DISCLAIMER

The Suggested Answers hosted in the website do not constitute the basis for evaluation of the students' answers in the examination. The answers are prepared by the Faculty of the Board of Studies with a view to assist the students in their education. While due care is taken in preparation of the answers, if any errors or omissions are noticed, the same may be brought to the attention of the Director of Studies. The Council of the Institute is not in anyway responsible for the correctness or otherwise of the answers published herein.

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

Answer any **five** *from the rest*

Question 1

(a) *The Balance Sheet of G Ltd as at 31st March 13 is as under. Comment on the presentation in terms of revised Schedule VI and Accounting Standards issued by NACAS.*

Heading	*Note No.*	*31st March, 13*	*31st March, 12*
Equity & Liabilities			
Share Capital	*1*	*XXX*	*XXX*
Reserves & Surplus	*2*	*0*	*0*
Employee stock option outstanding	*3*	*XXX*	*XXX*
Share application money	*4*	*XXX*	*XXX*
Non-Current Liabilities		*XXX*	*XXX*
Deferred tax liability (Arising from Indian Income Tax)	*5*	*XXX*	*XXX*
Current Liabilities			
Trade Payables	*6*	*XXX*	*XXX*
Total		*XXXX*	*XXXX*
Assets			
Non-Current Assets			
Fixed Assets-Tangible	*7*	*XXX*	*XXX*
CWIP (including capital advances)	*8*	*XXX*	*XXX*
Current Assets			
Trade Receivables	*9*	*XXX*	*XXX*
Deferred Tax Asset (Arising from Indian Income Tax)	*10*	*XXX*	*XXX*
P & I Debit balance		*XXX*	*XXX*
Total		*XXXX*	*XXXX*

(5 Marks)

(b) *Z Ltd changed its employee remuneration policy from 1st of April 2012 to* S *provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy the employees can either utilize or encash it. As at 31st*

March 13 the company obtained an actuarial valuation for leave encashment liability. However it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment. *(5 Marks)*

(c) *T. Ltd. Commenced its manufacturing activities from 1st April, 2012. In the course of production the company generated certain by-products. As at 31st March 13 the company did not value the by-products considering the value as insignificant. The auditor of the company is of the opinion that the by-products are inventory of the company and it should be valued and brought into books of account. Comment.(5 Marks)*

(d) *K Ltd. had 5 subsidiaries as at 31st March 2013 and the investments in-subsidiaries are considered as long term and valued at cost. Two of the subsidiaries net worth eroded as at 31st March 13 and the prospects of their recovery are very bleak and the other three subsidiaries are doing exceptionally well. The company did not provide for the decline in the value of investments in two subsidiaries because the overall investment portfolio in subsidiaries did not suffer any decline' as the other three subsidiaries are doing exceptionally well. Comment.* *(5 Marks)*

Answer

1. (a) Following Errors are noticed in presentation as per revised Schedule-VI:

    (i) Share Capital & Reserve & Surplus are to be reflected under the heading "Shareholders' funds", which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities yet it must be shown under head "shareholders' funds". The heading "Shareholders' funds" is missing in the balance sheet given in the question.

    (ii) Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of profit & Loss should be shown as a negative figure under the head 'Surplus'. The balance of 'Reserves and Surplus', after adjusting negative balance of surplus shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

    (iii) Revised Schedule VI requires that Employee Stock Option outstanding should be disclosed under the heading "Reserves and Surplus"

    (iv) Share application money refundable shall be shown under the sub-heading "Other Current Liabilities". As this is refundable and not pending for allotment, hence it is not a part of equity.

    (v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown

(vi) Under the main heading of Non-Current Assets, Fixed Assets are further classified as under:

(i) Tangible assets

(ii) Intangible assets

(iii) Capital work in Progress

(iv) Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Fixed Assets as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading "Long term loans and advances" under the heading Non-Current Assets.

(vii) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability

(b) As per para 11 of AS-15 on "Employee Benefits", issued by The Institute of Chartered Accountants of India, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Here, Z Ltd will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence the contention of the auditor is correct that full provision should be provided by the company.

(c) As per AS-2 on "Valuation of Inventories", issued by the Institute of Chartered Accountants of India, a production process may result in more than one product being produced simultaneously. This is the case when joint products are produced or when there is a main product & by-products. If the costs of conversion of each product are not separable, they are allocated on a rational & consistent basis.

