Paper 3 : Advanced Auditing Professional Ethics (Old Course)

1. XYZ Printers is a medium size printing press with turnover of Rs.100 crore for the financial Year 2015-16. The company buy paper rims for its press from different suppliers. You are the statutory auditor of the company for the year 2015-16 and the management has informed you that the company has bought paper rims from one of the supplier who is related to one of the director of XYZ Printers. What audit evidence do you need to collect for identifying and assessing the risk of material misstatement associated with related party transaction?

   a) Prior approval of the audit committee/shareholders for the transactions with the supplier, materiality/ significance of the transactions on company's financial statements, agreement entered into with the supplier and internal control for the transactions with the supplier.

   b) Only the prior approval of the audit committee/ shareholders for the transactions with the supplier is sufficient.

   c) Check whether the company has formulated any policy on dealing with related party transactions and materiality of transactions.

   d) As a statutory auditor you should check the internal controls and internal audit reports only.

2. You are the internal auditor of FCD Bank Limited for the year 2017-18 and the bank maintains all the data on computer. You are instructed by your senior to verify the loan against fixed deposits of the Navi Mumbai branch. As per the scope of audit, you need to ensure that proper lien has been marked on all the fixed deposits against which loan has been issued. Which of the following procedure you will follow for the same:

   a) Ensure that all the fixed deposit receipts are attached along with the approved loan documents.

   b) Ensure that all the fixed deposit receipts, against which the loan has been sanctioned, are discharged in favour of bank and check that the lien is marked in the computer software.

   c) Discuss the process followed for lien marking with the branch manager.

   d) Ensure that all the fixed deposit receipts, against which the loan has been sanctioned, are discharged in favour of bank, check that the lien is marked in the computer software and the fixed deposit should be kept separately with the branch manager.

3. Mr. Vijay Kapoor, Chartered Accountant, has been appointed the statutory auditor by M/s. XYZ Private Limited for the audit of their financial statements for the year 2015-16. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Vijay during the course of audit. Advise, whether Mr. Vijay should accept the proposed audit engagement and on what grounds he can accept/ refuse the proposal?

   i) As per SA 210 the auditor can refuse to accept the audit engagement as the management is not giving access to internal audit reports which are necessary in determining the internal controls in the company.

   ii) There is no limitation on the scope of the auditor's work, so the auditor should accept the appointment.

   iii) The auditor can accept the audit engagement if the management gives representation on its responsibility.

   Which of the following option is correct:

   a) (ii) only

b) Both (i) and (iii)

c) Both (ii) and (iii)

d) (iii) only

4. Best Manufacturers Limited is a manufacturing company and has entered into an agreement In February 2017 with CISCA Brothers for buying land in order to set up their new manufacturing unit. As per the agreement, Best Manufacturers were required to pay Rs.20 Lakhs as signing amount and the balance amount was required to be paid in three instalments of Rs.25 lakhs each in the month of May, July and September 2017. The title deed for the land was to be transferred after the payment of second instalment in July 2017, so in the accounts for the year 2016-17 of the Best Manufacturers the payment of signing amount was booked as an expense. Your firm have been appointed as auditor of financial statements of Best Manufacturers Limited for the year 2016-17. There is conflict between Financial Reporting Framework and Legal requirement, so what will be the duty of your firm in such case?

   a) Incorporate the changes in financial statements as per the legal requirement.

   b) As the title deed has not been transferred in favour of the company in the year 2016-17, there is no need to review the payment in terms of Accounting Standard or any other legal requirement.

   c) Take management representation on the same.

   d) Discuss the matter with management and ensure disclosure of the same in notes to accounts. In the absence of same, the auditor may consider issuing modified opinion.

5. BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2017-18. In order to review internal controls of the sales department of the company you visited the department and noticed the work division as follows:

   1) An officer was handling the sales ledger and cash receipts.

   2) Another official was handling dispatch of goods and issuance of Delivery challans.

   3) One more officer was there to handle customer/ debtor accounts and issue of receipts.

   As an internal auditor do you think that there was proper division of work? If not, why?

   a) There is proper division of work as the despatch and sales ledger maintenance work is allotted to different officials.

   b) Company has not done proper division of work as the receipts of cash should not be handled by the official handling sales ledger.

   c) Delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

   d) Both b and c are correct.

6. Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 2017-18. While verification of company's inventories as on 31st March 2018 you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of the inventories maintained by other parties, what is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be held and the stock as disclosed in company's records actually belongs to them?

   a) Ensure that the total stock including the stock with third party tally with the stock register maintained by the company.

b) Obtain confirmation from the third party/s with whom the inventories of the company are held and reconcile the same with stock register.
c) Conduct a physical verification of stock maintained with third party/s.
d) Obtain a written confirmation from the departmental head of the company for the inventories maintained at other places as audit evidence.

7. Bhishm Limited decided to appoint Mr. Rajvir, chartered accountants as the branch auditor for the audit of its Lucknow branch accounts for the year 2017-18. The decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company, held in April 2017, subject to shareholders' approval in AGM of the company scheduled to be held in June 2017. Meanwhile, the Principal Auditor of the company raised an objection that the branch auditor cannot be appointed without his consent. Whether the objection raised by company auditor is valid?

   a) The objection raised by company auditor is not valid as per section 143(8) of the companies Act, 2013 and the Board has authority to appoint branch auditor but should be approved by shareholders in General Meeting.

   b) The objection raised by company auditor is valid as it is necessary to consult/obtain the consent of Principal Auditor before appointing Branch Auditor.

   c) The Board of Directors has no authority to appoint Branch Auditor so the objection raised by Principal Auditor is valid.

   d) The objection raised by company auditor is not valid as it is compulsory to appoint branch auditor as per Sec.139 of the Companies Act, 2013.

8. Prakash & Co. Chartered Accountants are the internal auditor of Textbook Private Limited, for the year 2016-17. You have been instructed by your senior to check the internal controls for the investments done by the company during the year. While verifying the same you noticed that the property documents, share certificates and other investment documents have been kept in a safe custody locker, whose keys are kept with an authorised official of Accounts Department of the company and none other than that official has access to locker. As an internal auditor do you consider as material weakness in internal controls? If yes, how will you report the matter?

a) It cannot be considered as material weakness in internal control as the company might not have any other reliable employee within in its staff members.

b) The safe custody locker should always be under the control of two authorised officials. Therefore, the auditor should communicate such material weakness to the management or audit committee.

c) It is not material weakness to be reported as giving the keys to two or more persons can lead a situation of confusion only.

d) The auditor should discuss the observation with the management and there is no need of any written communication.

9. DSP Chartered Accountants have been appointed statutory auditors of Flakes Private Limited for the year 2016-17. The company's net profit has declined by 5% as compared to previous year in spite of increase in sales. On verification of company's profit & loss account it is noticed that in the current year a huge amount is debited as loss on sale of fixed assets due to which the profits has reduced. The auditor discussed the matter with management and was told that since the lot of fixed assets were lying idle due to their non-working condition, they have been sold at less than their written down value. As an auditor do you think that the fact regarding disposal of assets should be disclosed in auditor's report/ notes to accounts?

a) If the assets has been sold as per company's policy and under applicable Financial Reporting framework, then separate disclosure is not required in auditor's report/ notes to accounts.

b) As the sale of assets has an impact on profit for the current year, it should be disclosed in the notes to account of the Financial Statements.

c) Even if the assets has been sold as per company's policy and under applicable Financial Reporting framework, the auditor should disclose the facts in Emphasis of Matter Paragraph of Audit Report as the loss booked in Profit & Loss account has a material impact on the net profit of the company.

d) As the loss on sale of fixed assets is debited in Profit & Loss Account as per Accounting Standard, there is no requirement of disclosure of the same in any report.

10. The auditor is required to evaluate management's assessment of the entity's ability to continue as a going concern.

Certain events/ conditions were identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained, the auditor concludes that no material uncertainty exists, and no disclosures are explicitly required by the applicable financial reporting framework regarding these circumstances.

If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements, the auditor is required to request management to extend its assessment period to at least twelve months from that date. The management of the company would provide the financial support letter extended by its parent company.
In the given case, which one of the following options is correct?

a) The auditor may obtain the financial support letter from the parent company for a period of 12 months from year end date.

b) The auditor may obtain the financial support letter from the parent company for a period of 12 months from date of signing of the financial statements.

c) The auditor may obtain the financial support letter from the parent company for a period of 12 months or less from year end date.

d) The auditor may obtain the financial support letter from the parent company for a period of 12 months or less from date of signing of the financial statements.

