Test Series: March, 2019

MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP – II

PAPER – 6F: MULTIDISCIPLINARY CASE STUDY

*Attempt any **two** out of **three** case study based questions.*

Each Case Study carries 50 Marks.

Time Allowed – 4 Hours **Maximum Marks – 100**

Question 1

"Tea is not a mere commodity. It is a heritage based on values and culture full of sentiments and commitments."

Legend has it that tea was discovered by the great Chinese Emperor Shen Nung, more than four and a half thousand years ago. The story says that a leaf from a wild tea bush accidentally fell into a pot of boiling water, while the Emperor rested under a tree, the leaf then infused its goodness; and the rest, as we know, is history!

TOTAL TEA Limited is engaged in the business of tea plantation for over 40 years. It is engaged in the cultivation, processing and sale of bulk teas. The company produces high quality tea from estates in Assam and West Bengal. Its quality benchmarks and industry practices are among the best in the world; and it will continue to strengthen its operations to live up to its legacy and brand reputation.

TOTAL TEA Limited follows the tenets of a good corporate citizen, providing equal opportunity to all employees, in a safe and healthy working environment, ensuring social and economic development to sustain and improve quality of life. It is committed to safeguarding the environment by adopting an eco-friendly, transparent and participatory approach in all activities, whilst ensuring that the best quality of tea is produced.

CREDIBLE CERTIFICATIONS

Food Safety Management System (ISO 22000)

Fairtrade Certified

Rainforest Alliance Certified

Hazard Analysis Critical Control Point (HACCP)

Ethical Tea Partnership (ETP)

Company's widespread plantations, meticulous processes, honed art and science of blending, sustainable environmental practices and community initiatives have enabled it to reinforce its industry leadership across the country.

Company has tea estates, blending units and marketing offices across strategic locations. Company's discerning customers are spread across the country. It continues to leverage its robust marketing and delivery mechanisms to grow its global prominence and brand reputation.

BRAND

The Company markets its teas under the name of various tea estates, known as **'Tea Only'**. Hence, these 'Tea Only' have evolved into individual bulk tea brands, with a strong customer following in each of their preferred markets.

Budget

Total Tea Ltd. manufacturers two brands of tea namely Tea Only- Super and Tea Only Normal by blending of four grades of tea leaves as raw material in the following proportion:

Raw Material	Product Super	Product Normal
Grade A	70%	-
Grade B	30%	-
Grade C	-	40%
Grade D	-	60%

During the month of May 2017. It is expected that 200 tons of brand Super and 80 tons of brand Normal will be sold. Actual and budgeted inventories for the month of May 2017 are as follows:

	Actual inventories on 1st May, quantity in Tons	Budgeted inventories on 31st May, quantity in Tons
Grade A	40	50
Grade B	25	56
Grade C	150	250.90
Grade D	60	40.50
Product Super	40	20
Product Normal	20	15

Purchased tea leaves are seasoned and then held in stock or issued for production. During seasoning, they lost 15% of their initial weight.

TECHNOLOGY

The Company has invested in cutting-edge technologies to manufacture quality products and achieve high manufacturing efficiency through energy conservation and environmentally safe processes.

VALUE-ADDITION

The Company has in-house blending capacities, which control leaf mixture, liquor and aroma in a consistent manner in the final product to address wide-ranging customer needs.

QUALITY

The Company meticulously ensures that its teas comply with globally benchmarked quality standards, so that only the best products leave its factories.

PROCESSES

The Company has instituted operational discipline across gardens through the creation of a documented manual (standard operating procedures) to reduce arbitrary interventions, ensure process consistency and enhance knowledge sharing.

MARKETING

We have increased the proportion of tea marketed directly through strategic and private contracts in national and international markets. The result is higher realisations and better safeguards against cyclical market trends.

Finance and Accounts

The company's Profit & Loss Account for the year ended 31st March, 2019 shows a net profit of Rs. 550 lacs after debiting or crediting the following amounts:

(a) Depreciation Rs. 40 lacs.

(b) Interest amounting to Rs. 2 lacs on term loan from a bank for purchase of machinery for one of its tea factories.

(c) Repairs to factory building amounting to Rs. 15 lacs for which a sum of Rs. 10 lacs was withdrawn from Tea Deposit Account maintained with National Bank for Agricultural and Rural Development (NABARD) as per relevant section of the Income-tax Act.

(d) Profit from sale of green tea leaves plucked in own gardens Rs. 20 lacs.

(e) Rs. 5 lacs on account of stamp duty and registration fees for the issue of bonus shares.

(f) Rs. 10 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.

(g) Rs. 5 lacs written off as bad in respect of a trade debt transferred from Saraswati Tea Limited in previous year 2008-09 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.

(h) Rs. 2 lacs contributed to Employees Welfare Trust.

(i) Interest on inter-corporate deposit Rs. 1 lac and Rs. 1.50 lacs for February, 2019 and March, 2019 respectively, for which tax was deducted at source in the P.Y. 2018-19 and was paid to the Central Government in June, 2019.

Following additional information is furnished by the management:

(i) Depreciation as per Income Tax Rules, 1962 Rs. 55 lacs.

(ii) One financial institution converted arrears of interest of Rs. 10 lacs into a new loan in financial year 2015-16, which is repayable in five annual installments. The company has paid Rs. 2 lacs towards the installment due for the financial year 2018-19 in February, 2019.

