MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP – II

PAPER 6F: MULTIDISICIPLINARY CASE STUDY

Answer to Question 1

PART-A

1.1 (c)

1.2 (b)

1.3 (c)

1.4 (d)

1.5 (b)

1.6 (a)

1.7 (a)

1.8 (a)

1.9 (c)

1.10 (d)

Part B

Answer 1.11 Computation of total income Total Tea Ltd. for the A.Y.2019-20

Particulars	Rs.	
Profit and Gain from Business and Profession		
Net profit as per Profit & Loss Account		5,50,00,000
Add: **Items debited but to be considered separately or to be disallowed**		
Depreciation as per accounts	40,00,000	
Repairs to factory building to the extent of amount spent by withdrawal from Tea Deposit Account **(Note 2)**	10,00,000	
Sales tax due for which the company has furnished bank guarantee **(Note 4)**	10,00,000	
Contribution to Employees' Welfare Trust disallowed under section 40A(9) **(Note 6)**	2,00,000	62,00,000
		6,12,00,000
Less: **Amount credited to profit & loss account but not chargeable to tax**		
Profit on sale of green tea leaves plucked in own gardens is agricultural income and the same is exempt under section 10(1)		20,00,000
		5,92,00,000
Less: **Deductions allowable while computing business income**		
Depreciation as per Income-tax Rules	55,00,000	
Payment of new loan converted from arrear interest **(Note 8)**	2,00,000	57,00,000
		5,35,00,000

Deduction under section 33AB for making deposit in an account with NABARD as per scheme approved by the Tea Board, being lower of the following two amounts:		
Amount deposited	2,50,00,000	
40% of the profit from business of growing and manufacturing tea computed under the head "profits and gains from business and profession" before making this deduction (Rs. 5,35,00,000 x 40%)	2,14,00,000	2,14,00,000
		3,21,00,000
Less: 60% of above, being agricultural income as per Rule 8		1,92,60,000
Business income		1,28,40,000
Gross Total Income		**1,28,40,000**
Less: Deduction under Chapter VI-A		Nil
Total Income		**1,28,40,000**

Notes:

1. As per section 36(1)(iii), interest paid in respect of capital borrowed for the purpose of business or profession is allowed as deduction. The term loan was taken for purchasing machinery for use in a tea factory. Thus, the term loan was used for the purpose of business. Hence, interest on term loan is allowable as deduction. As interest has already been debited to the profit and loss account, no adjustment is required. It is assumed that the machinery was put to use immediately after acquisition and hence capitalization of interest is not required.
2. As per section 33AB(6), where any amount standing to the credit of the assessee in the account maintained with NABARD is utilized by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme approved by the Tea Board, such expenditure shall not be allowed as deduction. Therefore, the amount of Rs. 10 lacs withdrawn and utilized for incurring expenditure on repair to factory building is to be disallowed.
3. The Supreme Court, in the case of *CIT vs. General Insurance Corporation (2006) 286 ITR 232,* observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is only reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. The company has not acquired any benefit of enduring nature. There is no increase in capital base of the company. Therefore, stamp duty and registration fee in connection with issue of bonus shares is allowable as revenue expenditure under section 37(1).
4. According to section 43B, any tax, duty, cess or fee (by whatever name called) is allowed as deduction if they are actually paid on or before the due date of filing return of income under section 139(1) irrespective of the method of accounting followed by the assessee.

   In the case of *CIT vs. Udaipur Distillery Company Limited (2004) 268 ITR 305 (Raj),* it was held that actual payment requires that amount must flow from the assessee to the public exchequer as specified in section 43B. Mere furnishing of bank guarantee by the assessee towards sales tax dues does not mean actual payment of sales tax dues. Hence, it is not treated as payment to be eligible for deduction under section 43B.
5. Under section 36(1)(vii) read with section 36(2), an assessee can claim deduction in respect of bad debt, provided the amount of such debt has been taken into account in computing total income of the assessee and it is written off in the books of account of the assessee. In the case of *CIT vs. T.Veerabhadra Rao, K.Koteswara Rao & Co. (1985) 155 ITR 152 (SC),* the Apex Court held that the successor of a business is entitled to write off the predecessor's debt as a bad debt and claim deduction if the other conditions are fulfilled. This is so because the benefit of deduction in respect of bad debt is not accrued to the assessee by way of personal relief but relates to the business. Therefore, the

assessee company is entitled to deduction under section 36(1)(vii) read with section 36(2) in respect of debt transferred from the amalgamating company, Saraswati Tea Limited.

