



# CA Test Series.org (Since 2015)

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Answer Paper	
ADV. Audit & Professional Ethics	Duration: 65
Details: Test – 5	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.

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## **ANS-1**

**SA 701, “Communicating Key Audit Matters in the Independent Auditor’s Report”**, deals with the auditor’s responsibility to communicate key audit matters in the auditor’s report. It is intended to address both the auditor’s judgment as to what to communicate in the auditor’s report and the form and content of such communication. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- i. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
  - ii. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
  - iii. The effect on the audit of significant events or transactions that occurred during the period.
- The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

In the instant case, AKY Ltd., a listed company engaged in the business of software and its contracts with its various customers are also quite complicated and different. Further, the audit team spends significant time on audit of revenue and efforts towards audit of revenue also involve significant involvement of senior members of the audit team including audit partner during audit. This matter was also discussed with management at various stages. After completion of audit, the audit partner communicated the management regarding inclusion of paragraph on revenue recognition as key audit matter in his audit report.

In view of SA 701, the assessment of the auditor is valid as above matter qualifies to be a key audit matter in the opinion of auditor. Hence, it should be reported accordingly by the auditor in his audit report.

(6 marks)

**ANS-2**

In the instant case Operational Due Diligence is required to confirm that the business plan provided is achievable with the existing facilities plus the capital expenditure outlined in the business plan.

**Contents of a Due Diligence Report:** Briefly, the contents of a due diligence report can be discussed under:

1. Terms of reference and scope of verification.
2. Objective of due diligence.
3. Brief history of the company including shareholding pattern.
4. Assessment of management structure.
5. Assessment of financial liabilities with special emphasis on Interlocking investments and financial obligations with group/associates companies, amounts receivables subject to litigation, any other likely liability which is not provided for in the books of account.
6. Assessment of valuation of assets including comments on properties, terms of leases, lien and encumbrances including status of charges, liens, mortgages, assets and properties of the company.
7. Assessment of operating results.

8. Assessment of taxation and statutory liabilities.

9. Assessment of possible liabilities on account of litigation and legal proceedings against the company and suggestion on ways and means including affidavits, indemnities, to be executed to cover unforeseen and undetected contingent liabilities.

10 Assessment of net worth

11. Suggestions on various aspects to be taken care of before and after the proposed merger / acquisition.

12. Status of franchises, license and patents.

Finally, an executive summary may be prepared highlighting the significant areas.

**(4 marks)**

### **ANS-3**

As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

Provided nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being MD or whole-time director) unless he or his partners is interested in such company as auditor.

The Ethical Standards Board (ESB) noted that Public conscience is expected to be ahead of law.

Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardize their independence. In the view of the above, the

Board, via a clarification, decided that the auditor of a Subsidiary company cannot be a Director of its Holding company, as it will affect the independence of the auditor.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. Acting as Recovery Consultant in the banking sector' is covered under general permission.

In the given situation, M/s SS limited is a partly owned subsidiary of M/s HH limited. For the upcoming financial year, M/s DD & Co., Chartered Accountants, were appointed as the statutory auditors of SS limited. The CEO of the holding company was impressed with the knowledge and experience of Mr. D, one of the partners of the firm and hence, he offered Mr. D to take up the position of Director (not MD/ whole-time director) of HH limited. Further, Mr. D's friend approached him for an assignment for acting as a Recovery Consultant for a bank.

Therefore, in view of above in the given case, Mr. D should not accept the offer to be appointed as director of HH Limited. However, he can accept the assignment offered by his friend and can act as a recovery consultant for a bank.

(5 marks)

#### **ANS-4**

**Grossly Negligent and Bringing Disrepute to the Institute:** Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be 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.

Furthermore, Clause (2) of Part IV of the First Schedule to the said Act states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if

he, 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.

In the given case, Mr. Yuvi, a Chartered Accountant in practice, is grossly negligence in conduct of his professional duties by issuing clean reports on the balance sheet without examining the accounts.

Further, he has also brought disrepute to the profession by advising unethical practice to the managing director of the company. Therefore, Mr. Yuvi will be held guilty for professional and other misconduct under abovementioned Clauses to the Chartered Accountants Act, 1949.

(4 marks)

**ANS-5**

**Technique to be used for identifying any hidden patterns in the information:**

**Data Mining Techniques:** It is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns.

Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud. It explains various affinities, association, trends and variations in the form of conditional logic.

(3 marks)

**ANS-6**



**Failure to Disclose Material Facts:** As per Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading.

In this case, CA. Soft has come across information that a loan of Rs. 50 lakhs has been taken by the company from Gratuity Fund. This is contravention of Rules and the said loan has not been reflected in the books of account.

Further, this material fact has also to be disclosed in the financial statements. The very fact that CA. Soft has failed to disclose this fact in his report; he would be guilty for professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

**(3 marks)**

**ANS-7**

1. (c) Yes, it is a misconduct under clause 7 of Part I of First Schedule and he can be reprimanded, his name can be removed from the register of members for 3 months and fine up to Rs. 1,00,000.
2. (b) CA Kamal should consider issuing an adverse opinion and mentioning both the material discrepancies in the basis for adverse opinion paragraph of the auditor's report.
3. (c) The procedures of the investigating accountant looks completely reasonable considering his scope of work. Further, no changes are required in his work approach.

**(2×3 = 6 Marks)**

4. b) Initialization / Developing the plan / Obtain relevant evidence / Perform analysis / Reporting/ Court proceedings

5. (d) RP & Affiliates

6. (c) Familiarity Threat

7. 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.

(1×4 = 4 Marks)

