



CA RAVI AGARWAL'S

AUDIT COMPILER 2.0

FOR CA FINAL (NEW) MAY 2021 ONWARDS



MAIN HIGHLIGHTS

- ✓ Full Coverage of ICAI Study Mat
- ✓ Additional ICAI SM Dec 2020 Q's
- ✓ Includes New Illustrations
- ✓ All Past Papers
- ✓ All MTPs
- ✓ All RTPs (including Nov 2020)

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Standards on Auditing

SA 210 – Agreeing to the terms of audit engagement

1. RTP Nov 2019 Qn no 12

Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram.

What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement?

Answer

As per SA 210 “Agreeing the Terms of Audit Engagements”, in order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
 - (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - (iii) To provide the auditor with:
 - Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Further, if management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

In addition if the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

In the instant case, Mr. Ram should not accept the appointment as statutory auditor of XYZ Private Limited due to limitation imposed on his scope of work.

2. MTP-Apr-19 Qn No 5(a) 4 Marks:

AKJ Ltd. is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and have their corporate office in Delhi. Recently the company appointed new firm of Chartered Accountants as their statutory auditors. The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter?

Answer:

As per SA 210 Agreeing the Terms of Audit Engagements The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- (i) The objective and scope of the audit of the financial statements;
- (ii) The responsibilities of the auditor;
- (iii) The responsibilities of management;
- (iv) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- (v) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

3. May 2019 Qn no 2(c) 5 Marks

A professional accountant in public practice is always subject to various threats in compliance with fundamental principles of his profession and you, as a professional accountant, are worried about engagement specific threat in your audit assignment of M/s Soft Ltd. and want to implement some measures to eliminate and reduce the same. Enumerate some engagement specific safeguards which you may introduce in your work environment to ward off such threats.

Answer

Engagement-specific safeguards in the work environment may include:

- Involving an additional professional accountant to review the work done or otherwise advise as necessary.
- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- Involving another firm to perform or re-perform part of the engagement.
- Rotating senior assurance team personnel.

4.(RTP Nov'2020 Q No 13(a))

MEA Limited is a listed company having its operation across India. MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20. After making sure that all of them are qualified to be appointed as statutory auditor, MEA Limited issued engagement letter to all of them. But Mr. X was not clear on some points, so he requested MEA Limited to slightly change the terms of his engagement. This change will not impact the ultimate opinion on the financial statement. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor and identification of framework applicable. It also contains the reference to expected form and content of report from all three joint auditors. In your opinion what was the discrepancy in the Audit engagement letter issued by MEA Limited

Answer

Agreement on Audit Engagement Terms : As per SA 210, "Agreeing the Terms of Audit Engagements", the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

Subject to prescribed details under Law or Regulations, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- (i) The objective and scope of the audit of the financial statements;**

- (ii) The responsibilities of the auditor;
- (iii) The responsibilities of management;
- (iv) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- (v) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

In the given scenario, MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20 and issued engagement letter to all of them. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor, identification of framework applicable and reference to expected form and content of report from all three joint auditors. However, engagement letter issued by MEA Ltd. doesnot specify the responsibilities of management, whereas as per SA 210, it should also specify responsibilities of management

SA 220 - Quality Control for an Audit of Financial Statements

Multiple Choice Questions

1. MTP Apr 19 Qn no 19 (2 Marks)

Don't Pay for Fun (DPF) is a start-up who is trying to get funding from investors. One of the investor s has expressed interest in looking at the investment proposal but has insisted that the proposal also contain DPF's financial statements which are audited by an independent auditor. DPF engages CA Abhishek to conduct an independent audit and Abhishek issues an engagement letter for the independent audit to the owner of DPF which is duly acknowledged. DPF while finalising the financial statements is facing some difficulties so its owner requests Abhishek to provide advice as it needs to furnish the proposal to the investor fast. Since Abhishek is already engaged in the audit of the transactions, he assists DPF's accounting officer and the financial statements are finalised. Abhishek also completes the audit and presents the audit report which is provided to the investor. Has the condition set by the investor been fulfilled?