Most of the by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value & this value is deducted from the cost of the main product. In the given case, as the value of the by-products is insignificant, the realizable value of by products should be ascertained and it should be deducted from the cost of the main product.

An asset is a resource controlled by an enterprise as a result of past events from which the future economic benefits are expected. As per AS 2- Inventories are assets (a) held for sale in the ordinary course of business (b) in the process of production for such sale (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. As the stock of by-product is a resource controlled by T Ltd., it is an asset and it is inventory because it is held for sale in the ordinary course of business.

Hence, T Ltd. should deduct the realizable value of its by products from the cost of production of main product.

(d) As per AS-13 "Accounting for Investments" issued by the Institute of Chartered Accountants of India, long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

Keeping in view the above, K Ltd should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline.

Question 2

Give your comments with reference to Chartered Accountants Act, 1949 and Schedules thereto

(a) Mr. A, a practicing Chartered Accountant, failed to return the books of account and other documents of a client despite many reminders from the client. The client had settled his entire fees dues also. *(4 Marks)*

(b) Mr. B, a practicing Chartered Accountant as well as a qualified lawyer, was permitted by the bar council to practice as a lawyer also. He printed his visiting card where he mentioned his designation as Chartered Accountant and Advocate. *(4 Marks)*

(c) Mr. C, a practicing Chartered Accountant, in the course of the audit of a listed company discovered serious violations of the provisions of the Companies Act 1956, informed the Registrar of Companies out of public interest. *(4 Marks)*

(d) Mr. D, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements. *(4 Marks)*

Answer

(a) A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any professional or "Other Misconduct". As per part IV of the First Schedule to the Chartered Accountants Act, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he-

(1) is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;

(2) in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

A member may be found guilty of "Other Misconduct", as per clause 2, under the aforesaid provisions rendering, himself unfit to be member if he retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.

In the given case, Mr. A failed to return the books of accounts and other documents of his client without any reasonable cause, therefore, he would be guilty of professional misconduct under the aforesaid provisions.

(b) Under clause (7) of part -1 of First Schedule, a CA in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than 'Chartered Accountant" on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.

This clause prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public.

Members of the Institute in practice who are otherwise eligible may practice as advocates subject to the permission of the Bar Council but in such case, they should not use designation 'chartered accountant in respect of the matters involving the practice as an advocate. In respect of other matters they should use the designation 'chartered accountant' but they should not use the designation 'chartered accountant' and 'advocate' simultaneously. Since Mr. B has printed his visiting card where he mentioned his designation as Chartered Accountant and Advocate which is prohibited under the above clause and hence Mr. B is guilty of professional misconduct.

(c) Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 deals with the professional misconduct relating to the disclosure of information by a chartered accountant in practice relating to the business of his clients to any person other than his client without the consent of his client or otherwise than as required by any law for the time being in force would amount to breach of confidence. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. The Chartered Accountant may however, disclose the information in case it is required as a part of performance of his professional duties.

In the given case, Mr. C has disclosed serious violations of the provisions of the Companies Act, 1956 to Registrar of Companies without the consent of the client under the impression that it would be in public interest. Instead of disclosing the violations to the Registrar of Companies directly, he should impress on the client that while disclosure may entail only monetary penalties, nondisclosure and subsequent discovery thereof may entail imprisonment and fine, in addition to penalties. He should mention the violations in his report instead of informing the Registrar of Companies. Thus it is a professional misconduct covered by clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

(d) According to clause 7 of Part-I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties".

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard. He was guilty of professional misconduct under Clause (7).

Since Mr. D has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, therefore, the auditor is guilty of professional misconduct.

Question 3

(a) In the course of audit of Z Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls. *(4 Marks)*

(b) *In audit plan for T Ltd, as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them. Identify the sources of misstatements.* *(4 Marks)*

(c) *The auditor of H Ltd. Wanted to obtain confirmation from its creditors. But the management made a request to the auditor not to seek confirmation from certain creditors citing disputes. Can the auditor of H Ltd. Accede to this request?* *(4 Marks)*

(d) *R & Co, a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement.* *(4 Marks)*

Answer

(a) As per SA-330 on "The Auditor's Responses to Assessed Risks", changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.

Factors that may warrant a re-test of controls are-:

(i) A deficient control environment.

(ii) Deficient monitoring of controls.

(iii) A significant manual element to the relevant controls.

(iv) Personnel changes that significantly affect the application of the control.

(v) Changing circumstances that indicate the need for changes in the control.

(vi) Deficient general IT-controls.

