Auditing and Corporate Governance PYQ 2020

Q1. What kind of opinion shall an auditor give when he/she is unable to obtain sufficient and appropriate audit evidence that the financial statements are free from material misstatement? Explain. Also discuss briefly the different types of modified reports.

Ans. When an auditor is unable to obtain sufficient and appropriate audit evidence to support the financial statements, they should issue a qualified or adverse opinion. The type of opinion issued will depend on the severity of the issue identified during the audit.

A qualified opinion means that the auditor found some issues with the financial statements, but these issues are not severe enough to require an adverse opinion. The auditor will explain the nature of the issue in the audit report.

An adverse opinion means that the financial statements are materially misstated and do not accurately represent the financial position of the company. This type of opinion is issued when the issue is severe enough to affect the overall financial statements.

A disclaimer of opinion is issued when the auditor is unable to obtain sufficient audit evidence due to a lack of access to the necessary records or information.

A report with an emphasis of matter is issued when there is a need to draw attention to a particular matter that is already disclosed in the financial statements. This type of report is issued when the auditor believes that the matter could affect the user's interpretation of the financial statements.

In conclusion, when an auditor is unable to obtain sufficient and appropriate audit evidence that the financial statements are free from material misstatement, they should issue a qualified or adverse opinion depending on the severity of the issue. Other types of reports include a disclaimer of opinion and a report with an emphasis of matter.

Q2. You are working as the manager at an electronics manufacturing company for the past few years. One day you notice that the financial manager is window dressing the financial statements and is tampering with the books of accounts. As a loyal employee of the company, you want to disclose this foul play to the seniors, but you realise that even the seniors are involved. What would you do in such a scenario? What is the act of exposing and making public wrongful acts of others called? Explain its concept, various types, pros and cons, and the legal provisions relating to it.

Ans2 If you notice that the financial manager is window dressing the financial statements and tampering with the books of accounts, it is your duty as a loyal employee of the company to disclose this information to the appropriate authorities. However, if you realize that even the seniors are involved, you should seek external assistance such as reporting to the external auditors, regulatory bodies, or law enforcement agencies. It is important to do this while protecting yourself from any potential retaliation.

The act of exposing and making public wrongful acts of others is called whistleblowing. Whistleblowing is the act of reporting unethical or illegal behavior to a higher authority or regulatory body. It is often done by employees, former employees, or other stakeholders who have information about a company's unethical or illegal practices.

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There are two types of whistleblowing: internal and external. Internal whistleblowing occurs when an employee reports unethical or illegal behavior to someone within the organization, such as a supervisor or human resources department. External whistleblowing occurs when an employee reports the behavior to an external authority, such as a regulatory agency, law enforcement, or the media.

Pros of whistleblowing include exposing wrongdoing and potentially stopping unethical or illegal behavior, promoting accountability, and protecting the public interest. However, whistleblowing also has some cons, such as the risk of retaliation from the company, including job loss, demotion, harassment, and blacklisting.

There are legal provisions that protect whistleblowers from retaliation. For example, in the United States, the Whistleblower Protection Act of 1989 protects federal employees who report misconduct from retaliation. Similarly, the Sarbanes-Oxley Act of 2002 provides protection for whistleblowers who report accounting fraud or securities violations.

In conclusion, if you notice any unethical or illegal behavior in your workplace, it is your duty to report it to the appropriate authorities. Whistleblowing is a way to expose wrongdoing and promote accountability, but it also has potential risks. It is important to be aware of legal protections and to take steps to protect yourself from retaliation.

Q3. 'One of the major operating expenses related to its line costs (the fees that it paid to its third party telecom network providers for the right to access their networks) was underreported, by capitalising it on the balance sheet rather than properly expensing it. This resulted in both an increased net income and increased assets.' Identify and explain the scam being referred to above, bringing out the flaws in corporate governance.

Ans 3 The scam being referred to above is known as capitalizing expenses. This is a fraudulent accounting practice where a company misrepresents its expenses as assets on the balance sheet, thereby understating expenses and overstating assets.

In this case, the company has capitalized its line costs, which are the fees paid to third-party telecom network providers for the right to access their networks, on the balance sheet instead of properly expensing them. By doing this, the company has understated its expenses and overstated its assets, leading to an increased net income.

The flaw in corporate governance in this case is that the company's management has engaged in fraudulent accounting practices to manipulate the financial statements, which is a violation of accounting standards and ethical principles. This misrepresentation of financial information can mislead investors, analysts, and other stakeholders, leading to incorrect decisions.

This scam also shows a lack of internal controls within the company. The management has been able to manipulate the financial statements without being detected by the internal audit team, external auditors, or the board of directors. This highlights the need for stronger internal controls, effective corporate governance, and independent oversight to prevent fraudulent activities.

In conclusion, capitalizing expenses is a fraudulent accounting practice that misrepresents expenses as assets on the balance sheet. This scam highlights the flaws in corporate governance, including a lack of internal controls, unethical behavior by management, and inadequate oversight by the board

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of directors. It is important for companies to have strong internal controls, independent oversight, and ethical leadership to prevent fraudulent accounting practices and protect the interests of stakeholders.

