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MAY 2012

**GROUP PAPER-3
AUDITING AND
PROFESSIONAL ETHICS**

Total No. of Questions – 7

Total No. of Printed Pages – 4

Time Allowed – 3 Hours

Maximum Marks – 100

HBO

Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his answers in Hindi will not be valued.

Question No. 1 is compulsory.

Answer any **five** from the rest.

Marks

1. (a) A Ltd is a manufacturer of readymade garments. It sells its products to franchisees located across the country. Readymade garment industry is subject to change in trends of fashion and as such, some of the goods are returned and A Ltd accepts them back as sales returns. On the basis of past trends such returns are estimated to be at 20% of the sales of any year. For the financial year 2011-12, A Ltd had accounted for the actual sales return made upto 31st March 2012 but has not reversed the possible expected return that are likely to happen after 31st March 2012, in respect of the sale made for the FY 11-12. Mr. X the auditor of A Ltd wants this to be considered in the accounts for the year ended on 31st March 2012 but the company is of the opinion that although there is a probability of some goods being returned by the franchisees, there is no significant uncertainty regarding the amount of consideration that will be derived from the sale of goods, since the goods are not in the possession of the company and risk and rewards of ownership still lie with the franchisees and the company cannot record sales returns in its books of account in respect of goods that are likely to be received after the date of balance sheet. Comment.
- 5**

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- (b) R & Co. is the statutory auditor of S Ltd. For the financial year ended on 31st March 2012, S Ltd had disclosed in the notes (Note No. X) "The state pollution control board had ordered the closure of the company's only manufacturing plant on the ground that it is environmentally damaging, which the company had challenged in a law suit. Pending the outcome of the law suit the financial statements are prepared on a going concern basis". Further the financial statements prepared by the management of S Ltd include financial statements of certain branches which are audited by other auditors. What are the reporting responsibilities of R & Co ? 10
- (c) In the course of the statutory audit of Z Ltd, its statutory auditors, having determined that the work of internal auditor is likely to be adequate for the purpose of statutory audit, wanted to use the work of internal auditor in respect of physical verification of fixed assets. How an evaluation of this specific work done by the internal auditor can be done ? 5
2. Give your comments with reference to the Chartered Accountants Act, 1949 and Schedules thereto.
- (a) Z, 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 printers bills and by not caring to ascertain how many copies were sold and paid for. 4
- (b) X, a practicing Chartered Accountant in an application for permission to study submitted by his Articled Assistant to the council had confirmed that the normal working hours of his office were from 11 A.M. to 6 P.M. and the hours during which the Articled Assistant was required to attend classes were 7.00 A.M. to 9.30 A.M. According to the information from College, the Articled Assistant attended the classes from 10 A.M. to 1.55 P.M. 4

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(c) K, a practicing Chartered Accountant gave 50% of the audit fees received by him to L, who was not a Chartered Accountant, under the nomenclature of office allowance and such an arrangement continued for a number of years. 4

(d) M, a practicing Chartered Accountant sent a letter to another firm of Chartered Accountants, claiming himself to be a pioneer in liasoning with Central Government Ministries and its allied Departments for getting various Government clearances for which he had claimed to have expertise and had given a list of his existing clients and details of his staff etc. 4

3. (a) As the concurrent auditor of Z Bank Ltd you are requested by its management to draft an internal control policy in respect of loans and advances. What factors do you consider as important while drafting such a policy? 10

(b) T Ltd's previous year ended on 31st March 2012. During that period it made a claim for refund of customs duty which was admitted as due by the customs authorities during April 2012. T Ltd neither credited the claim in the profit and loss account nor reported the same in clause 13(b) of Form 3CD for the reason that this has been admitted as due by the authorities only in the next financial year. Further T Ltd had changed the method of determination of cost formula for the purpose of stock valuation from FIFO basis to Weighted Average Cost basis, but that was also not reflected in clause 11(b) of Form 3CD which requires reporting on change in accounting method employed. Comment. 6

(a) In the course of audit of Q Ltd, its statutory auditor wants to be sure of the adequacy of related party disclosures? Kindly guide the auditor in identifying the possible source of related party information. 8

(b) Z Ltd is intending to acquire A Ltd. It hires B & Co. a firm of Chartered Accountants to audit A Ltd. B & Co. has advised Z Ltd that A Ltd has overvalued its stock. 8

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5. (a) A, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas A should review in the assessment of independence of the practicing unit ? 4
- (b) State the key differences between financial and operational audit. 4
- (c) "Non-compliance of Section 58 AA inserted by the Companies (Amendment) Act, 2000 would occur where the company fails to intimate the Company Law Board, any default in repayment of deposits made by small depositors or part thereof or any interest there on." 8
- Discuss this statement and state reporting requirements under the Companies (Auditor's Report) Order, 2003 for non-compliance of Section 58 AA of the Companies Act, 1956.
6. (a) In the audit of K Ltd, its auditor wants to use CAATs for performing various audit procedures. Guide him as to what procedures can be performed using CAATs. 6
- (b) State the "Mandatory Review" areas of the audit committee. 4
- (c) In the course of audit of A Ltd you suspect the management has indulged in fraudulent financial reporting ? State the possible source of such fraudulent financial reporting. 6
7. Write short notes on any **four** of the following :
- (a) Mark to Market Margin 4
- (b) Cost Statements 4
- (c) Matter to be reported in respect of inventory in the case of a special audit of a non-corporate borrower of a Bank. 4

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