(b) According to SA-450 "Evaluation of Misstatements Identified during the Audit", the following are the sources of misstatements arising from other than fraud -

(i) An inaccuracy in gathering or processing data from which the financial statements are prepared;

(ii) An omission of an amount or disclosure;

(iii) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and

(iv) Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

(c) SA 505, "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management. The auditor may come across certain situations in which the management may request him not to seek external confirmation from certain parties because of dispute with the creditors, etc. The management, for example, might make such a request on the grounds that due to a dispute with the particular creditor, the request for confirmation might aggravate the sensitive negotiations between the entity and the creditor.

In such cases, when an auditor agrees to management's request not to seek external confirmation regarding certain creditors, the auditor should consider validity of grounds for such a request and assess management's integrity and obtain evidence to support the same. The auditor should also ask the management to submit its request in a written form, detailing therein the reasons for such a request.

If the auditor of H Ltd agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to the management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding that matter. While considering the validity of request, in case the auditor of H Ltd reaches at a conclusion that the same was not valid, he may appropriately modify the report.

(d) As per SA- 210 on "Agreeing the Terms of Audit Engagement", the auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

(i) Any indication that the entity misunderstands the objective and scope of the audit.

(ii) Any revised or special terms of the audit engagement.

(iii) A recent change of senior management.

(iv) A significant change in ownership.

(v) A significant change in nature or size of the entity's business.

(vi) A change in legal or regulatory requirements.

(vii) A change in the financial reporting framework adopted in the preparation of the financial statements.

(viii) A change in other reporting requirements.

Question 4

(a) In course of audit of Good Samaritan Bank as at 31st March 13 you observed the following :

(i) In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular

account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government ? (5 Marks)

(ii) *The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances. (3 Marks)*

(b) *As at 31st March 2013 while auditing Safe Insurance Ltd you observed that apolicy has been issued on 25th March 2013 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The company maintained that it is a usual practice in respect of big customers and the money was collected on 5th April, 2013. You further noticed that there was a fire accident in the premises of the insured on 31st March 2013 and a claim was lodged for the same. The insurance company also made a provision for claim. Please respond. (4 Marks)*

(c) *While writing the audit program for tax audit in respect of A Ltd you wish to include possible instances of capital receipt if not credited to Profit & Loss Account which needs to be reported under clause 13(e) of form 3CD. Please elucidate possible instances. (4 Marks)*

Answer

(a) (i) If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

(ii) The audit programme to verify advances against Life Insurance Policies is as under -

1. The auditor should inspect the policies and see whether they are assigned to the

bank and whether such assignment has been registered with the insurer.

2. The auditor should also examine whether premium has been paid on the policies and whether they are in force.
3. Certificate regarding surrender value obtained from the insurer should be examined.
4. The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

(b) No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

(c) The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under clause 13(e) of Form 3CD-

(a) Capital subsidy received in the form of Government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.

(b) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.

(c) Compensation for surrendering certain rights.

(d) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

Question 5

(a) J Ltd is interested in acquiring S Ltd. The valuation of S Ltd is dependent on future maintainable sales. As the person entrusted to value S Ltd what factors would you consider in assessing the future maintainable turnover ? (4 Marks)

(b) The Managing Director of X Ltd is concerned about high employee attrition rate in his company. As the internal auditor of the company he requests you to analyze the causes for the same. What factors would you consider in such analysis? (4 Marks)

(c) *E & Co, a firm of Chartered Accountants, requires your help in identifying the audit procedures that can be performed using CAATs. Please guide them.* *(4 Marks)*

(d) *As the auditor of a large multi locational company, in the planning process, you are requested to identify the inherent audit risk at the account balance and class of transaction level.* *(4 Marks)*

Answer

(a) In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

(i) Trend: Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.

(ii) Marketability: Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.

(iii) Political and economic considerations: Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?

(iv) Competition: What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

(b) The factors responsible for high employee attrition rate are as under:

(i) Job Stress & work life imbalance

(ii) Wrong policies of the Management

(iii) Unbearable behaviour of Senior Staff

(iv) Safety factors

(v) Limited opportunities for promotion

(vi) Low monetary benefits

(vii) Lack of labour welfare schemes

(viii) Whether the organization has properly qualified and experienced personnel for the various levels of works ?

(ix) Is the number of people employed at various work centres excessive or inadequate?

(x) Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?