11. Auditor's report on prior period i.e. year ended 31 March 2017 included a modified opinion on an unresolved matter. If such matter is not relevant/ immaterial to the current period figures in the financial statements for the year ended 31 March 2018, how should the auditors deal with this matter in his auditors report for the year ended 31 March 2018?

a) Since the matter is not relevant/ material to current period figures, no reporting in respect of this matter would be required in the auditors report for the year ended 31 March 2018.

b) Modify opinion on current period's financial statements because of the effects or possible effects of the unresolved matter on the comparability of the current period and corresponding figures in the auditors report for the year ended 31 March 2018.

c) Considering the matter is not relevant/ material to current period figures, the management may include a note in the financial statements and basis that no reporting in respect of this matter would be required in the auditors report for the year ended 31 March 2018.

d) Include an emphasis of matter because of the effects or possible effects of the unresolved matter on the comparability of the current period and corresponding figures in the auditors report for the year ended 31 March 2018.

12. DEF Ltd has outsourced its payroll to a third entity (service organization). What should be the basis followed by the auditor of DEF Ltd in respect of audit of payroll?

a) The auditor should obtain Type 2 report as audit evidence to support his understanding of about the design and implementation of controls at the service organisation. Type 2 report would also serve as audit evidence about the operating effectiveness of those controls.

b) The auditor may refer to the work of service auditor in his report containing an unmodified opinion and diminish his responsibility for the audit opinion.

c) The auditor should obtain Type 1 or Type 2 report as audit evidence to support his understanding of about the design and implementation of controls at the service organisation. Type 2 report would also serve as audit evidence about the operating effectiveness of those controls.

d) Since the payroll process is outsourced to a service organization, there is nothing much an auditor can do. Auditor should audit the other information for the financial statements and accordingly should issue his opinion.

13. The profits of XYZ Ltd was Rs. 1000 crores for the financial year ended 31 March 2018. While planning the audit of the financial statements of XYZ Ltd, the auditor determined the materiality of Rs. 50 crores. The materiality was taken as 5% of profits of XYZ Ltd. During the course of audit, on becoming aware of information during the audit, audit adjustments were passed which resulted in significant decline in the profits of XYZ Ltd. Post audit adjustments, the profits reduced to Rs. 500 crores. Because of the changes in profits of the company, the materiality may get reduced to Rs. 25 crores.

XYZ Ltd is a large size company having a turnover of Rs. 20,000 crores for the financial year ended 31 March 2018. Considering the size of the company, the auditor believes that materiality amount should not go below Rs. 50 crores as that would result in significant increase in their work and the work of the auditor may not get completed within the required timelines. Accordingly, the auditor wants to change the basis of materiality by increasing the percentage of profits or taking revenue as the basis for computation of materiality.
In the given situation, which one of the following options is correct?

a) Considering the size of the company, the auditor may be appropriate in changing the basis of materiality to save his work.

b) The basis of materiality cannot be changed to save the increased work of auditor if there has been additional information which resulted in decline of profits during the course of audit.

c) The auditor need not change the materiality basis. He can complete his audit using the materiality of Rs. 50 crores which was determined initially by him while planning the audit.

d) Since the profits of XYZ Ltd have got reduced due to audit adjustments, the same cannot be considered to be the basis for computation of materiality. Materiality has to be based on management computed numbers.

14. M/s ABC & Co LLP has been appointed as the statutory auditors of WEF Ltd. Previous auditor of WEF Ltd was M/s LMN & Co LLP. For the purpose of accepting position as the statutory auditors of WEF Ltd, M/s ABC & Co LLP has sent a written communication to M/s LMN & Co LLP to obtain no objection letter.

    In the given case, which one of the following options is correct?

    a) M/s ABC & Co LLP needs to ensure that his appointment has been made by WEF Ltd as per the provisions of the Companies Act 2013. Once that is done, ABC & Co LLP need not make any communication with LMN & Co LLP.

    b) M/s ABC & Co LLP needs to make a communication with LMN & Co LLP and obtain his no objection letter for accepting the position of statutory auditors of WEF Ltd. Once this is done, M/s ABC & Co LLP can be appointed by WEF Ltd. However, in that case it will not be mandatory to follow the provisions of the Companies Act 2013.

    c) M/s ABC & Co LLP needs to ensure that his appointment has been made by WEF Ltd as per the provisions of the Companies Act 2013. ABC & Co LLP also needs to make a communication with M/s LMN & Co LLP to obtain his no objection letter.

    d) M/s ABC & Co LLP needs to ensure that his appointment has been made by WEF Ltd as per the provisions of the Companies Act 2013. Once that is done, ABC & Co LLP need not make any communication with LMN & Co LLP.