6. As per section 40A(9), any contribution made by the assessee as an employer to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act or other institution for any purpose shall be disallowed, except where such contribution is paid to a recognised provident fund or approved superannuation fund or approved gratuity fund. Therefore, contribution to the Employees' Welfare Trust is to be disallowed.

7. No disallowance would be attracted under section 40(a)(ia) on interest on inter-corporate deposit relating to February 2019 and March 2019 since tax was deducted on such interest in the P.Y. 2018-19 and after deduction has been paid before the due date of submission of return of income of P.Y. 2018-19 i.e., 30.9.2019

8. As per *Explanation 3C* below section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

   The manner in which the converted interest will be allowed as deduction has been clarified vide *Circular No.7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid. Accordingly, the sum of Rs.2 lacs, being installment paid in February, 2019 shall be allowed as deduction while computing business income of P.Y. 2018-19.

Answer 1.12

Particulars	Rs.
List price of the goods (exclusive of taxes and discounts)	50,000
Tax levied by Municipal Authority on the sale of such goods [includible in the value as per section 15(2)(a)]	5,000
CGST and SGST chargeable on the goods [Not includible in the value as per section 15(2)(a)]	
Packing charges [includible in the value as per section 15(2)(c)]	1,000
Subsidy received from a non-Government body [Since subsidy is received from a non-government body, the same is included in the value in terms of section 15(2)(e)]	2,000
Total	58,000
Less: Discount @ 2% on Rs.50,000 [Since discount is known at the time of supply, it is deductible from the value in terms of section 15(3)(a)]	1,000
Value of taxable supply	**57,000**

Answer: 1.13

(i) Production Budget May'17 (tons)

Particulars	**Super**	**Normal**
Expected Sales	200	80
Add: Budgeted Inventory (31st May)	20	15
Total Requirements	220	95
Less: Actual Inventory (1st May)	40	20
Required Production	180	75

(ii) Materials Purchase Budget May'17 (tons)

Particulars	Grade A	Grade B	Grade C	Grade D
Requirement for Production	126.00 (180 × 70%)	54.00 (180 × 30%)	30.00 (75 × 40%)	45.00 (75 × 60%)
Add: Budgeted Inventory (31st May)	50.00	56.00	250.90	40.50
Total Requirements	176.00	110.00	280.90	85.50
Less: Actual Inventory (1st May)	40.00	25.00	150.00	60.00
Quantity to be purchased	136.00	85.00	130.90	25.50
Add: Lose of Weight* (Seasoning)	24.00	15.00	23.10	4.50
Quantity to be purchased (Gross)	160.00	100.00	154.00	30.00

(*) Quantity to be purchased × 15% / 85%

Answer to Question 2

PART – A

2.1 (D)

2.2 (A)

2.3 (B)

2.4 (C)

2.5 (C)

2.6 (A)

Alternative- Option (B)

2.7 (A)

2.8 (D)

2.9 (A)

2.10 (D)

PART – B

(2.11) (1) An entity's system of internal control contains manual elements and often contains automated elements. The use of manual or automated elements in internal control also affects the manner in which transactions are initiated, recorded, processed, and reported. An entity's mix of manual and automated elements in internal control varies with the nature and complexity of the entity's use of information technology. Further as per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", IT system also poses specific risks to an entity's Internal Control. They are reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both. Thus, objection of Finance team of the company regarding usage of BOTS in the audit process is not correct. The auditor should be provided access to the data that is required for usage of BOTS for audit purpose.

(2) As per SA 500, "Audit Evidence", when designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Thus, visit for verification of original is not beyond the scope of statutory audit required under the Companies Act.

(3) In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis. However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS. The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS. The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable. Thus, contention of management with respect to apply shared service approach of testing the homogeneous process and controls and applying the conclusion to all the individual entities rather than testing it multiple times is not tenable.

Alternative: Hold discussion with the auditors to highlight the structure of the shared service centre set up of the Company. Also highlight to them that the processes are so streamlined and structured that the shared service team ensures all processes are managed in a homogeneous manner and appropriate internal control exists which would provide the required comfort to the auditors for applying the SSC approach. Also inform the auditors that, they could do their own controls testing and understanding of the process before deciding on the same, duly considering the requirements of SA 500 on Audit Evidence and SA 315 on Identification and assessing risks of material misstatements through understanding of the entity and its environment. Reaffirm to the auditors that, whatever information is required for the auditors to conclude on the homogeneity and operating effectiveness of the controls at the shared service center, the same would be provided to them.