(c) CAATs may be used by E & Co, a firm of Chartered Accountants, in performing various auditing procedures, including the following:

(i) tests of details of transactions and balances, for example, the use of audit software for recalculating interest or the extraction of invoices over a certain value from computer records;

(ii) analytical procedures, for example, identifying inconsistencies or significant fluctuations;

(iii) tests of general controls, for example, testing the set-up or configuration of the operating system or access procedures to the program libraries or by using code comparison software to check that the version of the program in use is the version approved by management ;

(iv) sampling programs to extract data for audit testing;

(v) tests of application controls, for example, testing the functioning of a programmed control; and

(vi) Reperforming calculations performed by the entity's accounting systems.

(d) Evaluating Inherent Risk - To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors, having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which might have taken place since his last assessment.

Inherent audit risk at the level of Account Balance and Class of Transactions is:

(i) Quality of the accounting system.

(ii) Financial statements are likely to be susceptible to misstatement, for example, accounts which required adjustment in the prior period or which involve a high degree of estimation.

(iii) The complexity of underlying transactions and other events which might require using the work of an expert.

(iv) The degree of judgement involved in determining account balances.

(v) Susceptibility of assets to loss or misappropriation, for example, assets which are highly desirable and movable such as cash.

(vi) The completion of unusual and complex transactions, particularly at or near period end.

(vii) Transactions not subjected to ordinary processing.

Question 6

(a) H Private Ltd had taken overdrafts from two banks with a limit of 10 lacs each against the security of fixed deposit it had with those banks and an unsecured overdraft from a financial institution of 9 lacs. The said loans were outstanding as at 31st March 13. The paid up capital and reserves of the company as at that date was 40 lacs and its turnover during the financial year ended on 31st March 13 was 3 crores. The management of the

company is of the opinion that CARO 03 is not applicable to it because turnover and paid up capital were within the limits prescribed and loans taken against the fixed deposits cannot be considered. The company further contended that loan limit is to be reckoned per bank or financial institution and ·not cumulatively. Comment. *(4 Marks)*

(b) *XYZ Ltd has significant operations in a foreign country. Due to civil and political unrest in that country physical verification of inventory and fixed assets could not carried out and you are not· in a position to obtain audit evidence through other audit procedures also. The value of fixed assets and inventory forms part of 80% of the asset value of the company. As the auditor of XYZ Ltd what factors do you consider in your reporting responsibility. Also draft a suitable report that will be incorporated in the main audit report (Reporting under CARO 03 need not be considered).* *(8 Marks)*

(c) *R Ltd. As at 31st March, 2013 defaulted in the repayment of interest and principal due to a financial institution. The due date was 28th February, 2013. However, the defaulted amount was paid on 5th April, 2013. The company's management is of the opinion that since the default is set right before the audit completion these need not be reported in CARO 03. Comment and draft a suitable report.* *(4 Marks)*

Answer

(a) The Companies (Auditor's Report) Order (CARO), 2003, exempts private limited companies from its application which fulfils all the following conditions:

(i) its paid-up capital and reserves are rupees fifty lakh or less;

(ii) its outstanding loan from any bank or financial institution are rupees twenty five lakh or less; and

(iii) its turnover does not exceed rupees five crore.

In the case of H Pvt. Ltd., its paid-up capital is less than ₹ 50 lakhs, turnover is less than ₹ 5 crores but its outstanding loan from banks and financial institution is Rs 29 Lakhs. Loans against Fixed deposits are to be taken into consideration to compute the outstanding loan from any bank or financial institution. For the limit of ₹ 25 Lakhs as loans from banks and financial institutions, all loans from banks and financial institutions are to be taken cumulatively. Hence, the contention of the company is not correct. Here, H. Ltd. does not satisfy all conditions and CARO, 2003, therefore, will be applicable.

(b) As per SA-501 "Audit Evidence-Specific Considerations for Selected Items", if attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705. In the given case, the auditor has to modify his report.

Following factors are to be considered in auditor's reporting responsibility:

(a) Inventories and the Fixed Assets are material to the financial statements.

(b) Auditor is unable to attend physical verification of the inventories and fixed assets. In other words, physical verification becomes impracticable due to civil and political unrest in the foreign country, where the inventory and fixed assets are located, posing threats to the safety of auditor.

(c) Auditor failed to obtain proper and sufficient audit evidence, even by alternative audit procedures.

