidence that controls at the service organisation are operating effectively, he shall determine whether the service auditor's report provides SAAE about the effectiveness of the controls to support the user auditor's risk assessment by:

- (i) Evaluating whether the description, design and operating effectiveness of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;
- (ii) Determining whether complementary user entity controls identified by the service organisation are relevant to the user entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;
- (iii) Evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and
- (iv) Evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's F.S. and provide SAAE to support the user auditor's risk assessment.

(b) Circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

- (a) Disclosure is required by law, for example:
 - (i) production of documents or other provision of evidence in the course of legal proceedings; or
 - (ii) disclosure to the appropriate public authorities of infringements of the law that come to light;
- (b) Disclosure is permitted by law and is authorised by the client or the employing organisation; and
- (c) There is a professional duty or right to disclose, when not prohibited by law:
 - (i) To comply with the requirements of peer review or quality review of the Institute
 - (ii) To respond to an inquiry or investigation by a professional or regulatory body;
 - (iii) To protect the professional interests of a professional accountant in legal proceedings; or
 - (iv) To comply with technical and professional standards, including ethics requirements.

Points to be kept in mind in deciding whether to disclose confidential information:

In deciding whether to disclose confidential information, factors to consider, depending on the circumstances, include:

- (i) Whether interests of any parties, including third parties, could be harmed if the client or employing organisation consents to the disclosure of information by the professional accountant.
- (ii) Whether all the relevant information is known and substantiated, to the extent practicable.
- (iii) The proposed type of communication, and to whom it is addressed.
- (iv) Whether the parties to whom the communication is addressed are appropriate recipients.

(c) Internal controls required to be implemented and operated to demonstrate that the Audit trail (or Edit Log) feature was functional, operated and was not disabled:

In order to demonstrate that the audit trail feature was functional, operated and was not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors, as appropriate. An illustrative list of internal controls which may be required to be implemented and operated are given below:

- (i) Controls to ensure that the audit trail feature has not been disabled or deactivated.
- (ii) Controls to ensure that User IDs are assigned to each individual and that User IDs are not shared.
- (iii) Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.
- (iv) Controls to ensure that access to the audit trail (and backups) is disabled or restricted and access logs, whenever the audit trails have been accessed, are maintained.

Question 3

- (a) Core Limited submitted a credit proposal to XYZ Bank Limited for the sanction of a Term Loan of Rs. 150.00 crore required for procuring and installing a latest Plant and machinery for their upcoming project. Based on the application, XYZ Bank Limited approached CA P to investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by Core Limited, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan. Elucidate the steps that should be undertaken by CA P? **(5 Marks)**
- (b) CA N is carrying out an audit of restated financial statements of BQR Limited for past 3 financial years i.e. 2023-24, 2022-23 and 2021-22 for onward submission to SEBI pursuant to their upcoming IPO (Initial Public Offer). CA N is planning to issue an Audit Report on 5th August, 2024 covering these restated financial statements. Before issuing the audit report, CA N requested Management Representation Letter from the management of the Company for this assignment. The Management of the Company provided Management Representation Letter dated 1st April, 2024 covering the period of financial year 2023-24 only as they were not in position to provide for the financial year 2022-23 and 2021-22 because they were not in place during that period. How would CA N deal with the above situation as per relevant Standard on Auditing? **(5 Marks)**
- (c) CA Raj, a practicing chartered accountant, is offered to take up an appointment as a "Secretary" in his professional capacity by the Central Government for a Metro Project for a term of 2 years not on a salary- cum-full-time basis. After giving deep thought to the offer, CA Raj accepted the appointment, Comment in terms of the Chartered Accountant Act, 1949 and Schedules thereto. **(4 Marks)**

Answer:

- (a) **Steps to investigate the profitability of an entity:**

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

- (a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:

- (i) Sales to Average Inventories held.
 - (ii) Sales to Fixed Assets.
 - (iii) Equity to Fixed Assets.
 - (iv) Current Assets to Current Liabilities.
 - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
 - (vi) Equity to Long Term Loans.
 - (vii) Sales to Book Debts.
 - (viii) Return on Capital Employed.
- (c) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

(b) **Written representations:**

- SA 580 “Written Representations” deals with the auditor’s responsibility to obtain written representations from management and, where appropriate, those charged with governance.
- In accordance with SA 580, the written representations shall be for all financial statements and period(s) referred to in the auditor’s report. However, situations may arise where current management were not present during all periods referred to in the auditor’s report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons’ responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.
- In this case, auditor’s report is covering 3 financial years i.e. 2023-24, 2022-23 and 2021-22, but Management of the Company provided Management Representation Letter covering the period of financial year 2023-24 only as they were not in position to provide for the financial year 2022-23 and 2021-22 because they were not in place during that period.

Conclusion: Considering the requirements of SA 580 as stated above, requirement for the auditor to request written representations that cover the whole of the relevant period(s) still applies and in case, management does not provide the requested written representations, the auditor shall:

- (d) Discuss the matter with management;
- (e) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (f) Take appropriate actions, including determining the possible effect on the opinion in the auditor’s report in accordance with SA 705.

(c) **Members deemed to be in Practice:**

- Pursuant to Sec. 2(2)(iv) of the Chartered Accountants Act, 1949, read with Regulation 191 of Chartered Accountants Regulations, 1988 a member shall be deemed to be in practice if he, in his professional capacity and neither in his personal capacity nor in his capacity as an employee, acts as a liquidator, trustee, executor, administrator, arbitrator, receiver, adviser or representative for costing, financial or taxation matters or takes up an appointment made by the Central Government or a State Government or a court of law or any other legal authority or acts as a Secretary unless his employment is on a salary-cum-full-time basis.

- In the given case, CA Raj, a practicing chartered accountant, is offered to take up an appointment as a "Secretary" in his professional capacity by the Central Government for a Metro Project for a term of 2 years not on a salary-cum-full-time basis. After giving deep thought to the offer, CA Raj accepted the appointment
- As the employment is not on a salary cum full time basis, CA Raj can accept the appointment as a "Secretary" in his professional misconduct and as such there is no violation of any provisions of Chartered Accountants Act, 1949.

Conclusion: No Misconduct arises on part of CA Raj in accepting the appointment as a "Secretary" in professional capacity.

Question 4

- (a) CA Giri is a senior partner of M/s TSV Associates. M/s TSV Associates is a reputed firm of Chartered Accountants which has been in practice for more than five decades. The firm undertakes statutory audits of large listed companies across various industry sectors and has more than fifty qualified experienced professionals. CA Giri has been assigned as an Engagement Quality Control Reviewer for an audit engagement of a listed company. What are the aspects, which would be looked into by CA Giri as an EQCR in relation to the engagement?

Upon completion of the review, CA Giri has identified certain issues, with respect to revenue recognition and adequacy of provisions relating to onerous contracts. The views of CA Giri are not accepted by the Engagement Partner. Suggest the ways of resolving the differences of opinion between CA Giri and the engagement partner.

(5 Marks)

- (b) MNC Limited has engaged CA Lalit to help the company in compilation of the financial information. CA Lalit explained his team members, the scope of work and the responsibilities under this engagement. The team members have done mostly audit engagements and do not have exposure to compilation engagements. Discuss the key issues that CA Lalit should deliberate and guide his team members with respect to this engagement and the manner it differ from assurance engagements. Give your views on the applicability of SQC 1 to this engagement.

(5 Marks)

- (c) SU Limited is amongst the top 1000 listed entities. With the introduction of new reporting requirements by SEBI on ESG parameters called the Business Responsibility and Sustainability Report (BRSR), it requires SU Limited to make disclosures on their performance against the various principles of the "National Guidelines on Responsible Business Conduct". One of the principles emphasizes that the business decisions in an organization should be open to disclosure and accessible to the relevant interested parties. Elucidate the essence of core elements associated with the aforesaid principle.