- a. No, the investor had asked for independent audit.
- b. Yes, as the audit report is issued after proper audit engagement letter and also examination of the books of accounts.
- c. No, because CA Abhishek did not change the terms of engagement to include the advice part alongwith the independent audit. In order for his audit report to be independent, he should have charged separate fees for the advice.
- d. Yes, DPF has hired a qualified CA to conduct the audit. Not only there is no evidence to suggest that the auditor allowed any misrepresentation, but

the auditor himself advised DPF in finalising the financial statements which speaks highly of the quality of financial statements.

Answer: Option (a) No, the investor had asked for independent audit.

2. MTP Oct 2019 Qn no 19 (2 Marks)

One of your audit client Vernon Co with a year ending 31 March 2019 is planning to prepare the financial statements from the next year as per Indian Accounting Standards (Ind AS). The finance director of Vernon Co has contacted the audit engagement partner, asking if your firm can provide training on Ind AS to the accounts department of the entity. This will help them to understand all the provisions of Ind AS and the transition process will be easier.

Which of the following options needs to be considered by the audit engagement partner?

- (a) The issue is whether there is a self-interest threat, as the auditor will receive separate training fees for the service provided. The audit partner should decline the training assignment.
- (b) The issue is whether the audit firm would be likely to possess the requisite competence to provide such training to the staff of the entity. The audit partner should decline not all the qualified people are good trainers.
- (c) The audit partner could go ahead with the training service and disclose the fact in its audit report about the service provided during the period. This will safeguard and reduce the threat to an acceptable level.
- (d) The audit partner needs to assess the materiality of the figure, and the degree of subjectivity involved. If it considers that safeguards like using separate personnel, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the training assignment.

Answer: (d) The audit partner needs to assess the materiality of the figure, and the degree of subjectivity involved. If it considers that safeguards like using separate personnel, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the training assignment.

3. RTP Nov 2019 Qn no 7 and Study Material

VKPL & Associates, a firm of Chartered Accountants, have been operating for the last 5 years having its office in Gurgaon. The firm has staff of around 25 persons with 3 Partners.

The firm has been offering statutory audit, risk advisory and tax services to its various clients. The major work of the firm is for taxation services. The audit partners also discussed that the firm needs to work significantly to improve the quality of the services they offer and that would also help the firm to grow its business. Considering this objective, the firm started training programmes for the

staff which were made mandatory to be attended.

During one of the training programmes on quality, a topic was discussed regarding the information that should be obtained by the firm before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. It was explained that the following points may assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate (as per SA 220):

- (i) The integrity of the principal owners, key management and those charged with governance of the entity;
- (ii) The qualification of all the employees of the entity;
- (iii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- (iv) The remuneration offered by the entity to its various consultants;
- (v) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (vi) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

We would like to understand from you which of the above mentioned points are relevant for the topic under discussion or not?

- (a) i, ii, iv and v.
- (b) ii, iv, v and vi.
- (c) iii, iv, v and vi.
- (d) i, iii, v and vi.

Answer: Option D

4. MTP Mar 2019 Qn no 18 (2 Marks)

You are a manager in the audit department of Narang & Co, and you are dealing with several ethical and professional matters raised at recent management meetings, all of which relate to audit clients of your firm:

One of your client Bernwood Co has a year ending 31 March 2018. During this year, the company established a pension plan for its employees, and this year end the company will be recognising for the first time a pension deficit on the balance sheet, in accordance with Ind AS 19 Employee Benefits. The finance director of Bernwood Co has contacted the audit engagement partner, asking if your firm can provide an actuarial valuation service in respect of the amount recognised.

Which of the following options need to be considered by the audit engagement

partner?