(iii) A sum of Rs. 250 lacs deposited in NABARD on 15th June, 2019 as per the relevant section of the Income Tax Act.

The Company has provided the following particulars relating to tea sold by it to More Tea Pvt. Ltd.

Particulars	Rs.
List price of the Tea (exclusive of taxes and discounts)	50,000
Tax levied by Municipal Authority on the sale of such tea	5,000
CGST and SGST chargeable on the tea	10,440
Packing charges (not included in price above)	1,000

The Company received Rs. 2,000 as a subsidy from a NGO on sale of such Tea. The Price of Rs. 50,000 of the tea is after considering such subsidy.

Total Tea Ltd. offers 2% discount on the list price of the tea which is recorded in the invoice for the goods.

PART A

1.1. Ayushman Medical Centre, a clinical establishment, has provided the following information:

S. No.	**Particulars**	**Rs. (excluding GST if applicable)**
(i)	Consultancy charges paid to doctors	10,00,000
(ii)	Food supplied to in-patients as adviced by the dietician of the Ayushman Medical Centre	5,00,000
(iii)	Food supplied to attendants of the in-patients	2,50,000

(iv)	Alternative medical treatments by way of Naturopathy. Such therapy is a recognized system of medicine in terms of section 2(h) of Clinical Establishments Act, 2010	3,50,000
(v)	Reiki healing treatments. Such therapy is not a recognized system of medicine in terms of section 2(h) of Clinical Establishments Act, 2010	5,00,000
(vi)	Preservation of stem cells by Ayushman Medical Centre's cord blood bank	90,000

You are required to compute the value of taxable supply of Ayushman Medical Centre, if any, in the light of relevant GST provisions

(a) Nil

(b) 2690000

(c) 750000

(d) 1250000

1.2. Kesar Maharaj, a registered supplier, gave a classical dance performance in an auditorium. The consideration charged for the said performance is Rs. 1,60,000. Such performance is not for promotion of any product/services. Rate of CGST and SGST on such services is 9% each. Assuming the services supplied by him to be intra-State supplies, which of the following statements are true?

(a) GST liability of Kesar Maharaj is Nil as services provided by him are exempt.

(b) Kesar Maharaj is liable to pay CGST and SGST of Rs. 14,400 and Rs.14,400 respectively

(c) Kesar Maharaj is liable to pay CGST and SGST of Rs. 900 and Rs.900 respectively

(d) None of the above

1.3. Which of the statement(s) is/are not correct?

(1) A person having aggregate turnover of Rs. 18,00,000 in a financial year can take voluntary registration. The person has business operations in Uttar Pradesh and Jammu and Kashmir.

(2) A person having aggregate turnover of Rs. 18,00,000 in a financial year can take voluntary registration. The person has business operations in Uttar Pradesh and Assam.

(3) A person having aggregate turnover of Rs. 18,00,000 can take voluntary registration. The person is an agriculturist having operations in Uttar Pradesh and Jammu and Kashmir.

(4) A person having aggregate turnover of Rs. 18,00,000 can take voluntary registration. The person is an agriculturist having operations in Uttar Pradesh and Assam.

(a) (1)

(b) (2), (4).

(c) (2), (3), and (4)

(d) (3) and (4)

1.4. Which of the option is correct?

(a) Supplies to EOU's can be made without payment of tax under bond/LUT

(b) Supplies to EOU's are zero rated.

(c) Both (a) and (b) are correct

(d) None of the above

1.5. Mr. X of Agra, Uttar Pradesh purchased goods from Mr. Y of Mumbai, Maharashtra. While the goods were being packed in Mumbai godown of Mr. Y, Mr. X got an order from Mr. K of Bangalore, Karnataka for the said goods. Mr. X agreed to supply the said goods to Mr. K and asked Mr. Y to deliver the goods to Mr. K at Bangalore.

What is/are the place of supply(ies) in this case?

(a) Agra

(b) Agra, Bangalore

(c) Bangalore

(d) Mumbai

1.6. Division S sells one of its products to division T in the same group. The product cost consists of Rs.40 for materials, Rs.15 for direct labour, Rs.2.50 for variable overhead and Rs.27.50 for fixed overhead. S division sets its profit margin equal to 20% of the variable cost. What is the ideal transfer price if S is operating at full capacity?

(a) 96.5

(b) 57.5

(c) 85.0

(d) 69.0

1.7. Company has an obsolete machine that are carried in factory at a total cost of 26,200. If this machine are upgraded at a total cost of Rs.12,600, it can be sold for Rs.22,800. As an alternative, the machine can be sold in its present condition for Rs.11,200. The sunk cost in this situation is:

(a) 26,200

(b) 12,600

(c) 22,800

(d) 11,200

1.8. Company has two divisions, K and L. Each division is currently considering the following separate projects:

Particulars	Division K	Division L
Capital Required for the project	Rs. 16·3 million	Rs.11·1 million
Sales Generated by project	Rs. 7·2 million	Rs.4·4 million
Operating Profit Margin	15%	12%
Cost of Capital	5%	5%
Current ROI	7.5%	4.5%

If RI is used as the basis for the investment decision, which Division(s) would choose to invest in the project?

(a) Division K only

(b) Division L only

(c) Both Division K and Division L

(d) Neither Division K nor Division L

1.9. Company has fixed its targets for the next year as follows:

(1) Gaining a score of 5·3 or above on customer satisfaction surveys

(2) Increasing the number of chargeable hours handled by consultants to 7·1 per day

(3) Reducing departmental expenditure by 10%

Which of the above targets assesses economy, efficiency and effectiveness?