(4 Marks)

Answer:

- (a) **Aspects to be considered while performing EQCR for audit of F.S.:**

In accordance with requirements of SQC 1 read with SA 220, CA. Giri needs to consider the following aspect while performing EQCR for audit of F.S. of ABC Ltd.:

- (1) The engagement team's evaluation of the firm's independence in relation to the specific engagement.
- (2) Significant risks identified during the engagement and the responses to those risks.

- (3) Judgments made, particularly with respect to materiality and significant risks.
- (4) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
- (5) The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- (6) The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- (7) Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
- (8) The appropriateness of the report to be issued.

Difference of Opinion:

As per requirements of SA 220, If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

(b) Concept of Compilation Engagement:

- SRS 4410 "Compilation Engagement" deals with the practitioner's responsibilities when engaged to assist management with the preparation and presentation of historical financial information without obtaining any assurance on that information, and to report on the engagement in accordance with this SRS.
- Compilation engagement is an engagement in which a practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information of an entity in accordance with an applicable FRF and issues a report.
- Management may request a professional accountant in public practice to assist with the preparation and presentation of financial information of an entity.
- Since a compilation engagement is not an assurance engagement, a compilation engagement does not require the practitioner to verify the accuracy or completeness of the information provided by management for the compilation, or otherwise to gather evidence to express an audit opinion or a review conclusion on the preparation of the financial information.
- The practitioner's objectives in a compilation engagement under this SRS are to:
 - (a) Apply accounting and financial reporting expertise to assist management in the preparation and presentation of financial information in accordance with an applicable financial reporting framework based on information provided by management; and
 - (b) Report in accordance with the requirements of this SRS.
- Scope of a compilation engagement will vary depending on the circumstances. However, in every case it will involve assisting management in the preparation and presentation of the entity's financial information in accordance with the FRF, based on information provided by management. In some compilation engagements, management may have already prepared the financial information itself in a draft or preliminary form.

Applicability of SQC 1:

SQC 1 is applicable to all Engagement Standards. Since SRS 4410 is also one of Engagement Standards, SQC 1 applies to firms in respect of firm's compilation engagements too.

(c) Core Elements associated with Principle 1 – Ethics, Transparency and Accountability:

The first principle of NGRBC emphasizes that the business decisions in an organisation should be open to disclosure and accessible to the relevant interested parties.

The essence of the core elements associated with the first principle are:

- (i) The entities' governing structure should develop policies, procedures, and practices for their offices, factories, and work areas, ensuring that ethics is not compromised.
- (ii) The information relating to the policies, procedures, and practices along with the performance should be made available to the stakeholders.
- (iii) In case of adverse effects, more care has to be taken for transparent disclosures.
- (iv) The entities in the value chain should be encouraged to adopt these principles by the governance structure.
- (v) The entities should proactively respond to the outside entities that violate the nine principles of the BRSRs. This includes their suppliers, distributors, sub-contractors, or regulatory officers that may engage with the business concern.

Question 5

- (a) GAK Limited has compiled the interim financial information, as per the Listing agreement requirements and submitted to the auditors for their review. CA Reena, has been assigned on the engagement to review the interim financial information of GAK Limited. Based on the inquiries and other review procedures carried out, CA Reena, assessed that GAK Limited, has been facing continuous working capital shortages. No financial institutions or banks are ready to lend additional funding limits to GAK Limited, since the company has been continuously incurring losses for over 3 years and the company has defaulted payment of loan instalments & interest over the last one year and operations have been curtailed significantly.