- (a) The issue is whether there is a self-review threat, as the valuation of the amount recognised would be recorded in the financial statements. The audit partner should decline the work of valuation service.
- (b) The issue is whether the audit firm would be likely to possess the requisite competence to provide such a valuation service. The audit partner should decline since not professionally qualified to provide the valuation service.
- (c) Narang & Co. needs to assess the materiality of the figure, and the degree of subjectivity involved. If it considers that safeguards like using separate personnel, performing a second partner review, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the valuation service.
- (d) The audit partner could go ahead with the valuation service and disclose the fact in its audit report about the service provided during the period. This will safeguard and reduce the threat to an acceptable level.

Answer: (c) Narang & Co. needs to assess the materiality of the figure, and the degree of subjectivity involved. If it considers that safeguards like using separate personnel, performing a second partner review, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the valuation service.

Descriptive Questions

MTP Apr 18 Qn no.1(a) 5 Marks

1. Rishikumar & Co. has been appointed as an auditor of PK Ltd. for the financial year 2016 -17. CA. Kumar, one of the partners of M/s Rishikumar & Co., completed entire routine audit work by 29th May, 2017. Unfortunately, on the very next morning, while roving towards office of PK Ltd. to sign final audit report, he met with a road accident and died. CA. Rishi, another partner of M/s Rishikumar & Co., therefore, signed the accounts of PK Ltd., without reviewing the work performed by CA. Kumar. Advise, whether CA. Rishi is right in expressing an opinion on financial statements the audit of which is performed by another auditor.

Answer

Relying on Work Performed by Another Auditor: As per SA 220 "Quality Control for an Audit of Financial Statements", an engagement partner taking over an audit during the engagement may apply the review procedures such as the work has been performed in accordance with professional standards and regulatory and legal requirements; significant matters have been raised for further consideration;

appropriate consultations have taken place and the resulting conclusions have been documented and implemented; there is a need to revise the nature, timing and extent of work performed; the work performed supports the conclusions reached and is appropriately documented; the evidence obtained is sufficient and appropriate to support the auditor's report; and the objectives of the engagement procedures have been achieved.

Further, one of the basic principles, which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried, is that when the auditor delegates work to assistants or uses work performed by other

auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. This is the fundamental principle which is ethically required as per Code of Ethics.

However, the auditor should carefully direct, supervise and review work delegated. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.

In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA. Kumar. However, the report could not be signed by him due to his unfortunate death. Later on, CA. Rishi signed the report relying on the work performed by CA. Kumar. Here, CA. Rishi is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA. Kumar provided he further exercises adequate skill and due care and review the work performed by him as required in compliance with SA 220.

2.MTP-OCT-18 Qn No 1(a) 5 Marks:

OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Engagement partner had completed his reviews in entirety by May 10, 2018. Comment.

Answer:

Review by Engagement Partner: As per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. For audits of financial statements of listed entities, the engagement partner shall:

- Determine that an engagement quality control reviewer has been appointed;
- Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- Not date the auditor's report until the completion of the engagement quality control review. SA 700, "Forming an Opinion and Reporting on Financial Statements", requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities

where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

In the instant case, OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018.

Thus, in the given case, signing of auditor's report i.e. on May 12, 2018 which is before the completion of review engagement quality control review i.e. May 15, 2018, is not in order.

3. RTP May 2019 Qn no 11(C), MTP-OCT-19 Qn No 6(c) 4 Marks:

During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220. (ALSO IN STUDY MAT)

Answer

As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

- Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if

considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

SQC 1 – Quality Control of Firms that perform audit and reviews historical information and other assurance related service engagements

1. RTP May 2019 Qn no 11(b)

BSS & Associates is a partnership firm of Chartered Accountants which was established five years back. The firm was offering only advisory services at the beginning, however, after audit rotation and advent of GST, firm sees lot of potential in these areas also and started looking for opportunities in these areas also. These services being assurance in nature, the firm required some internal restructuring and set up some policies and procedures for compliance year on year.

The firm started getting new clients for these new services and is now looking to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it has been setting up a process to document how the issues were resolved.