(4) So far as the Arm's Length Pricing (ALP) principle of Transaction Net Margin Method (TNMM) is concerned which is adopted from Income Tax view point, it is an approved method under Income Tax Act, but there is no such separate ALP for the purpose of reporting under the Companies Act. Therefore, challenge of audit team contemplating separate ALP for the purpose of reporting under the Companies Act is not correct. However, acknowledge the fact that the arm's length determination under Companies Act, 2013 cannot be exclusively only on the basis of TNMM as considered for Income Tax Act. Rather, for Companies Act, the arm's length determination should be based on the related party transactions approval policy framed by the Audit Committee/Board as per the Companies Act. Inform the auditors that the same would be aligned and a proper justification would be provided to them to substantiate the arm's length nature of the related party transactions.

(5) SA 505 "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. If the management refuses to allow the auditor to a send a confirmation request, the auditor shall (i) inquire as to Management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness, (ii) evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and (iii) perform alternative audit procedures designed to obtain relevant and reliable audit evidence. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those in charge of governance and also determine its implication for the audit and his opinion.

(6) As per SA 620, "Using the Work of an Auditor's Expert", during the audit, the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert. Expertise in a field other than accounting or auditing may include expertise in relation to specified matters. In the instant case, the auditee has entered into 4 major contracts for which sizeable margins are recognized, audit team can used their expert i.e. engineering expert for validating the assumption relating to cost incurred, cost to come and the expected margins/losses as such estimates are critical and would have a substantial impact on the result of the company. Therefore, objection of Supraja is not correct.

(7) As per SA 510 "Initial Audit Engagements-Opening Balances, if the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated. Thus, requirement of reviewing the audit working papers of previous auditor is not correct.

(8) As per SA 600, Using the work of Another Auditor, when the principal auditor uses the work of another auditor, the principal auditor should determine how the work of the other auditor will affect the audit. In certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. Further, the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. Thus, audit team can review the books of accounts of the joint venture in Dubai, in case finance team deny auditor may qualify the report accordingly.

Alternative: Inform the finance team that section 143 of the Companies Act, 2013 provides the auditors with the right to access the books of accounts and other information's of subsidiaries including joint ventures. Accordingly, if the auditor believes that the review of the JV records is relevant duly considering materiality, organize the same. In the absence of same auditor may qualify the report accordingly.

(9) Request by the Audit manager that the entire draft annual report of the company be provided to them upfront before finalizing the same is not valid because in annual report auditor is required to provide the audited balance sheet along with audit report with respect to financial statements. It has nothing to do with draft annual report. The objective of the audit is to express an opinion on financial statements and other information relating to financial statements only. The auditor does not report on Director's Report, Management Discussion and Analysis, Corporate Governance Report, Financial Highlights etc.

(10) The auditor is required to verify compliance with laws and regulation. Further he is also required to verify the same as per SA 500 Audit Evidence. For the same he is required to reconcile the transactions as per books with the details as per the Goods and Service Tax Network data w.r.t input credit, expenses accounted, income accounted and also between the TDS credits taken and the interest income accounted as per books with the Form 26AS of the Company. Further it is also required for reconciliation of profits between the costing records maintained for cost audit purposes with that of financial records. Thus contention of Sukanaya 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 is not correct.

(11) The auditor's objective in an audit of internal financial controls over financial reporting is to express an opinion on the effectiveness of the company's internal financial controls over financial reporting. It is carried out along with an audit of the financial statements. Because a company's internal controls cannot be considered effective if one or more material weakness exists, to form a basis for expressing an opinion, the auditor must plan and perform the audit to obtain sufficient appropriate evidence to obtain reasonable assurance about whether material weakness exists as of the balance sheet date. A material weakness in internal financial controls may exist even when the financial statements are not materially misstated.

Further, the auditor must evaluate the severity of each control deficiency that comes to his or her attention to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses as of the balance sheet date. In planning and performing the audit, however, the auditor is not required to search for deficiencies that, individually or in combination, are less severe than a significant deficiency.

(12) Contention of auditor Sai Ram to withdraw the review reports issued on the quarterly financial information earlier based on limited review and not to report is not correct however, he may issue qualified or modified opinion in the absence of all the details/support required for finalising the audit. Therefore, the auditor could consider issuing the report after required modifications or qualifications.