Economy Efficiency Effectiveness

(a) 1 3 2

(b) 2 1 3

(c) 3 2 1

1.10. Which ONE of the following factors could explain a favourable direct material usage variance?

(a) Poorer Management of Materials

(b) Lower Quality Material

(c) The company had reduced training of production workers as part of a cost reduction exercise.

(d) Better Management of Materials ***(10 x 2 = 20 Marks)***

PART B

1.11. Compute total income of the company for the Assessment Year 2019-20 stating the reasons for each item. Ignore provisions relating to Minimum Alternate Tax.

(12 Marks)

1.12. Determine the value of taxable supply made by Total Tea Ltd to More Tea Ltd.

(6 Marks)

1.13. Calculate the following in respect of Budget :

(i) The Production Budget for the month of May 2017 (in quantity) ***(5 Marks)***

(ii) the Raw Material Purchase Budget for May 2017 (in quantity) ***(7 Marks)***

Question 2

Background

You are the Chief Financial Officer (CFO) of Tom & Tinken Limited, an Infrastructure Company specializing in various fields such as buildings, dams, bridges, airports, power plants etc. You have taken over this role after having a successful tenure of about 15 years in Wisdom Constructions Limited, who is the direct competitor to Tom & Tinken Limited. Timing of your entry in Tom & Tinken Limited is very crucial especially since the previous CFO, Mrs. Ramamani, has resigned due to personal reasons in the middle of the year-end financial audit process and the Company has recently appointed M/s. Jags & Raghav Associates, Chartered Accountants, as the auditors of the Tom & Tinken Ltd. for a period of 5 years in view of the audit rotation requirements stipulated under the Companies Act, 2013.

The management has very high expectations from you regarding the role you need to play in contributing to Tom & Tinken Ltd. given the timing as well as the multiple challenges impacting the organization with respect to financial reporting. The following key priorities for you have been spelt out by the management;

- Transform the Finance Team
- Ensure smooth completion of the audit
- Maximize the shareholder's value
- Ensure Zero non-compliance with Regulatory requirements

To better understand your role and the team, you have started your journey by interacting with various personnel in the company and collected certain valuable inputs.

<u>Company Profile</u>

Tom & Tinken Limited is a listed company which has a tremendous track record of showing consistent business growth and is one of the key companies closely monitored by the Analysts and other shareholders. It has 3 subsidiaries in America, Asia and also in Africa and one joint venture in Dubai. It also has an insignificant trading activity relating to certain construction machinery spares which is primarily exported to European market.

The company is professionally managed and various financial institutional investors are holding about 40% of the overall equity share capital of the company. The company has a vibrant leadership team lead by Mr. Prasanna Pai, who is the Chief Executive Officer (CEO), an MBA from Indiana Institute of Management. He is very action oriented and is consciously pushing all his team leads to deliver the best. The company's business is primarily dependent on the infrastructure projects of the government and government agencies since the share of the private sector entities has come down drastically over a period of time. Being a market leader, Tom & Tinken is able to withstand the pressure from the competition even though the margins are becoming thin.

Profile of the Finance Team

Mr. Vamsy Krishna is the Financial Controller who will be directly reporting to you and he has about 10 years of experience. He is a veteran in the company and has an indepth understanding of various business activities of the Company and the operating environment. He is a Cost & Management Accountant and also a Bachelor of Commerce from the Tagore University. He is supported by 2 Finance Managers, namely, Ms. Supraja and Ms. Sukanya who are Commerce Graduates specializing in Statutory Finance and Business Finance respectively. There are also 4 other Accountants and 6 executives supporting the Finance managers in their respective areas.

Key Financial Highlights

Vamsy has informed you that a draft financial summary for the FY 2017-18 was prepared subject to certain pending items and the same was presented to the management and also to auditors. Key financial highlights as per such management accounts subject to certain open items are as under:

Particulars	**FY 2017-18 Draft Unaudited/ Provisional ₹ in crores**	**FY 2016-17 Audited ₹ in crores**
Revenue From Operations	72,430	68,776
Other Income	344	213
Total Income	**72,774**	**68,989**
Operating Expenses+	61,288	52,348
Administration & selling Expenses	4,333	1,455
Finance Cost	2,322	1,888
Depreciation*	2,876	2,487
Total Expenditure	**70,819**	**58,178**
Profit Before Tax	**1,955**	**10,811**

* Also includes amortization of Expenses of ₹ 22 crores.

+ Excludes GST paid and claimed as refund on certain eligible items amounting to ₹ 1254 crores.

Open Accounting Matters requiring resolution

Supraja and Sukanya, the Finance Managers summarized the following items which are open and are pending to be dealt with in the financial statements for your consideration. They already finished having a discussion with Vamsy and their views, were available, are also provided for your reference.

(a) An amount of ₹ 2.45 crores towards Accrual of certain liabilities relating to Refurbishment of certain spares meant for a specialized crane is yet to be made. The spares for refurbishment were sent in March 2018. Completion of the refurbishment/receipt of spares by the Company is expected only in March 2019. Spares have a life of more than a year.

(b) An amount of ₹ 4.35 crores relating to certain export benefits relating to export of construction machinery to Europe is yet to be accounted pending submission of export benefit documents with the concerned authority though the entitlement is more or less established.