15. The auditor is required to audit a complete set of annual financial statements for the year ended 31 March 2018 prepared under Ind AS by the management solely for preparation of consolidated financial statements of the holding company. Is the auditor required to include 'Other Legal and Regulatory Requirements' to comment on matters such as maintenance of proper books of accounts, compliance with accounting standards etc. in the audit report?

    a) Since the auditor is required to audit complete set of annual financial statements for the year ended 31 March 2018 prepared under Ind AS, it will be mandatory for the auditor to include 'Other Legal and Regulatory Requirements' in his audit report.

    b) The audit report is not issued pursuant to requirement of section 143 and hence 'Other Legal and Regulatory Requirements' is not required to be included in the audit report.

    c) The audit report is not issued pursuant to requirement of section 143 and hence some of the requirements related to 'Other Legal and Regulatory Requirements' may be included in the audit report as per the discretion of the management of the Company.

    d) The auditor may include 'Other Legal and Regulatory Requirements' in the audit report but he would need approval of the Board of Directors for doing so.

16. A Ltd. is a company in the business of buying and selling modern and contemporary Indian arts.

    Following are the assets (in millions) of the Company on 31 March 2017:

    - Fixed assets: INR 10
    - Investments: INR 20
    - Loans and advances: INR 40
    - Inventories: INR 400
    - Trade receivables: INR 10
    - Cash and cash equivalents: INR 20

    The management has not obtained valuation of inventories as at 31 March 2017 from a valuation expert in art forms. The auditors could not perform alternate procedures for valuation of inventories. Therefore, auditors were not able to comment on the carrying value of inventories. However, the auditors were able to obtain sufficient appropriate audit evidence in respect of all other captions of financial statements. The auditors qualified their opinion in the auditor's report. What are your views on auditors qualifying their report?

a) The auditors were able to obtain sufficient appropriate audit evidence in respect of all captions of financial statements other than inventories. The auditors may qualify their opinion in the auditor's report considering only one caption of the financial statements could be misstated.

b) Total assets amount to Rs. 500 million, out of which, Rs. 400 million pertaining to inventories comprises of 80% of total assets. This signifies that the auditors are not able to obtain sufficient appropriate audit evidence on 80% of the assets. Hence, possible misstatement, if any, could be pervasive. Therefore, the auditors should issue adverse opinion.

c) Total assets amount to Rs. 500 million, out of which, Rs. 400 million pertaining to inventories comprises of 80% of total assets. This signifies that the auditors are not able to obtain sufficient appropriate audit evidence on 80% of the assets. Hence, possible misstatement, if any, could be pervasive. Therefore, the auditors should disclaim their opinion.

d) Inventory is considered to be an important component of the financial statements. This is one of the items wherein significant risk may exist from the audit's perspective. Auditor should take cognizance of this fact and accordingly decide his opinion – qualified/ adverse/ disclaimer.

17. X Ltd is in the business of trading of industrial equipments. The Company's operations are based out of India and Germany. For the purpose of hedge, the company has taken forward contracts. The Company is Phase 1 company as per the requirements of Ind AS and hence forward contracts have been fair valued for the purpose of preparation of financial statements. The Company also got its property, plant and equipment fair valued. The Company has shown its fair valuation reports in respect of above items to the auditors. What should be the responsibility of the auditors in this case?

a) The auditor may refer to the work of the valuer in his report containing an unmodified opinion and accordingly reduce the his responsibility for the audit opinion.

b) The auditor may refer to the work of the valuer in his report for forward contracts but not for property, plant and equipment, containing an unmodified opinion and accordingly reduce the his responsibility for the audit opinion.

c) The auditor may refer to the work of the valuer in his report for property, plant and equipment but not for forward contracts, containing an unmodified opinion and accordingly reduce the his responsibility for the audit opinion.

d) The auditor may involve his own expert for the purpose of audit of fair valuation of forward contracts and property, plant and equipment. But in any case he cannot reduce his responsibility for the audit opinion by referring to the work of the valuer in his report.

18. PQR Ltd has three subsidiaries, two associates and five joint ventures. The standalone and consolidated financial statements of PQR Limited are audited by M/s Jain & Co LLP (Group auditors) for statutory reporting in India. The standalone financial statements of other group companies of PQR Ltd are audited by some other audit firms (component auditors). For the purpose of consolidation, the instructions sent by M/s Jain & Co LLP to component auditors state that the principal auditors would be working on the principle of division of responsibility.