(2.12) <u>Analysis of all the Open Accounting Matters</u>

(a) Since spares are meant to be used for a specialised crane and is expected for completion in March, 2019, it will not be expensed. However, liability has to be accounted for as follows:

Capital work-in-progress (spares) A/c	Dr.	Rs. 2.45 crore	
To Provision / Liability for spares (vendor) A/c			Rs. 2.45 crore

(b) As per para 7 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance", Government grants, including non-monetary grants, shall be recognised when there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

Here, as per the information given in the question, it is clear that the entitlement is more or less established though the submission of export benefit documents is pending. Looking over the substance of the transaction, it can be considered as there is a reasonable assurance for receiving the export benefit and also it can be measured reliably. Further, it is assumed that the entity will comply with the conditions attached to it. Hence, it shall be accounted (assuming that the benefit is received in cash), as follows:

Bank A/c	Dr.	Rs. 4.35 crore	
To Government Grant			Rs. 4.35 crore

(c) Since, as per the information given in the question, contractually all the payments statutorily required to be made to contract employees are to be borne by the company under the contractual terms entered into with the manpower service provider, the company has to account for the leave/gratuity liabilities in the reporting period ending on 31st March, 2018 for Rs. 2.44 crore. Here the relation is not exactly of employer and employee as they are contractual employees, such expense would be under the head "Other expense" as follows:

Other Expense A/c	Dr.	Rs. 2.44 crore	
To Provision for expense (gratuity/leave liabilities)			Rs. 2.44 crore

(d) Since from the question it can be inferred that the ESOP was in existence on the transition date and no accounting for its outstanding expense was done in the prior period, it will be considered as error and retrospective effect will be given through 'Retained Earnings'.

Retained Earnings A/c	Dr.	Rs. 1.46 crore	
To ESOP Outstanding A/c			Rs. 1.46 crore

(e) As per Ind AS 109, the amount of expected credit loss for doubtful receivables should be accounted for in the year ended on 31st March, 2018 for Rs. 1.20 crore. Also ECL provision shall be made on Retention Receivables also as they are financial asset of the company. So ECL provision on it of Rs. 0.75 crore shall also be made in the year ended on 31st March, 2018. Total provision to be made is of Rs. 1.95 crore.

(f) Contribution to the political party needs to be accounted for only if an obligation has arisen as at the balance sheet date. A mere commitment would not warranty an accounting for such provision. Hence, it shall not be provided for in the books as on 31st March, 2018.

(g) Foreign exchange payables are to be accounted on each reporting date on the basis of the spot rate only. Therefore, following correction entry shall be passed:

Forex loss A/c	Dr.	Rs. 0.23 crore	
To Foreign Exchange payables A/c			Rs. 0.23 crore

(h) Actualisations of estimate difference are period adjustments which shall be recognized in the Profit and Loss Account. Adjustment of the same in the Retained Earnings directly as on 1st April, 2017 is not correct. A reversal entry should be passed as follows:

Profit and Loss A/c	Dr.	Rs. 3.49 crore	
To Retained Earnings			Rs. 3.49 crore

Further, as per the accounting standard also the difference in estimate is not adjusted retrospectively.

(i) As per Ind AS 10, Proposed dividend shall not be included in the finance cost in the financial year 2017-2018, because generally it is declared after the reporting period. In the given case, the date of declaration of proposed dividend has not been given. It is assumed to be after the reporting date. With respect to dividend, evidence for its declaration does not exist at the end of the reporting period. Hence Rs. 1.2 crores should be accounted in the year 2018-2019.

(2.13)(a) According to section 177(6) of the Companies Act, 2013, the Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

As per section 177(7), the auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.

As per section 177(8), the Board's report under section 134(3) shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefor.

Thus, the Audit committee can refer the investigation related director to outside agency. Further, since the Board has not accepted the recommendation of the Audit Committee, the same shall be disclosed in Board's report under section 134(3) along with the reasons therefor.

(b) As per section 134 auditor and company secretary is required to check the compliance with financial statements and secretarial standards however, section does not specify anything about the directors compliance. So, dissent of one of the director on the approval of unaudited financial statements will not affect the approval by majority.

(c) As shareholders are the main stakeholders in a company, they have the right to inspect the accounts register and also the books of the firm and can ask questions about the same if they feel so.

(d) If there is difference between the various segment disclosures as per the business and as per the financial statements, the CEO may be asked for the explanation. Further, the same could be discussed with the auditors to obtain their views on compliance with the accounting standards and necessary changes be made, as required in order to ensure such inconsistency is avoided.

(e) As per section 134(3) of the Companies Act, 2013, there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made (i) by the auditor in his report; and (ii) by the company secretary in practice in his secretarial audit report.

Further, the presentation made by the statutory auditors to those charged with governance is not for reporting to general public/shareholders and cannot be shared as it is.

(f) According to section 134 (1) of the Companies Act, 2013, the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

The Company Secretary has to see the compliance of the provisions of the Companies Act, 2013.

Also, discussions with Divya should be held to understand the concerns and ensure the same are addressed wherever those are relevant to ensure appropriateness of the financial reporting. Where it involves matters of interpretation, hold discussions to share the views and back them with professional opinion so that the decisions taken by the Company are well thought through and is in compliance with laws and regulations.