Under such circumstances CA Reena, who is doing the review for the first time, noted that GAK Limited has not disclosed any information in the interim financial information relating to material uncertainties. Given the situation, please advise CA Reena, what kind of review report required to be issued? If, GAK Limited has disclosed information relating to material uncertainty, can CA Reena give a clean report? Discuss. **(5 Marks)**

- (b) R Limited is a listed company engaged in manufacture of round bars. The company is having investment in the following components:
- (i) 2 Subsidiary Companies
 - (ii) 1 Joint Venture Company
 - (iii) 2 Associate Companies
 - (iv) 3 Business entities under common control
 - (v) Interest in assets, liabilities, revenues, and expenses in a joint operation with 1 Company

R Limited and all its components are required to present their accounts as per Ind AS. While preparing consolidated financial statements, R Limited consolidated its components on a line-by-line basis by adding together like items of assets, liabilities, income, expenses, and cash flows.

R Limited seeks your advice on the accounting treatment in respect of the above components for consolidation in accordance with the Companies (Indian Accounting Standards) Rules, 2015. **(5 Marks)**

- (c) TP Limited is a listed company engaged in the business of manufacturing of kids garments under the brand name of MM. M/s. R & Associates, firm of chartered accountants, are appointed as a Statutory Auditor of the Company for the year 2023-24. CA R is looking after the audit of the Company. During audit, CA R observed that there are number of notices received from GST Department and Income Tax Department for various issues. Further during plant visit, CA R observed that few child labourers are engaged in some of the activity. In response to the observation made, CA R followed the procedure as envisaged in SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements". According to CA R, the provisions of SA 250 and the provisions of NOCLAR (Non- Compliance with Laws and Regulations) under Revised Code of Ethics are one and the same. Do you agree? If not, give your comments. **(4 Marks)**

Answer

(a) Review Report:

- SRE 2410 "Review of Interim Financial Information performed by the Independent Auditor of the Entity" deals with the auditor's professional responsibilities when the auditor undertakes an engagement to review the interim financial information of an audit client and on the form and content of the report.
- As per SRE 2410, if, as a result of inquiries or other review procedures, a material uncertainty relating to an event or condition comes to the auditor's attention that may cast significant doubt on the entity's ability to continue as a going concern, and adequate disclosure is made in the interim financial information the auditor modifies the review report by adding an emphasis of matter paragraph.
- The auditor may have modified a prior audit or review report by adding an emphasis of matter paragraph to highlight a material uncertainty relating to an event or condition that may cast significant doubt on the entity's ability to continue as a going concern. If the material uncertainty still exists and adequate disclosure is made in the interim financial information, the auditor modifies the review report on the current interim financial information by adding a paragraph to highlight the continued material uncertainty.
- If a material uncertainty that casts significant doubt about the entity's ability to continue as a going concern is not adequately disclosed in the interim financial information, the auditor should express a qualified or adverse conclusion, as appropriate. The report should include specific reference to the fact that there is such a material uncertainty.

Conclusion: Based on the above stated requirements of SRE 2410, following conclusions may be drawn:

- (a) In case, GAK Limited has not disclosed any information in the interim financial information relating to material uncertainties, CA Reena, should express a qualified or adverse conclusion, as appropriate. The report should include specific reference to the fact that there is such a material uncertainty.
- (b) In case, GAK Limited has disclosed information relating to material uncertainty, CA Reena shall modifies the review report by adding an emphasis of matter paragraph.

(b) Accounting treatment for consolidation in accordance with the Companies (Indian Accounting Standards) Rules, 2015:

For consolidation of subsidiaries in accordance with the Companies (Indian Accounting Standards) Rules, 2015, accounting treatment may be as follow:

- (i) Financial statements of the parent and its subsidiaries are combined as per Ind AS 110, "Consolidated Financial Statements" on a line-by-line basis by adding together like items of assets, liabilities, income, expenses and cash flows;
- (ii) Related goodwill/ capital reserve (or gain on bargain purchase) and non-controlling interest is determined as per Ind AS 103;
- (iii) Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method in accordance with Ind AS 103;
- (iv) Adjustments like elimination of intra-group transactions, balances, unrealised profits and deferred tax etc. are made in accordance with the requirements of Ind AS 110;
- (v) Investments in associates and joint ventures are accounted for using the Equity Method as prescribed in Indian Accounting Standard (Ind AS) 28, "Investments in Associates and Joint Ventures".
- (vi) Interests in assets, liabilities, revenues and expenses in a joint operation are accounted for as part of separate financial statements of the entity in accordance with Indian Accounting Standard (Ind AS) 111, "Joint Arrangements";
- (vii) In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate in accordance with Ind AS 103.