(c) Certain employees are taken on a contract basis from a manpower service provider and the leave/gratuity liabilities calculated in accordance with the accounting standards relating to such employees are not accrued for in the financials of the company though contractually all the payments statutorily required to be made to such contract employees are to be borne by the company under the contractual terms entered into with the manpower service provider. The amount involved as at 31 March, 2018 is ₹ 2.44 crores.

(d) The stock option cost was not accounted under the Indian GAAP in prior years and the amount of fair value, if required, pending to be dealt with for FY 2017-18 is ₹ 1.46 crores. This is the cost to be settled in the previous year.

(e) The amount of expected credit loss for doubtful receivables pending to be accounted as at 31 March, 2018 is ₹ 1.20 crores and the company intend to account it proportionately on a Straight line basis over the calendar year 2018 to spread the impact of the same. Further, no Expected Credit Loss (ECL) provision is considered for the Retention Receivables under the contractual terms, which, if determined, would be ₹ 0.75 crores as at 31 March, 2018.

(f) An amount of ₹ 0.50 crores committed to the political party as at 31 March, 2018 by the CEO, is pending to be accounted in view of the approvals required under the Companies Act, 2013.

(g) Certain foreign exchange payables are accounted using the forward rate instead of the closing spot rate as at 31 March, 2018. The impact of change required, if any, on recalculation under the spot rate basis would be ₹ 0.23 crores of exchange loss.

(h) An amount of ₹ 3.49 crores is adjusted against the Retained earnings directly as at 1 April, 2017 in view of the significant estimation difference relating to loss provision made for certain construction contracts pertaining to prior periods based on actual crystallizations in line with the accounting standard requirements.

(i) Dividend Proposed for the FY 2017-18 is included as part of Finance Cost amounting to ₹ 1.2 crores.

Open Audit Issues requiring Resolution

Mr. Sai Ram, Partner from M/s. Jags & Raghav Associates met with you and briefed the following outstanding matters/issues from the audit point of view:

(a) There is an issue with respect to using BOTS for the purpose of audits especially in the area of control testing. The Finance team of the Company has objected to the usage of such BOTS in the audit process and has not provided access to the data that is required for usage of BOTS for audit purposes.

(b) The original underlying documents/ vouchers are not available and only the scanned copies of the documents were made available for audit purposes. The audit team has requested for a visit to the scanning center at Manali which is yet to be organized. Vamsy strongly believes that such a visit/verification of the originals is unwanted and is beyond the scope of statutory audit required under the Companies Act.

(c) The company has an internal Shared service center at Bengaluru and all the financial and accounting records for the entire Tom & Tinken Group across Asia, America, Africa and Gulf are maintained centrally and the processes followed are homogeneous in nature from a financial reporting angle. For the purpose of audit of the consolidated and stand alone financial statements of the group/ individual companies, the accounts team expects the auditors to follow a shared service approach of testing the homogeneous processes and controls and applying the conclusions to all the individual entities rather than testing it multiple times. The audit team has not accepted this view and the matter is pending resolution.

(d) With respect to intercompany transactions between the Company and its international subsidiaries, the Arn's Length Pricing (ALP) principle of Transaction Net Margin Method (TNMM) is adopted from the Income Tax view point. The audit team has challenged this method and is insisting on a separate ALP for the purpose of reporting under the Companies Act since the requirement of evaluating the ALP for Companies Act is different from the Income Tax Act.

(e) The Audit team wants to send out the confirmation for a key vendor, namely, Glory and Gavy Limited who has a credit balance of ₹ 104.12 crores as at 31 March, 2018. However, Vamsy strongly objected to the same and has not agreed to send the balance confirmation. The reason for not sending the confirmation is primarily on account of certain disputes with the party which may get revived on sending such audit confirmations.

(f) In connection with 4 major contracts entered into during the year for which sizable margins are recognised, the audit team would like to use their engineering specialist for validating the assumptions relating to costs incurred, cost to come and the expected margins/ losses, if any, since such estimates are critical and would have a substantial impact on the results of the company. Supraja has objected to the same since the same was never done in the past and such an exercise would only delay the audit/financial reporting and beyond the audit scope requirements.

(g) The Audit team would like to review the audit work papers of the previous auditors and has requested the company to facilitate the same. However, Sukanya strongly believes that no such practice is in vogue in India and the opening balances/ previous year audited financials can be presumed to be correct and the company will not entertain any such requests from the current auditors.

(h) Similarly the audit team wanted to review the books of account of the Joint Venture in Dubai which is audited by another auditor based out of Dubai. However, the finance team of the company is unable to facilitate/ support any such review by the parent company auditors.

(i) The Audit Manager, Kodali Ashish Krishna has also put in a request to the Finance Team that the entire draft annual report of the Company may please be provided to them upfront before finalizing the same since they have to validate/verify the same. However, Vamsy feels that the audit is required only for the financial statements and is not intended for the annual report which has various elements such as Directors Report, Management Discussion and Analysis, Corporate Governance Report, Financial Highlights etc. which are beyond the purview of statutory auditors.

(j) The audit team requested for a reconciliation of the transactions as per books with the details as per the Goods and Service Tax Network (GSTN) data w.r.t input credit, expenses accounted, income accounted etc. and also between the TDS credits taken and the interest income accounted as per books with the Form 26AS of the Company and also the reconciliation of profit between the costing records maintained for cost audit purposes with that of the financial records. Sukanya strongly believes that the audit is required only based on the books maintained by the company and there is no need to extend such audit to third party/independent data maintained by the Regulators intended for different purposes.