(2.14) (a) As per Ind AS 109, diminution in the value of investment in subsidiary shall be routed through Profit and Loss and not adjusted against the reserves in the Balance sheet.

(b) According to proviso to section 123 (1):

"Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf:

Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves."

Hence, in the given case, the company cannot use the short- term borrowings from the bank for working capital purposes to pay the dividend.

(c) The amount of deposit repayable has to be transferred to the deposit reserve account and the same cannot be used by the company for any other purpose excepts repayment of deposits.

(d) As per the Companies Act, 2013, only accrual basis has to be followed for accounting of financial data. Hence providing Asset Retirement obligations on cash basis at actuals is not appropriate.

(e) As per the information given in the question, the company is adopting Ind AS. Therefore, it has to present its financial results on the basis of Ind AS only along with the corresponding Ind AS numbers for bench marking. Also comparatives should also be given as per Ind AS only. It cannot provide the financial results as per AS alongwith the Ind AS numbers.

Answer to Question 3

PART A

3.1 Option (B) : Yes for 100 %

3.2 Option (B) : Rs. 1137 lakhs

3.3 Option (C) : Rs. 123.22 lakhs

3.4 Option (D) : Rs. 273 lakhs

3.5 Option (C) : Rs. 25 lakhs

3.6 Option (B) :No

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

3.8 Option (B): No, it cannot be denied; else this would result in possible scope of making audit qualification for the auditors.

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

3.10 Option (B): No.

PART B

Answer 3.1

1. Clause (i) (b) of the CARO, 2016 requires "whether the fixed assets have been physically 0verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account."

   The Order requires the auditor to report whether the management" has verified the fixed assets at reasonable intervals. What constitutes "reasonable intervals" depends upon the circumstances of each case. The factors to be taken into consideration in this regard include the number of assets, the nature of assets, the relative value of assets, difficulty in verification, situation and geographical spread of the location of the assets, etc. The management may decide about the periodicity of physical verification of fixed assets considering the above factors. **While an annual verification may be reasonable, it may be impracticable to carry out the same in some cases. Even in such cases, the verification programme should be such that all assets are verified at least once in every three years.** Where verification of all assets is not made during the year, it will be necessary for the auditor to report that fact, but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.

   In the present case, assets have been physically verified by the management only in the ensuing year ending on 31-03-2018. No physical verification was carried out during the year ended on 31-03-2017. The auditor is required to report as per clause (i) (b) of para 3 of CARO 2016 on physical verification of fixed assets by the management at reasonable interval and about material discrepancies were noticed, if any subject to verification of the same before the issuance date of audit report

2. As per clause (xiii) of para 3 of CARO 2016, the auditor is required to report "whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;"

   Therefore, the duty of the auditor, under this clause is to report whether related party disclosures as required by relevant Accounting Standards (AS 18, as may be applicable) are disclosed in the financial statements.

   In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016 receipt of computers at free of cost from Parent Company which is transactions with the related party of which details have not been disclosed in the financial statements as required by the applicable accounting standard 18.

3. Clause (viii) requires an auditor to report "whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided)"

   Under this clause, the auditor is required to report whether the company has defaulted in repayment of loans or borrowings to a financial institution or bank or Government or dues to debenture holders. If the answer is in the affirmative, the auditor is also required to mention the period of default and the amount of default, lender wise. In the present case Rising Star Ltd. defaulted in repayment of loan to Chevy Chase Bank for 2 quarters and levied penalty interest amounting rupees 0.23 lakh. The auditor is required to report such default of repayment of loan taken from Chevy Chase bank in accordance with clause (viii) of para 3 of CARO 2016.

4. As per clause (xiii) of para 3 of CARO 2016, the auditor is required to report "whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;"

   In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016 receipt of long term borrowing from Parent Company which is transactions with the related party.

5. Clause (i) (c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.

   In the present case, the Company has office along with freehold land in Chandigarh. Though company has paid its purchase cost in full however, this property is pending to be registered in the name of the company i.e. title deed is not in the name of Company since 2008. Therefore, the auditor is required to report the same in accordance with clause (i)(c) of para 3 of CARO 2016.

6. As per clause (xiii) of para 3 of CARO 2016, the auditor is required to report "*whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;*"

   Therefore, the duty of the auditor, under this clause is to report (i) Whether all transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 ("Act"); (ii) Whether related party disclosures as required by relevant Accounting Standards (AS 18, as may be applicable) are disclosed in the financial statements.