(c) SA 250 and NOCLAR:

View of CA R, that the provisions of SA 250 and the provisions of NOCLAR (Non- Compliance with Laws and Regulations) under Revised Code of Ethics are one and the same is not correct. There exists difference among SA 250 and provisions of NOCLAR, given as below:

- (i) SA 250 is applicable only on Audit, and not on other Assurance engagements. However, NOCLAR is applicable on professional accountants in service, and in practice.
- (ii) SA 250 talks of auditor's responsibilities for laws having direct effect on the determination of material amounts and disclosures in the financial statements (such as tax and labour laws); and other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business. NOCLAR, while being alike to SA 250 till this point, is further ahead of it in that it takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.
- (iii) SA 250 does not define stakeholders. NOCLAR is related to affect of non-compliance on investors, creditors, employees as also the general public.
- (iv) 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. This provision is not existent in SA 250.

Question 6

- (a) You are appointed as a Statutory Auditor of SDA Limited for the year 2023-24 in the place of CA T. During audit you found an order dated 01.05.2023 under section 148 of the Income Tax Act, 1961 wherein tax of ₹ 50 lakhs were demanded owing to undisclosed cash sales of ₹ 150 lakhs for the financial year 2020-21 which was accepted by the company and the applicable tax was paid by the Company during the year 2023-24. The company has not recorded such undisclosed income in their books of account during the year 2023-24. On further inquiring the matter with CA T, you came to know that CA T resigned due to non-recording of such transaction by the company. Is there any reporting responsibility casted on you regarding the above matters under CARO, 2020 for the year 2023-24? **(5 Marks)**
- (b) MNC Limited, is engaged in manufacture & sale of FMCG products. It has manufacturing locations across various states in India and engages dealer channels to sell its products. One dealer is appointed for each district within the state and products are dispatched from the nearest manufacturing location to the dealer. Considering the voluminous transactions, MNC Limited has a robust ERP network, for recording the transactions. As statutory auditors of MNC Ltd., your firm is about to commence the current year audit. The audit team includes certain IT experts and discussions are underway amongst the team members. As an IT manager of the engagement team, explain the key areas for an auditor to understand IT environment. **(5 Marks)**
- (c) CA Kumar, a practicing-chartered accountant, is well known in the field of pleading of Income Tax cases at Income Tax Tribunal and does not provide any assurance services. Considering the long standing in the field, CA Kumar is approached by XYZ Limited to file an appeal in the Tribunal against the Income Tax Demand of Rs. 10 crore which was added by the CIT(A) and to plead on behalf of XYZ Limited in the matter. CA Kumar offers to accept the case with the following fee structure:
- The fees for filing an appeal and to plead at Income Tax Tribunal will be higher of the following (a) or (b):
- (i) ₹ 5,00,000/-
- (ii) 10% of Tax Demand Reduced.

Comment on the act of CA Kumar in terms of the Chartered Accountant Act, 1949 and Schedules thereon.

(5 Marks)**OR**

Yo-Yo Finance Limited is a NBFC-ML as per revised categorisation of NBFC done by RBI. YAK & Associates, firm of chartered accountants, are appointed as Statutory Auditors of the Company for the year 2023-24. The audit team consist of CA Y, 1 Audit Manager and 3 junior assistants. The Audit Manager is recently appointed, who is not having much exposure in the field of Auditing of NBFCs. During the engagement team meeting, the Audit Manager asked CA Y, regarding the audit procedures to be undertaken to verify whether the aforesaid Company has followed Prudential Norms? As an Engagement partner suggest any four procedures to the Audit Manager.