(k) The Audit team has also highlighted various deficiencies, which are not material weaknesses, in the Procure to Pay process and has indicated its intention of qualifying the Internal Control over Financial Report to be issued on the financial statements as part of the audit report under the Companies Act.

(l) Sai Ram has also indicated that in the absence of all the details/support required for finalizing the audits, he cannot issue the audit report and will also consider withdrawing the Review Reports issued on the quarterly financial information earlier based on Limited Review.

<u>Key Items of discussion with the Company Secretary</u>

Based on your discussion with Ms. Divya, Company Secretary, following matters requires your attention/action:

(a) The Audit Committee (AC) of the company has recommended referring an item relating to the whistle blower referral on one of the directors of the Company to an independent investigating agency which was over ruled by the Board of Directors. The same was concluded by the Board as frivolous complaint based on its own independent assessment.

(b) One of the Directors of the company has recorded his dissent for approving the quarterly unaudited financial results of the company last time though the majority approved the unaudited financial results.

(c) A shareholder of the Company has sent a request to the company as well as to the auditor of the company seeking explanation on the provisions made for diminution in the value of investments which is pending disposal.

(d) The financial analysis details as provided to the analysts by the CEO with respect to various segmentation of the business is completely different from that of the segment disclosures made in the financial statements/ results and there has been several questions raised on the same.

(e) There is a request from a Foreign Institutional Investor (FII), who is a shareholder of the company to make the presentation made/ to be made by the statutory auditors to the AC/Board public.

(f) Further, Divya is also having apprehensions regarding various accounting matters and, hence, is evaluating the feasibility of not signing the statutory financial statements in view of the legal issues that could come up at a later point of time.

Inputs from the CEO

Prasanna Pai, the CEO has requested you to consider the treatment of following items:

(a) The amount of provision made for the diminution in the value of investments in the African Subsidiary amounting to ₹ 12.30 crores included as part of Administrative Expenses. He wants to explore the possibility of directly adjusting this against the reserves in the Balance Sheet considering that the same represents the write down of a capital investment.

(b) Since the liquidity is a challenge for the company in the near future, the possibility of taking a short term borrowing from the bank for working capital purposes and using it for dividend distribution, if approved by the board/ shareholders.

(c) The amount of unclaimed liabilities of ₹ 1.97 Crores relating to employees who have left the company and the depositors who have not claimed for the past 10 years currently disclosed as part of liabilities may be written back to the Profit & loss account since the same was no longer payable.

(d) Providing Asset Retirement obligations on cash basis at actuals which has been accounted currently on estimation basis in line with the accounting policy followed by the Company.

(e) The possibility of presenting the financial results under the previous Indian GAAP (pre Ind AS) along with the Ind AS numbers in the financial statements for bench marking purposes.

You have to deal with the open accounting matters, address the audit concerns, deal with the issues raised by the Company secretary and also revert to the CEO of the Company on various matters raised by him. Please note that the financial statements of the company for the year under review are prepared using Ind AS for the first time.

PART- A

Answer the following questions: 2 Marks each)

2.1 The amount to be accrued, if any, in connection with the refurbishment of spares as at 31 March 2018 referred to above is in the nature of:

A. Contingent Liability

B. Constructive Obligation

C. Construction Obligation

D. Crystalized Liability

2.2 Expected Credit Loss Provisioning (ECL) is not required for Retention Receivables arising out of contractual terms.

A. Not Correct since it is a financial asset / contract asset

B. Correct since it is a contract asset

C. Depends on the facts and circumstances

D. ECL is Not applicable for Infrastructure companies

2.3 Difference between estimate and the actual relating to the prior periods would be considered as a prior period adjustment under IND AS:

A. Yes, based on matching Principle

B. No, actualisations of estimate difference are period adjustments in Profit & Loss Account

C. Depends on the outcome of evaluation of differences by the Board

D. Depends on the nature of the item requiring estimation

2.4 Board has the power to overrule the decisions of the Audit Committee (AC) under the Indian Companies Act, 2013:

A. No

B. Yes, after informing the Regulator

C. Yes, but disclosure need to be made with reasons therefor in the Board Report

D. Would vary based on the nature of the decisions of the AC and the profile of the AC Chair)

2.5 Auditor of the Company is having an obligation to validate all the financial and non-financial information provided along with the audited financial statements as part of the Annual Report

A. Yes, as required under the Auditing Standards

B. No, it is only voluntary on the part of the auditors

C. Limited to financial information only

D. Yes, to the extent it related to the relevant Information not reported as part of the financial statements.

2.6 Company Secretary is equally responsible for ensuring compliance with the accounting standards and other reporting requirements relating to the financial statements under the Indian Companies Act, 2013 similar to that of the CFO

A. Yes, it is demonstrated by his requirement to sign the financial statements where required

B. No

C. Yes, for listed Companies

D. Depends on the decision of the Board

2.7 The Company and the Auditor is duty bound to provide the information required by the shareholders at any time.

A. No

B. Company is responsible but not the auditor as per the requirements of the Companies Act, 2013

C. Auditor is responsible but not the Company as per the requirements of the Companies Act, 2013

D. Yes, both are responsible under the Companies Act, 2013

2.8 All deficiencies irrespective of its nature, as identified by the auditors relating to internal control over financial reporting, would need to be reported appropriately as part of their audit report to the shareholders under the Companies Act, 2013.