Draft of the suitable report to be incorporated in the main audit report:

"Our responsibility is to express an opinion on these financial statements based on our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were appointed as auditors of the Company and we report that we could not observe the counting of physical inventories and physical verification of fixed assets due to civil and political unrest in foreign country where the company has significant operation. We were also unable to satisfy ourselves by alternative means concerning the inventory quantities and fixed assets of the company held at March 31st 20XX, which are stated in the Balance Sheet at ₹ XXX and ₹ XXX, respectively.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

As required by section 227(3) of the Companies Act, 1956, we report that:

As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit.

(c) As per Para 4 (xi) of CARO, 2003 the auditors of a company has to state in his report that whether the Company has defaulted in repayment of its dues to financial institutions or bank or debentures holders and if yes the period and amount of default to be reported. The auditor should report the period and amount of all defaults existing at the balance sheet date.

In this case R Ltd has defaulted in repayment of principal and interest falling due on 28-02-2013. As R Ltd defaulted in the repayment of principal and interest, so the auditor has to report in his audit report that the Company has defaulted in its repayment of principal and interest to the financial institution to the extent of defaulted amount. The period of default i.e 35 days has also to be stated as per this clause.

Draft Report

"The company has defaulted in repayment of principal and interest to the financial institution amounted to ₹………, that become due on 28th Feb, 2013. Also the period of default is 35 days".

Question 7

Write short notes on any ***four*** *of the following :*

(a) *Restrictions on investments of funds of a central co-operative society.* *(4 Marks)*

(b) *Technical, ethical and professional standards as per statement on peer review* *(4 Marks)*

(c) *Corresponding figures* *(4 Marks)*

(d) *Permanent Consolidated Adjustments* *(4 Marks)*

(e) *Volatility Margin, its computation and its application.* *(4 Marks)*

Answer

(a) Restrictions on Investment of funds of a Central Cooperative Society. - Provisions of the Central Act put some restrictions on investments of funds of a Central Cooperative Society. According to Section 32 of the Central Act, a Central Cooperative Society may invest its funds only in any one or more of the following:

(a) In the Central or State Co-operative Bank.

(b) In any of the securities specified in Section 20 of the Indian Trusts Act, 1882.

(c) In the shares, securities, bonds or debentures of any other society with limited liability.

(d) In any co-operative bank, other than a Central or State co-operative bank, as approved by the Registrar on specified terms and conditions.

(e) In any other moneys permitted by the Central or State Government.

The principal provision relating to the investments of funds of a co-operative society, the Central as well as State Acts does not mention anything about the investment of reserve fund outside the business specifically.

(b) Technical, Ethical and Professional Standards as per statement on peer review.

As per the Statement, Technical, Professional and Ethical Standards means

(i) Accounting Standards issued by ICAI and /or prescribed and notified by the Central Government of India;

(ii) Standards issued by the Institute of Chartered Accountants of India including

(a) Engagement standards

(b) Statements

(c) Guidance notes

(d) Standards on Internal Audit

(e) Statements on Quality Control

(f) Notifications / Directions / Announcements / Guidelines / Pronouncements / Professional standards issued from time to time by the Council or any of its committees.

(iii) Framework for the Preparation and presentation of financial statements, framework of statements and Standard on Auditing, Standard on Assurance Engagements, Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the Institute of Chartered Accountants of India and framework for assurance engagements;

(iv) Provisions of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being Reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.

(c) Corresponding Figures

Comparative information where amounts and other disclosures for the preceding period are included as part of the current period financial statements, and are intended to be read in relation to the amounts and other disclosures relating to the current period. These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship to the current period figures.

(d) Permanent Consolidated Adjustments - Permanent consolidated adjustments are those adjustments that are made only on the first occasion of the preparation and presentation of consolidated financial statements. Permanent consolidated adjustments are:

(a) determination of excess or deficit of the cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made (determination of goodwill or capital reserve);

(b) determination of the amount of equity attributable to minorities at the date on which investment in subsidiary is made; and

(c) determination of goodwill or capital reserve arising on application of equity method to account for investments in associates in consolidated financial statements.

(e) Volatility Margin: Volatility margin is imposed to curb excessive volatility in the market and to act as a deterrent to building up of excessive outstanding positions.

Computation Price variations on account of calls, bonuses, rights, mergers, amalgamations and schemes of arrangements are adjusted for determining volatile securities and adjustments in prices is made for the purpose of computation of volatility, when securities are traded ex-benefits.

Application Securities that attract volatility margin and the applicable margin rates are announced on the last day of the trading cycle and are applicable from the first day of the succeeding trading cycle. The volatility margin is levied on the net outstanding positions of the member, in each security, based on the respective margin rates.