   In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016, one of related party transaction amounting 3.25 lakhs per month i.e. in lieu of marketing services has been noticed of which amount Rs. 0.25 lakh per month is exceeding the arm's length price has not been disclosed highlighting the same as related party transactions as per AS 18.

7. As per clause (xiii) of para 3 of CARO 2016, the auditor is required to report "*whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;*"

   In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016 CFO of the company refused to provide the related party transaction of amounting rupees 47 lakh on the ground that same is perceived to be confidential and cannot be shared with auditors, is not in order.

8. Clause (x) requires. *whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.*

   In the instant case, a fraud has been identified in recruitment of employees by the HR Department wherein certain sums were alleged to have been taken as kickback from the company of amounting rupees approx. 12 lakh. The auditor is required to report on the same as per clause x of para 3 of CARO 2016.

Answer 3.2.

Material misstatements on the management prepared financial statements which could impact the true and fair view of the financial statements are :

1. No physical verification of the assets was carried out during the year ended on 31-03-2017. There are some discrepancies which are noticed only on physical verification of assets. So, discrepancies could remain unnoticed in the financial statements for want of physical verification of assets.

2. Pending accounting of penal interest of Rs. 0.23 lakh on default repayment of loan for 2 quarters from Chevy Chase Bank may lead to material misstatement impacting the true and fair view of the financial statements.

3. Difference between TDS as per books and TDS as per 26 AS may lead to material misstatement as there is overstatement of revenue by rupees 14.50 lakh and there is no valid explanation available for the difference amount.

4. As per AS 22, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised. Where deferred tax asset is recognised against unabsorbed depreciation or carry forward of losses under tax laws, it is recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

   In the present case, though management has informed that market conditions will be improved and company would be totally profitable in the next 3 years' time but as per CEO of the company there is no firm contract/projects that are available on the hand to demonstrate. As per facts given in case, virtual certainty lacking in view of AS 22, therefore recognisation of unabsorbed losses based on management assessment as deferred tax assets is not correct and will lead to material misstatement which could impact the true and fair view of the financial statements.

5. The company followed 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 is correct, however, they have provided depreciation using the rates stipulated for continuous process plant is not correct. As per Schedule II Computers does not fall in continuous process plant category. Further, computers are included as NESD in Part 2 of Schedule II, which is category of assets in respect of which no extra shift depreciation is permitted. Therefore, though computers are used for 24 hours i.e. triple shift but no extra shift depreciation is permitted on the same. In the instant case, the Company

has provided depreciation on computers which are used during all the 3 shifts using the rates stipulated for continuous process plant as per its accounting policy is incorrect and would be misleading resulting into material misstatement and hence impacting true and fair view.

6. As per AS 29 A provision is a liability which can be measured only by using a substantial degree of estimation. Further, a provision should be recognised when (a) an enterprise has a present obligation as a result of a past event;(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. In the instant case, Rising Star Limited should made the provision for Rs. 250 lakh for legal notice served by Right International Inc. for patent infringement claiming because as per legal opinion possibility of cash outflow is more than not under the existing legal framework. Therefore, non-provision of rupees 250 lakh may lead to material misstatement and impact true and fair view of financial statements.

7. Pursuant to the provisions of Section 124(5) of the Companies Act, 2013, dividend which remains unpaid or unclaimed for a period of seven years from the date of its transfer to unpaid dividend account is required to be transferred by the Company to Investor Education and Protection Fund (IEPF), established by the Central Government under the provisions of Section 125 of the Companies Act, 2013. The details of unpaid dividend amount should also be disclosed in accordance with the provisions given in the Companies Act, 2013. Rising Star Limited should also transfer the 38 lakh rupees which is unclaimed dividend pertaining to period beyond 7 years and which should be transferred to IEPF. Write back of unclaimed dividend to Statement of Profit & Loss under other income is not correct in view of provisions of the Companies Act, 2013. Therefore, financial statements will lead material misstatement and not present true and fair view.

8. As per AS 11 exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period. Thus, non-accounting of mark to market loss of rupees 13.74 lakhs on the outstanding forward contracts pertaining to highly probable transactions during the year will overstate the revenue which will be leading the material misstatements and not present true and fair view.

9. As per AS 15 on "Employee Benefits", gratuity benefit is a defined benefit obligation as per which actuarial valuation using the projected unit credit method, which recognizes each period of service as giving rise to additional unit of employee benefit entitlement. Thus, even though employee has not completed 5 years of service, liability for gratuity is to be accrued as and when service is rendered by the employees.