A. Yes, material weaknesses, significant deficiencies and other deficiencies need to be included as part of the audit report to the shareholders.

B. Yes to the extent approved by the AC/Board.

C. Nothing needs to be reported to the shareholders.

D. Deficiencies which are material weaknesses need to be considered suitably for reporting to the shareholders.

2.9 Auditee can decide on the nature/ extent of the audit procedures required to be carried out by the statutory Auditors in connection with the audit if the financial statements under the Indian Companies Act, 2013

A. No

B. Yes, with the approval of the shareholders

C. Yes, since the company appoints the statutory Auditor

D. Depends on the facts and circumstances

2.10 Any additional information as determined by the management can be provided as part of the financial statements over and above the minimum disclosure requirements stipulated under the Indian Companies Act, 2013.

A. Strictly No, since the disclosure requirements are mandated under the Indian Companies Act, 2013

B. Yes always, as long as the minimum/stipulated disclosure requirements are complied with

C. Can be discussed and decided based on the mutual consent of the auditor and the auditee

D. Yes, provided the same is required for better understanding of the financial statements.

PART B

Answer the following:

2.11 What will be your response to the Statutory Auditors regarding various matters highlighted by them as part of the audit process? (12 Marks)

2.12 Based on your review of the aforesaid case, Analyse the various adjustments & also items which do not require any adjustments in your view, to the draft financial statements of the company. (6 Marks)

2.13 How will you deal with the issues raised by the company secretary from the financial reporting and compliance perspective? (6 Marks)

2.14 What will be your response to the CEO on his proposals regarding various matters and explain the basis for your conclusion. (6 Marks)

Question 3

Background

You have recently joined as an Audit Partner in M/s. XYZ & Co., Chartered Accountants ("the Firm") based out of Mohali which has a variety of clients in the Technology, Software and Media segments. All their clients are based out of Mohali and Chandigarh. One of the key clients of the firm is Superstar Group which has several subsidiaries and your Firm does the audit and taxation work for all these entities. You have been assigned to support the Lead Client Service Partner for the Super Star Group, Mr. Madhav Mahajan, Partner, in the audit of Rising Star Limited. You have been provided with the below information to facilitate your audit.

Company Information

Rising Star Limited (the Company), which is a subsidiary of Super Star Limited, a Public Company (unlisted), was incorporated on 1st February, 2007 under the Indian Companies Act, 1956. It specializes in the business of developing graphical images for its various clients spread across the world. The shareholding pattern of the Company as at 31st March, 2017 are as under:

Particulars	*No. of Shares (in lakhs)***	*Total paid up Equity Share Capital (₹ In lakhs)*
Super Star Limited	*45.00*	*450.00*
*Mr. Thomas Edison (as a nominee of Super Star Limited)**	*32.50*	*325.00*
*Mrs. Morgrate Edison (as a nominee of Super Star Limited**	*22.50*	*225.00*
Total	***100.00***	***1000.00***

*The Company has complied with the requirements of the Companies Act, 1956/2013 with respect to taking note of/filing the beneficial interest of Super Star Limited in the Company with the Registrar of Companies.

**Face Value of ₹10 each.

Whilst the Company was doing well in the initial periods, due to global recession in this segment, the business performance has gone South recently.

The Finance Director of the Company, Mr. Mangesh has requested the Statutory Auditors. M/s. XYZ & Co; Chartered Accountants to take up the audit and issue the audit report before the Board meeting scheduled in the month of June, 2017 based on which certain critical decisions impacting the future operations of the Company would be taken including a probable merger The CEO of the Company, Mr. Stanley is in active discussion with the parent company and the Board of Directors. This information is proposed to be kept confidential as at this stage.

(A) Key financial data as per Management Information provided for Audit

The Company has also provided you with the management prepared financial statements for your audit. You have taken charge of this engagement and requested Ms. Manasa Maheswari, the Audit Manager to support you on this engagement.

The key Financial highlights of the Company as at 31st March, 2017 as per the Management prepared financial statements are as under:

₹ in Lakhs

Particulars	**As at 31st March, 2017**	**Particulars**	**For the year ended 31st March, 2017**
Equity Share Capital	1,000	Revenue-Net	4,255

Capital Reserve (not arising on amalgamation)	250	Profit (Loss) After Tax	(124)
General Reserve	125	Operating cash flows	(452)
Profit & Loss Account	(238)	Investing cash flows	(230)
Long Term Borrowings from the Parent Company	20	Financing Cash flows	923
Net Current Assets	(14)	Extra-ordinary Income	220
Cash & cash equivalents as at 1/4/2016 (excluding restricted cash and bank balances)	32	Deferred Tax Income	10
Bank Borrowings	12	Tax paid on Sales Revenue	12
Off Balance sheet exposure in the form of contingent liabilities to the extent not paid and not provided for	122	Interest expenses	22

(B) Information reported by the Audit Engagement Team:

The Engagement Team lead by Ms. Manasa Maheshwari has reported the following matters to you based on their field audit :

(1) No physical verification of the assets was carried out during the year ended 31st March, 2017 and the same was due only in the ensuing year ending 31st March, 2018 as per the management policy approved by the Board which was assessed to be acceptable from the audit point of view at the time of policy formulation.