The firm is now looking to work with only select clients which are in line with the policies of the firm. The firm understands that the extent of knowledge it will have regarding the integrity of a client will grow within the context of an ongoing relationship with that client. With regard to the integrity of a client, you are required to give some examples of the matters to be considered by the firm as per the requirements of SQC 1.

Nov 2019 Qn no 1(C) 4 Marks

MB & Associates is a partnership firm of Chartered Accountants which was

established seven years back. The firm is getting new clients and has also, been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1

Answer

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

With regard to the integrity of a client, matters that the firm considers include, for example:

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

SA 230 -Audit Documentation

Multiple Choice Questions

1. RTP May 2019 Qn no 2

Ram & Shyam Co LLP is an old firm of Chartered Accountants with Ram and Shyam as the audit partners. The firm has various statutory audit and internal audit engagements which are looked after by Ram and Shyam respectively. In the previous year ended 31 March 2018, one of the audit engagements of the firm was picked up for peer review and peer reviewer raised various observations regarding the audit documentation. Some of the information regarding audits were missing from the audit files as per the observation of the peer reviewer.

Ram & Shyam are in the process of establishing a robust mechanism for audit documentation so that the same is available for a long duration and would lead to audit efficiencies also in the future years. Ram and Shyam would like to understand the period for which audit documentation should be maintained by them as per the Standard on Auditing 230. Please advise.

- a. 10 years.
- b. 9 years.
- c. 8 years.
- d. 7 years.

Answer: Option D

Descriptive Questions

1. RTP May 2020 Qn no 11(C)

Mr. PM, a practising Chartered Accountant, has been appointed as an auditor of Truth Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit?

ANSWER:

Factors Influencing the amount of Working Papers: As per SA 230 "Audit Documentation", which refers to the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached, the amount of audit working papers depend on factors such as-

- (i) The size and complexity of the entity.
- (ii) The nature of the audit procedures to be performed.
- (iii) The identified risks of material misstatement.
- (iv) The significance of the audit evidence obtained.
- (v) The nature and extent of exceptions identified.

- (vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- (vii) The audit methodology and tools used.
- (viii) Timely preparation of Audit Documentation.

SA240 -The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Descriptive Questions

1. RTP Nov 2019 QN no 2(b)

M/s Innocent Limited has entered into a transaction on 25th February, 2018, near year-end, whereby it has agreed to pay ` 5 lakhs per month to Mr. Yuvraj as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but ` 60 lakhs is provided in books of account as on March 31, 2018.

Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Innocent Limited, what would be your approach?

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

Keeping in view the above, it is clear that Company has passed fictitious journal entries near year end to manipulate the operating results. Also Auditor's enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable.

Accordingly, the auditor would adopt the following approach-

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and

- (iii) If the auditor withdraws:
- (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ` 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ` 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2020, 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.

2. MTP-OCT-19 Qn No 6(a) 5 Marks:

Mr. Shah is reviewing the anti-fraud controls for a construction company. The company has witnessed a few frauds in the past mainly in the nature of material stolen from the sites and fake expense vouchers.

Mr. Shah is evaluating options for verifying the process in detecting fraud and the corrective action to be taken in such cases. As an expert, you are required to advise Mr. Shah as how inventory fraud occurs and the verification procedure to be followed for detecting the same.

Answer:

Inventory frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

- (i) Employees may simply remove goods from the premises.
- (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
- (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (a) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (b) availability of sufficient data from which such a record can be constructed.

The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent.

The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

Study Material

3. In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'N'.

Auditor's Responsibilities Relating to Fraud: As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

As per SA 580 "Written Representations", if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.