Answer 3.3

1. *As per AS 18 If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the prescribed details.* Receipt of free of cost Computers and long term borrowing (on no agreed terms and repayment of interest and principal) from the Parent Company need separate disclosure in financial statements as per AS 18. **Therefore, no proper disclosure for transactions with related party would be a disclosure deficiency having impact on the true and fair position of the company.**

2. The amount of restricted bank balances as at 1.4.2016 and 31.3.2017 was rupees 120 lakhs and the company does not believe the same as qualifying for disclosure under Cash and Cash Equivalents is not correct as prescribed in para 45 of Accounting Standard 3 "Cash Flow Statement", an enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it. Therefore, disclosure of restricted bank balances should be done in accordance with AS 3.

3. AS 29 states that a liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. Therefore, payment of rupees 1.22 lakhs under protest in lieu of certain disputed tax claim is required to be disclosed as Contingent Liability. Though Company believes that it has a fair chance and not provided for the same. Non-provision for disputed tax claim is not substitute of non-disclosure of such Current Liability. Therefore, non-disclosure of the same will be constituted as disclosure deficiency impacting true and fair view.

4. Though as per substance over form freehold land appearing in financial statements is correct however, non-registration of the same should be separately disclosed in notes to financial statements. Non-disclosure of the same in notes to accounts will be considered as disclosure deficiency that could impact the true and fair view of financial statements. Further, classification of above land should also be as Assets held for Sale in financial statements.

5. AS 5 states that when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Here the gain on sale of land is more than 5% of net -revenue. Hence, based on size and non-recurring nature of the transaction, it is opined that is shall be presented as an exceptional item. Therefore, separate disclosure as exceptional item is required for gain on sale of freehold land at Kurukshetra in financial statements as per AS 5.

6. *As per AS 18 If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the same.* **Therefore, no proper disclosure for transactions with related party would be a disclosure deficiency having impact on the true and fair position of the company.** In the present case, one of related party transaction amounting 3.25 lakhs per month i.e. in lieu of marketing services has been noticed of which amount Rs. 0.25 lakh per month is exceeding the arm's length price has not been disclosed highlighting the same as related party transactions as per AS 18.

7. Default in repayment of borrowing is required to be disclosed in the financial statements of the Company.

8. The amount of 0.25 lakhs paid to a network firm of the statutory auditor needs to be disclosed by way of a footnote as remuneration paid to a network firm of the statutory auditor.

Answer 3.4

As per SA 260, "Communication with Those Charged with Governance", the auditor shall communicate with those charged with governance:

(a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;

(b) Significant difficulties, if any, encountered during the audit;

(c) Unless all of those charged with governance are involved in managing the entity:

   i. Significant matters arising during the audit that were discussed, or subject to correspondence, with management; and

   ii. Written representations the auditor is requesting;

(d) Circumstances that affect the form and content of the auditor's report, if any; and

(e) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.

In the instant scenario, the auditor of Rising Star Limited is required to prepare a brief summary of following items to be reported to those in-charge of governance in accordance with SA 260 is as under:

1. The company followed 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 is correct, however, they have provided depreciation using the rates stipulated for continuous process plant is not correct. As per Schedule II Computers does not fall in continuous process plant category. Further, computers are included as NESD in Part 2 of Schedule II, which is category of assets in respect of which no extra shift depreciation is permitted. Therefore, though computers are used for 24 hours i.e. triple shift but no extra shift depreciation is permitted on the same.

2. The amount of restricted bank balances as at 1.4.2016 and 31.3.2017 was rupees 120 lakhs and the company does not believe the same as qualifying for disclosure under Cash and Cash Equivalents is not correct as prescribed in para 45 of Accounting Standard 3 "Cash Flow Statement", an enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it. Therefore, disclosure of restricted bank balances should be done in accordance with AS 3.

3. As per AS 18 If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the name of the transacting related party; a description of the relationship between the parties; a description of the nature of transactions; volume of the transactions either as an amount or as an appropriate proportion; any other elements of the related party transactions necessary for an understanding of the financial statements; the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and amounts written off or written back in the period in respect of debts due from or to related parties.

   (i) One of related party transaction amounting 3.25 lakhs per month i.e. in lieu of marketing services has been noticed of which amount Rs. 0.25 lakh per month is exceeding the arm's length price has not been disclosed highlighting the same as related party transactions as per AS 18.

   (ii) CFO of the company refused to provide the related party transaction of amounting rupees 47 lakh on the ground that same is perceived to be confidential and cannot be shared with auditors, is not in order.

   (iii) Receipt of free of cost Computers and long term borrowing (on no agreed terms and repayment of interest and principal) from the Parent Company need separate disclosure in financial statements as per AS 18.