(2) There was no disclosure of outstanding Letter of Credits (LCs) opened for import of certain assets from USA under contingent liabilities in the financials prepared by the Company amounting to ₹ 55 Lakhs.

(3) Gratuity liability was not provided for employees who have joined the Company during the past 3 years, the aggregate amount of which would be ₹ 12.50 Lakhs on the basis that they are yet to complete the stipulated minimum years of service.

(4) Certain computers were received from the parent company free of cost, the value of which is ₹ 0.23 Lakhs and no accounting or disclosure of the same has been made in the notes on accounts.

(5) The loan availed from Chevy Chase Bank remained outstanding to the extent of ₹ 12 Lakhs excluding the penal interest charged by the bank amounting to ₹ 0.23 Lakhs for default in repayment for 2 quarters, pending to be accounted by the Company.

The Management has also informed that this is not an information to be disclosed in the financial statements and does not have any bearing on the reporting of Auditors either.

(6) TDS receivable as per books is more than the cumulative balance as per Form 26AS by ₹ 14.50 Lakhs. No valid explanation was made available for the difference amount.

(7) The Company has not provided for any tax expense in the books of accounts due to tax losses. The Company has recognized deferred tax asset on the unabsorbed Business losses based on management assessment.

(8) The Company follows the method of providing depreciation as per Section 123 of the Companies Act, 2013 using the useful lives prescribed as per Schedule II of the Companies Act, 2013. It has provided depreciation on computers which are used during all the 3 shifts using the rates stipulated for continuous process plant since these assets are used for 24 hours (3 shifts).

(9) The amount of restricted bank balances as at 1-4-2016 and 31-3-2017 was ₹120 lakhs and the Company does not believe the same as qualifying for disclosure under Cash and Cash Equivalents.

(C) Review of Board Minutes

Whilst the Audit team has identified various matters, they need your advice to conclude on the same. You have asked them to review the Board minutes and other secretarial / regulatory records based on which the following additional matters were brought to your attention:-

(10) The long term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far.

(11) An amount of ₹ 1.22 Lakhs has been paid under protest against certain tax claims under dispute where the Company believes it has a fair chance and hence not provided for in the financial statements nor was it disclosed as contingent liabilities. During the discussions, the Company has also mentioned that since they have not provided for the same, this would not be an item in the Companies (Auditor's Report) Order, 2016 (CARO, 2016) reporting by the Auditors as disputed dues.

(12) The Company is in the process of selling its office along with the freehold land available at Chandigarh and is actively on the lookout for potential buyers. Whilst the same was purchased at ₹ 25 Lakhs in 2008, the current market value is ₹ 250 Lakhs,

This property is pending to be registered in the name of the Company, due to certain procedural issues associated with the Registration though the Company is having a valid possession and has paid its purchase cost in full. The Company has disclosed this amount under Fixed Assets though no disclosure of non-registration is made in the notes forming part of the accounts.

(13) An amount of ₹ 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an

independent assessment, the consideration paid is higher than the arm's length pricing by ₹0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts' paid, no separate disclosure has been made in the notes forming part of the accounts highlighting the same as a 'related party' transaction.

Ms. Manasa Maheshwari, your Audit Manager has reported that she had asked for certain information relating to another 'related party' transaction (quantum likely to be about ₹ 47 lakhs) and the CFO has refused to provide the same since the same is perceived to be confidential and cannot be shared with Auditors.

(14) The Internal Auditor of the Company has identified a fraud in the recruitment of employees by the HR department wherein certain sums were alleged to have been taken as kick-back from the employees for taking them on board with the Company. After due investigation, the concerned HR Manager was sacked. The amount of such kickbacks is expected to be in the range of ₹12 Lakhs.

(15) Right International Inc., has served a legal notice on the Company claiming ₹250 Lakhs for patent infringement and the Company has challenged the notice through its legal counsel. An 'independent legal opinion obtained on this matter suggests that the possibility of a cash outflow is more likely than not under the existing legal framework /available evidence as made available to the legal counsel.

(16) The remuneration for the auditors has been fixed by the shareholders as a fixed sum and a percentage based on the profitability of the Company.

(17) CEO of the Company, Mr. Stanley has put forward a proposal to pay dividends to the shareholders notwithstanding the current financial condition. He proposes to manage the cash flows by borrowing from the bank. He would also like to provide for the same in the financial statements for the year ended 31st March, 2017 on approval by the Board.

(18) The Management has informed that it feels that the market conditions will improve and the Company would be totally profitable in the next 3 years' time and expects new orders/higher revenues in the coming years to fuel higher profitability. During discussions on this topic, Mr. Stanley informed that whilst there are no firm contracts/projects that are available on hand to demonstrate, Management is fully aware of their business environment and their assessment can be taken as sacrosanct.

(D) Findings based on File Review

After a careful consideration of the matters reported by the engagement team, you have also reviewed the financial statements, audit working papers and noted the following additional matters for your conclusion and overall assessment;

(19) An amount of ₹ 0.25 Lakhs paid to M/s. Hemamalini Associates, Chartered Accountants (a network firm of XYZ & Co., Chartered Accountants, where Mr.

Madhav Mahajan is also a partner) towards various tax representation services has not been disclosed anywhere in the financial statements separately.

(20) Certain unclaimed dividends amounting to ₹ 38 Lakhs pertaining to the prior periods beyond 7 years have" been written back to the Statement of Profit & Loss under 'Other income'.