Q4.'The OECD code/principles cover the issues of corporate governance around international trade and global stock markets more comprehensively than the Cadbury code'. Discuss.

Ans4 The OECD (Organization for Economic Cooperation and Development) principles on corporate governance are a set of guidelines developed to promote good corporate governance practices globally. The Cadbury code, on the other hand, is a UK-specific code of best practice for corporate governance.

While both the OECD principles and the Cadbury code address issues of corporate governance, the OECD principles are more comprehensive in covering corporate governance issues related to international trade and global stock markets.

The OECD principles provide guidance on various aspects of corporate governance, such as the rights of shareholders, the role of the board of directors, transparency and disclosure, and the responsibilities of management. The principles are designed to be flexible and adaptable to different legal, economic, and cultural systems, making them applicable in different countries and regions.

The OECD principles also specifically address issues related to international trade and investment. For example, the principles recommend that companies should have policies and procedures in place to manage the risks associated with international business, including corruption, bribery, and money laundering. The principles also recommend that companies should respect the human rights of workers and communities in the countries where they operate.

In comparison, the Cadbury code primarily focuses on the UK corporate governance system and provides recommendations on the roles of the board of directors, audit committees, and remuneration committees. While it is relevant for companies operating in the UK, it may not be as comprehensive in addressing issues related to international trade and investment.

In conclusion, the OECD principles on corporate governance are more comprehensive in covering issues related to international trade and global stock markets than the Cadbury code. The OECD principles provide guidance on a wider range of corporate governance issues and are designed to be adaptable to different legal, economic, and cultural systems, making them applicable globally.

Q5.'A code of ethics make decision-making easier at all levels of an organization by reducing ambiguity and considerations of individual perspectives in ethical standards'. Discuss

Ans5 A code of ethics is a set of guidelines that outlines the values, principles, and standards of conduct that govern the behavior of individuals and organizations. Having a code of ethics in place can make decision-making easier at all levels of an organization by reducing ambiguity and individual perspectives in ethical standards.

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Firstly, a code of ethics provides clear guidance on what is considered acceptable behavior and what is not. This helps employees to understand what is expected of them and reduces the ambiguity in ethical decision-making. It provides a framework for decision-making, making it easier for employees to make ethical decisions in different situations.

Secondly, a code of ethics provides a common set of values and principles that all employees can agree upon. This reduces individual perspectives in ethical standards, which can vary depending on personal beliefs, cultural background, and other factors. By having a common set of values and principles, employees are more likely to make decisions that are consistent with the organization's overall ethical standards.

Thirdly, a code of ethics promotes accountability and transparency. By setting clear expectations and standards of conduct, employees are more likely to take responsibility for their actions and be held accountable for any unethical behavior. This promotes a culture of transparency, where employees are encouraged to report any unethical behavior they observe, knowing that they will be protected and that the organization takes ethics seriously.

In conclusion, a code of ethics is an essential tool for organizations to promote ethical behavior and decision-making. It reduces ambiguity in ethical decision-making, reduces individual perspectives in ethical standards, and promotes accountability and transparency. By providing clear guidance on what is considered acceptable behavior and what is not, a code of ethics can make decision-making easier at all levels of an organization and ensure that the organization operates in an ethical and responsible manner.

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Q6.Should a company spend money on CSR? An Indian listed public company has an annual turnover of Rs 2,500 crores in financial year 2019-20. Its net profits for the last three years were Rs. 205 crores, Rs. 190 crores, and Rs. 191 crores respectively. Make the CSR policy for this company.

Ans6 Yes, a company should spend money on CSR (Corporate Social Responsibility) as it is an important aspect of responsible business conduct. CSR is not only important for the social and environmental well-being of the community but also for the long-term success and sustainability of the company itself.

Given the financials of the Indian listed public company, with an annual turnover of Rs 2,500 crores and consistent net profits of around Rs 190-205 crores, the company has the financial capability to allocate a certain percentage of its profits towards CSR activities.

Here is a suggested CSR policy for the company:

1. Areas of Focus: The company can focus its CSR activities on areas such as education, healthcare, environmental sustainability, community development, and poverty alleviation, depending on the specific needs of the community in which it operates.

2. Budget Allocation: The company can allocate 2-3% of its net profits towards CSR activities. Based on the average net profits of Rs. 195 crores over the last three years, this would translate to an annual CSR budget of Rs. 4.5-5.85 crores.

3. CSR Activities: The company can undertake various CSR activities such as building schools, providing scholarships to students from low-income families, sponsoring healthcare camps,

supporting local NGOs working on community development, and implementing environmental sustainability initiatives.

4. Implementation and Monitoring: The company can establish a CSR committee to oversee the implementation of CSR activities and ensure that they align with the company's values and goals. The committee can also monitor the impact of these activities on the community and report on the same.

5. Collaboration and Partnerships: The company can collaborate with other organizations and stakeholders such as NGOs, government bodies, and local communities to leverage their expertise and resources for the effective implementation of CSR activities.

By implementing such a CSR policy, the company can not only contribute to the well-being of the community but also enhance its brand reputation and build long-term stakeholder trust and loyalty.

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