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Answer Paper	
ADV. Audit & Professional Ethics	**Duration**: 65
Details: Test – 3	**Marks**: 35

Instructions:

- All the questions are compulsory
- Properly mention test number and page number on your answer sheet, Try to upload sheets in arranged manner.
- In case of multiple choice questions, mention option number only Working notes are compulsory wherever required in support of your solution
- Do not copy any solution from any material. Attempt as much as you know to fairly judge your performance.

ANS-1

When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework is Different than that of the Parent: A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements.

The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. Thus, using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements.

It may be noted that **change in the selection of the method of depreciation is an accounting estimate and not an accounting policy** as per Ind-AS 8. Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That **method should be applied consistently from period to period** unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods for calculation of depreciation for its assets, if their expected pattern of consumption is different. The **method once selected in the stand- alone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.**

In the given case, assets of R Co. Ltd. (subsidiary company) is depreciated using straight line method, assets of S Co. Ltd. (subsidiary company) are depreciated using written down value method and assets of parent company (H Co. Ltd.) are depreciated using straight line method, is in order. However, each part of an item of Property Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately under Component Method of Depreciation as per AS 10 on Property, Plant and Equipment.

Thus, R Co. Ltd., though adopting straight line method but does not giving effect to component accounting of depreciation in respect of high value assets , **is not in compliance with Ind AS 16/ Accounting Standard 10 Property Plan and Equipment.**

(5 marks)

ANS-2

Non-Performing Asset: The bank is a consortium member of cash credit facilities of Rs. 50 crores to Xalta Limited Bank's own share is Rs. 10 crores only. During the last two quarters against a debit of Rs. 1.75 crores towards interest, the credits in Xalta Ltd's account are to the tune of Rs. 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights.

In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as nonperforming asset.

(4 marks)

ANS-3

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

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

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

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

The auditor should report the same in his report accordingly.

(4 marks)

ANS-4

Maintenance of Solvency Margin: Section 64VA of the Insurance Act, 1938 as amended by Insurance Laws (Amendment) Act, 2015 requires **every insurer and re - insurer to maintain an excess of the value of assets over the amount of liabilities at all times which shall not be less**

than 50% of the amount of minimum capital as stated under section 6 (requirement as to capital) of the Act and arrived at in the manner specified by the regulations.

If, at any time, an insurer or re-insurer **does not maintain the required control level of solvency margin, he is required to submit a financial plan to the Authority** indicating the plan of action to correct the deficiency. If, on consideration of the plan, the Authority finds it inadequate, the insurer has to modify the financial plan.

Sub-section (2) of section 64VA states that **if an insurer or re-insurer fails to comply with the prescribed requirement of maintaining** excess of value of assets over amount of liabilities, it shall **deemed to be insolvent and may be wound up by the Court** on an application made by the authority.

Therefore, in the said case Contingencies Ltd has not maintained the Solvency Margin throughout the year. Accordingly, **contention of Contingencies Ltd.** that solvency margin is required to be maintained as per limits prescribed only on last day of the financial year **is not tenable.**

(5 marks)

ANS-5

Yes, because SA-402 "Audit Considerations relating to an Entity using a Service Organization" requires the auditor to perform the following audit procedures-

- Obtaining an understanding of the services provided by a service organization
- Understanding the control relating to services provided by the service organization.
- Further procedures when a sufficient understanding cannot be obtained from the user entity
- Responding to the assessed risks of material misstatement
- Tests of controls

- Fraud, non-compliance with laws and regulations and uncorrected misstatements in relation to activities as the service organization Merely checking the calculation of printed payroll report is not sufficient as per SA-402, the above procedures has to follow for getting sufficient and appropriate audit evidence as regards service organization.

(3 marks)

ANS-6

Reporting for issue of shares for value exceeding fair market value: In this case, AB Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2020-21, it receives consideration for issue of shares (i.e. 80 per share) which exceeds the face value (i.e. 10 per share) and fair market value of the shares (i.e. ? 60 per share).

Provisions and Explanations: A tax auditor has to furnish the details of shares issued during the previous year, under clause 29 of Form 3CD, in case, the assesses received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib) of the Income Tax Act, 1961. Section 56(2)(viib) provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources".

Since section 56(2)(viib) is applicable to companies in which public is not substantially interested, reporting under this clause is to be done only for corporate assesses. The auditor should obtain from the auditee, a list containing the details of shares issued, if any, by him to any person being a resident and verify the same from the books of accounts and other relevant documents.

Conclusion: As per the facts of the case, provisions and explanations given above, the income generated by AB Ltd., due to differences in consideration received and fair market value of shares issued, is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(viib) of the Income Tax Act, 1961. Therefore, the tax auditor of AB Ltd. is required to furnish the details of shares issued under clause 29 of Form 3CD. The contention of the management of the company, behind non-reporting, that it is a normal issue of shares, is not acceptable.

(4 marks)

ANS-7

1. (c) The Group auditors need not test journal entries of components requiring analytical response at group level

2. (b) Allahabad branch falls under the compulsory audit criteria as per RBI Guidelines, however Rae Bareilly branch whose aggregate deposits are less than 50% of the aggregate deposits of the Bank is not required to be compulsorily covered for concurrent audit.

3. (a) 15 days

(2×3= 6 Marks)

4. (c) under Clause (ix) of Para 3 of CARO, 2020.

5. (c) All the partners of the firm can collectively sign 600 tax audit reports.

6. (c) None of the payment to a single party during a day exceeds the prescribed limit, thus, it should not be reported in Form 3CD.

7. (c) 12

(1 × 4 = 4 Marks)