In the instant case, the auditor observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

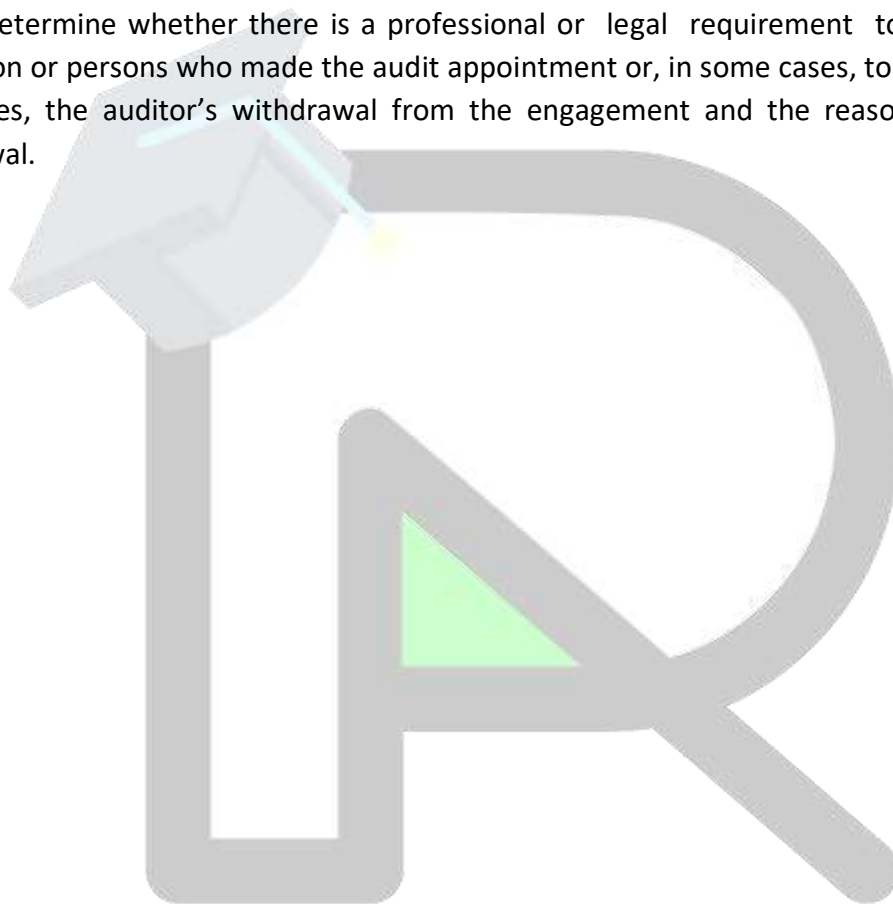
It may be noted that, if management does not provide one or more of the requested written representations, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ` 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ` 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2020, 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.

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- (iii) If the auditor withdraws:
 - (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.



SA 250 -Consideration of laws and regulations in an audit of financial statements.

Multiple Choice Questions

1. MTP Mar 2019 Qn no 17 (2 Marks)

KJA Ltd is in the business of consultancy services. The business of the company has been growing significantly and considering the nature of business, it becomes subject to various laws and regulations. Compliances have also increased because of this and management has found this very difficult to keep in pace with the changing regulatory requirements. The statutory auditors of the company, Shilpa & Associates, have considered compliance with laws and regulations as a significant risk for the purpose of their audit.

Auditors had a audit planning meeting with the management and management has understood that it will be their responsibility including those charged with governance to ensure that the company's operations are fully compliant with the provisions of various laws and regulations. This may also have an impact on the reported amounts and disclosures in the financial statements of the company.

Management is planning to ensure full compliance and may implement policies and procedures, wherever required, to assist in the prevention and detection of non-compliance with laws and regulations. Please suggest among the following which one will not be a policy/ procedure to be implemented to assist in the prevention and detection of non-compliance with laws and regulations in accordance with SA 250?

- (e) Maintaining a register of significant transactions of the company with comparison to particular industry and a record of complaints.
- (f) Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- (g) Developing, publicising and following a code of conduct.
- (h) Instituting and operating appropriate systems of internal control.

Answer: (a) Maintaining a register of significant transactions of the company with comparison to particular industry and a record of complaints.

Descriptive Questions

1. May 2018 -4(b)-4 Marks

As an Auditor of TRP Ltd., you are suspicious that there might be non-compliance with laws and regulations to which the Company is subject to. Indicate the possible areas or aspects where you may have to look out for forming an opinion as to whether your suspicion has some basis to further inquire.