4. Pursuant to the provisions of Section 124(5) of the Companies Act, 2013, dividend which remains unpaid or unclaimed for a period of seven years from the date of its transfer to unpaid dividend account is required to be transferred by the Company to Investor Education and Protection Fund (IEPF), established by the Central Government under the provisions of Section 125 of the Companies Act, 2013. The details of unpaid dividend amount should also be disclosed in accordance with the provisions given in the Companies Act, 2013. Rising Star Limited should also transfer the 38 lakh rupees which is unclaimed dividend pertaining to period beyond 7 years and which should be transferred to IEPF. Write back of unclaimed dividend to Statement of Profit & Loss under other income is not correct in view of provisions of the Companies Act, 2013.

5. As per AS 11 exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on

cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period. Thus, accounting of mark to market loss of rupees 13.74 lakhs on the outstanding forward contracts pertaining to highly probable transactions to be done on December 2018 on the basis of date of settlement is not in order as per Accounting Standard 11.

6. Para 12 of AS 5 states that when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Here the gain on sale of land is more than 5% of net -revenue. **Hence, based on size and non-recurring nature of the transaction, it is opined that is shall be presented as an exceptional item.**

   Further, as per para 75 of AS 10, the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognised. Gains should not be classified as revenue, as defined in AS 9, Revenue Recognition.

   Further, separate disclosure is required for gain on sale of freehold land at Kurukshetra in financial statements as per AS 5.

7. Though as per substance over form freehold land appearing in financial statements is correct however, non-registration of the same should be separately disclosed in notes to financial statements. Further such land should be classified as asset held for sale/disposal.

8. Denying for the related part details of Rs. 47 Lakhs is imposing limitation on scope of auditor in view of SA 705.

9. Overstatement of revenue by amounting rupees 14.50 lakhs due to difference in amount of TDS receivable as per books and the cumulative balance as per Form 26 AS.

10. As per AS 29 A provision is a liability which can be measured only by using a substantial degree of estimation and provision should be made when (a) an enterprise has a present obligation as a result of a past event;(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. In the instant case, Rising Star Limited should made the provision for Rs. 250 lakh for legal notice served by Right International Inc. for patent infringement claiming rupees because as per legal opinion possibility of cash outflow is more than not under the existing legal framework.

11 As per section 123 of the Companies Act, 2013, dividend cannot be declared or paid by a company for any financial year except (a)out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Section 123(2), or (b)out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in the manner aforementioned and remaining undistributed, or (c)out of the balances of profit mentioned in (a) and (b) above; or (d) out of money provided by the Central Government or a State Government for the payment of dividend by the company pursuant to the guarantee given by that Government. Therefore, putting forward a proposal to pay dividend to the shareholders notwithstanding the current financial condition which is in loss by CEO of the Company and his proposal to manage the cash flows by borrowing from the bank is not correct in view of section 123 of the Companies Act, 2013.

Answer 3.5

As per section 143 (3) (j) the auditor's report shall also state such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014. Rule 11 of CAAR prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely:-

(a) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

(b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

(c) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

(d) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30th December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company.

In the instant case, the auditor of Rising Star Limited is required to report the following matters as per Rule 11 of CAAR 2014:

(I) **"**whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;"

  (i) Rising Star Limited should disclosed the impact of payment made under protest against certain tax claims amounting rupees 1.22 lakhs.

  (ii) Legal notice served by Right International Inc. for patent infringement claiming rupees 250 lakhs.

(II) "whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;"

As per AS 11 exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period. Thus, as per Rule 11 of CAAR 2014 the auditor is also required to report on mark to market loss of rupees 13.74 lakhs on the outstanding forward contracts pertaining to highly probable transactions.

(III) "whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company."

Pursuant to the provisions of Section 124(5) of the Companies Act, 2013, dividend which remains unpaid or unclaimed for a period of seven years from the date of its transfer to unpaid dividend account is required to be transferred by the Company to Investor Education and Protection Fund (IEPF), established by the Central Government under the provisions of Section 125 of the Companies Act, 2013. The details of unpaid dividend amount should also be disclosed in accordance with the provisions given in the Companies Act, 2013. Rising Star Limited should also transfer the 38 lakh rupees which is unclaimed dividend pertaining to period beyond 7 years and which should be transferred to IEPF. Write back of unclaimed dividend to Statement of Profit & Loss under other income is not correct. The auditor is required to disclose this as per Rule 11 of CAAR 2014.

(IV) "whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30th December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company".

The auditor is also required to report as per Rule 11 of CAAR 2014 on disclosure in its financial statements with respect to holdings as well as dealing in specified bank notes during the prescribed period. The auditor is also required to ensure/ report on above specified bank notes that whether these are in accordance with the books of accounts maintained by the company.