(21) The Market to Market Loss of ₹ 13.74 Lakhs as at 31st March, 2017 on the outstanding forward contracts pertaining to highly probable transactions which have an original tenure of 3 years is proposed to be accounted by the Company as and when the settlement transaction is scheduled which is likely to happen in December 2018. The Company has not adopted hedge accounting consistently.

(22) Extraordinary income arose from the gain on sale of freehold land at Kurukshetra.

(23) The Finance Director of the Company was also enquiring about the applicability of Indian Accounting Standards (IND AS) for the Company. He said that considering the parameters mentioned for applicability of IND AS and the Company's turnover, profit after tax and net worth for the last financial years, it is not applicable for the entity for the financial year 2016-17 and, hence, existing Indian GAAP has been considered by the Company in the preparation of its financial statements. He has also asked you to confirm the same.

(24) During your interactions with Mr. Mangesh, the Finance Director of the Company, he has indicated that he would expect a clean opinion on the financial statements and reference to matters which would have negative perception could be ignored considering the possibility of the merger under evaluation. He has also indicated that he does not expect any further adjustments to the financial statements since the same has been shared with the bankers already.

Based on the above information, you have to provide your inputs on the below aspects to your Lead Client Service Partner to assist him in forming his opinion.

PART–A

3.1 Whether Superstar Limited needs to consolidate the financial statements of Rising Star Limited under the Companies Act 2013 ?

(A) No

(B) Yes, for 100%

(C) Yes, but only to the extent of 45%

(D) Consolidation requirement itself is not applicable under the Companies Act, 2013 being an unlisted entity. **(2 Marks)**

3.2 What is the Net Worth of the Company as per the Management prepared financial statements as at 31st March, 2017 ? (₹ in Lakhs)

(A) 887

(B) 1137

(C) 1015

(D) 1125 **(2 Marks)**

3.3 What is the total amount of contingent liabilities of Rising Star Limited as at 31st March, 2017? (₹ in Lakhs)

(A) 122

(B) 178.22

(C) 123.22

(D) 213.22 **(2 Marks)**

3.4 What is the amount of Cash and Cash Equivalent to be disclosed in the Cash Flow Statement as at 31st March, 2017 ? (₹ in Lakhs)

(A) 241

(B) 723

(C) 149

(D) 273 **(2 Marks)**

3.5 The amount at which the Chandigarh property to be accounted in the books of account as at 31st March, 2017 is _________ (₹ in Lakhs)

(A) 250

(B) 275

(C) 25

(D) 225 **(2 Marks)**

3.6 Do you think that the "Deferred Tax Asset" recognition on the unabsorbed business losses is appropriate:-

(A) Yes

(B) No

(C) Yes, since it is based on Management assessment and the same is as per the AS 22.

(D) It depends/based on the decision to be taken by the CEO regarding the probable merger. **(2 Marks)**

3.7 Whether gain on sale of land at Kurukshetra accounted as an extra-ordinary income is acceptable under the Companies Act, 2013 reporting framework?

(A) Yes, it is appropriate.

(B) No, this may be accounted as an exceptional item.

(C) No, this should be accounted as 'income from operations'.

(D) It depends on the decision to be taken by the CEO regarding the probable merger.

(2 Marks)

3.8 Certain information considered as confidential by the Management for sensitive purposes can be rightfully denied to the auditors.

(A) Yes, for valid reasons as assessed by the Management.

(B) No, it cannot be denied; else this would result in possible scope of making audit qualifications for the Auditors.

(C) Can be denied after taking the consent from the Board.

(D) Can be denied after informing the Regulators. **(2 Marks)**

3.9 In view of the discussions by the Finance Director with you, reference to unfavourable or qualified answers in the Companies (Auditor's Report) Order, 2016 (CARO, 2016) where applicable may be avoided.

(A) Yes, based on the request from the client.

(B) No, where required, due disclosure as required under the Companies Act, 2013 needs to be made.

(C) Considering the merger possibility, such matters may be reported to the Board and can be avoided in CARO, 2016.

(D) Entire reporting under CARO, 2016 may be dropped. **(2 Marks)**

3.10 Whether Auditors' remuneration as proposed by the shareholders is acceptable to you?

(A) Yes

(B) No

(C) Permissible since the shareholders have approved the remuneration

(D) Cannot decide based on available information. **(2 Marks)**

PART-B

Answer the following:

3.11 Are there any matter(s) that need to be reported with unfavourable response under the Companies (Auditor's Report) Order, 2016-(CARO, 2016)? If so, explain the same with relevant rationale. **(8 Marks)**

3.12 Summarise the material misstatements, if any; on the management prepared financial statements which could impact the true and fair view of the financial statements. Please provide the basis for your assessment briefly. **(8 Marks)**

3.13 What are the disclosure deficiencies, if any, in the Management prepared financial statements that could impact the true and fair view of the financial statements? Please provide the basis for your assessment briefly. **(6 Marks)**

3.14 Provide a brief summary of items to be reported to those in-charge of governance, where applicable, based on your audit findings for Rising Star Limited, duly considering the Auditing Standards and the applicable provisions of the Companies Act, 2013.

(4 Marks)

3.15 As an auditor of Rising Star Limited, state the matters to be reported under Rule 11 of the Companies (Audit and Auditors) Rules, 2014? What are those matters and how would you report them? **(4 Marks)**