The instructions further state that the Group auditor may review selected working papers of the component auditors covering identified areas of emphasis, if required.

Considering the local regulatory requirements, the component auditors do not agree to get their working papers reviewed from the Group auditors. Please choose the course of action for the Group auditors in the given case.

a) As per the Standards of Auditing in India, "When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report would be stating the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited/reviewed by the component auditors have been included in the financial information of the entity." The Group auditor is not required to audit the financial statements of the components.

b) For the purpose of consolidation, the Group auditor would have to issue his opinion on the consolidated financial statements which would comprise the financial statements of the components and hence the Group auditor is required to audit the financial statements of the components.

c) For the purpose of consolidation, the Group auditor would have to issue his opinion on the consolidated financial statements which would comprise the financial statements of the components. Hence the Group auditor may either audit the financial statements of the components or review the work of the component auditors.

d) For the purpose of consolidation, the Group auditor would have to issue his opinion on the consolidated financial statements which would comprise the financial statements of the components. Hence the Group auditor would be required to review the work of the component auditors. If the component auditors do not provide access to their working papers to the Group auditors, the Group auditors may qualify his auditors report.

19. M/s ABC & Co LLP has been appointed as the statutory auditors of WEF Ltd. Previous auditor of WEF Ltd was M/s LMN & Co LLP. WEF Ltd is subsidiary of WEF Holding Ltd, UK. For the purpose of consolidation, WEF Ltd is required to send financial information of the company for the year in the Reporting package comprising of balance sheet, statement of profit and loss, statement of cash flow and notes to accounts. Since WEF Holding Ltd has many group companies across the globe, to ensure consistency in reporting of numbers under various heads, a standard reporting package is used by all the group companies. The group companies do not have any provision to change the groupings/ classifications which need to be reported as per the Group accounting manual which is prepared as per the Group's accounting policies. Group follows IFRS.

ABC & Co LLP is also required to audit the reporting package of WEF Ltd as per IFRS. During the course of audit, the auditor observed that some classifications are not in line with IFRS, however, due to the limitation of the reporting package no such corrections can be made. How should the auditor deal with this?

a) Since all the classifications are in line with the requirements of the Group as per the Reporting package, the auditor need not change anything and should issue clean report.

b) Since all the classifications are in line with the requirements of the Group as per the Reporting package, the auditor need not change anything and should issue clean report. However the auditor may also include a note separately in respect of the corrections required.

c) Since all the classifications are in line with the requirements of the Group as per the Reporting package, the auditor cannot change anything. However, the auditor is required to issue to report as per IFRS wherein the classifications are wrong and hence the auditor should issue qualified report if the amount is material.

d) Since all the classifications are in line with the requirements of the Group as per the Reporting package, the auditor need not change anything. However the auditor should issue his report as per the Group accounting manual instead of IFRS.

20. AKB Ltd is a large sized company having diversified business activities. The company's operations are spread across various locations within India and outside India. The company has many units and plants. The no of transactions of the company is large and it uses SAP as its ERP package. The company appointed LLM & Associates as their new tax auditors for the current year. Tax auditors were reviewing the statutory compliances and observed that currently there is no process of the company to check whether TDS has been correctly deducted on all transactions or not. Since the transactions of the company may be running in thousands and covers various provisions of TDS, the management believes that such a process cannot be established. Also in the past this exercise was never done and no case of any short/non-deduction of TDS has been reported in Form 3CD in the past. How should the tax auditor deal with this matter in his report?

a) Management is right and hence it should be ignored by the tax auditor.

b) Tax auditor should test check and basis that he should close this point.

c) Management should provide a reconciliation to the auditor reconciling the accruals/ expenses with TDS deducted during the year to ensure TDS is deducted appropriately. If the same is not available, tax auditor should qualify his report.

d) Management should set up a process as per the requirement of the tax auditor. For the current year, tax auditor should obtain management representation on this matter and should close this accordingly.

Solution

1	(a)	2	(b)	3	(b)	4	(d)	5	(d)
6	(b)	7	(a)	8	(b)	9	(c)	10	(a)
11	(b)	12	(c)	13	(b)	14	(c)	15	(b)
16	(c)	17	(d)	18	(a)	19	(c)	20	(c)