(4 Marks)

Answer:**(a) Reporting of Undisclosed Income and Considerations of issues raised by outgoing auditor:**

- Clause (viii) of Paragraph 3 of CARO, 2020 requires the auditor to report whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961, if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.
- Clause (xviii) of Para 3 of CARO, 2020 requires the auditor to report whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

The incoming auditor should consider the reasons for resignation. The incoming auditor should also refer to last audit/review report issued by the outgoing auditor to understand the modifications, if any, in the audit/review report.

- In the given case auditor found that there were unrecorded cash sales of ₹ 150 lakhs for the financial year 2020-21 which was accepted by the company and the applicable tax was paid by the company during the year 2023-24; Company has not recorded such undisclosed income in their books of account during the year 2023-24; CA T resigned due to non-recording of such transaction by the company.

Conclusion: Auditor is under a duty to report the matter under Clauses (viii) and (xviii) of Para 3 of CARO, 2020. In addition, auditor is required to determine the impact of undisclosed transactions on the financial statements of current year and make suitable modifications in audit report as per requirements of SA 705.

(b) Key areas for an auditor to understand IT environment:

- Understand the flow of transaction:** The auditor's understanding of the IT environment may focus on identifying and understanding the nature and number of the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing or storing those transactions or information.
- Identification of Significant Systems:** The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.
- Identification of Manual and Automated Controls:** An entity's system of internal control contains manual elements and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement.
- Identification of the technologies used:** The need to understand the emerging technologies implemented and the role they play in the entity's information processing or other financial reporting activities and consider whether there are risks arising from their use. Given the potential complexities of these technologies, there is

an increased likelihood that the engagement team may decide to engage specialists and/or auditor's experts to help understand whether and how their use impacts the entity's financial reporting processes and may give rise to risks from the use of IT.

- (v) **Assessing the complexity of the IT environment:** Not all applications of the IT environment have the same level of complexity. The level of complexity for individual characteristics differs across applications. Complexity is based on the following factors – automation used in the organization, entity's reliance on system generated reports, customization in IT applications, business model of the entity, any significant changes done during the year and implementation of emerging technologies.

(c) **Charging Fees on a percentage Basis:**

As per Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, Regulation 191 allow the Chartered Accountant in practice to charge the fees in respect of Non-Assurance Services to Non-Audit Clients, based on a percentage of profits, or which are contingent upon the findings or results of such work.

In the given case, CA Kumar offers to accept the fees for filing an appeal and to plead at Income Tax Tribunal will be higher of the following (a) or (b):

- (a) ₹ 5,00,000/-
(b) 10% of Tax Demand Reduced.

Conclusion: CA. Kumar, a practicing Chartered Accountant shall not be held guilty of professional misconduct as he is charging fees on percentage basis in case of rendering non-assurance services to non-audit clients.

OR

Audit Procedures to verify compliance of Prudential Norms:

- (i) Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans and investments for failure to repay public deposits and norms for concentration of credit/investments.
- (ii) An auditor should ensure that the Board of Directors of every NBFC granting/intending to grant demand/call loans shall frame and implement a policy for the company.
- (iii) An auditor should assess on the basis of examinations conducted by him whether the NBFC has complied with the prudential norms. In particular, he should verify that advances and other credit facilities have been properly classified as standard/substandard/doubtful/loss and that proper provision has been made in accordance with the Directions.
- (iv) In respect of Non-Performing Assets, an auditor should check whether the unrealised income in respect of such assets has not been taken to the Profit & Loss Account on an accrual basis. Income from NPAs should be accounted for on realisation basis only.

- (v) Check whether all accounts which have been classified as NPAs in the previous year also continue to be shown as such in the current year also. If the same is not treated as an NPA in the current year, the auditor should specifically examine such accounts to ascertain whether the account has become regular and the same can be treated as performing as per the Directions.



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