Answer:

Indications of Non-Compliance with Laws and Regulations: When the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations, possible areas or aspects to look out for forming an opinion are:

- Investigations by regulatory organisations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- Unusual payments towards legal and retainership fees.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorised transactions or improperly recorded transactions.
- Adverse media comment.

2. MAY 2018 RTP Qn no. 1(d)

While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.

ANSWER

Compliance with Other Laws: As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

Further, non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be

provided for in the financial statements, but are not considered to have a direct effect on the financial statements.

In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement.

Study Material

3. R & M Co. wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS Ltd. R & M Co. seeks your guidance for identifying the indications of non-compliance with Laws and Regulations

As per SA 250, "Consideration of Laws and Regulations, the auditor shall perform the audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements by inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and Inspecting correspondence, if any, with the relevant licensing or regulatory authorities. However, when the auditor becomes aware of the existence of, or information about, the following matters, it may also be an indication of non-compliance with laws and regulations:

- Investigations by regulatory organisations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- Unusual payments towards legal and retainership fees.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.

- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorised transactions or improperly recorded transactions.
- Adverse media comment

SA 265 -Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management

Descriptive Questions

1. RTP May 2020 Qn no 12(b), MTP-OCT-18 Qn No 5(e) 4 Marks:

During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

RTP Nov 18 Qn no 4

During the course of audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and
- (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
- (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

SA 299 - Joint Auditors

Descriptive Questions

1. MTP-Apr-19 Qn No 1(a) 5 Marks:

NMN & Co LLP and ABC & Associates LLP are the joint statutory auditors of BHS Ltd. BHS Ltd. is a listed company and has been in existence for the last 50 years. Since beginning this company was audited by MQS & Associates but due to audit rotation, the company had to bring in new auditors. Considering the size of the company, two auditors were appointed as joint auditors. Since the company is new to these auditors and the concept of joint auditors to whom audit work has been divided, management had a discussion and understood that each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. Advise.

Answer:

SA 299 “Joint Audit of Financial Statements” deals with the professional responsibilities which the auditors undertake in accepting appointments as joint auditors. The joint auditors are required to issue common audit report, however, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.

A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s)

shall make a reference to the separate audit report(s) issued by the other joint auditor(s). Further, separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading “Other Matter **Paragraph**” as per SA 706, “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report”.

Each joint auditor is entitled to assume that:

- The other joint auditors have carried out their part of the audit work and the work has actually been performed in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. It is not necessary for a joint auditor to review the work

performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.

- The other joint auditors have brought to said joint auditor’s notice any departure from applicable financial reporting framework or significant observations that are relevant to their responsibilities noticed in the course of the audit.

Where financial statements of a division/branch are audited by one of the joint auditors, the other joint auditors are entitled to proceed on the basis that such financial statements comply with all the legal and regulatory requirements and present a true and fair view of the state of affairs and of the results of operations of the division/branch concerned.

Before finalizing their audit report, the joint auditors shall discuss and communicate with each other their respective conclusions that would form the content of the audit report.

2. May 2019 Qn no 1(b) 5 Marks

Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March, 2019.

In the course of audit, it has been observed that there is a major understatement in the value of inventory. The inventory valuation work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors.

Comment on the above situation with regard to responsibilities among joint auditors.

Answer

Responsibility and Co-ordination among Joint Auditors: As per SA 299, “Joint Audit of Financial Statements”, where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of the work

would usually be in terms of audit identifiable units or specified area. In some cases due to the nature of the business entity under audit, such a division of the work may not be possible. In such situations, the division of the work may be with reference to items of assets or liabilities or income or expenditure or with reference to period of time. The division of the work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

In respect of the audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate audit of the work performed by him. On the other hand all the joint auditors are jointly and severally responsible –

- (i) The audit work which is not divided among the joint auditors and is carried out by all joint auditors;
- (ii) Decisions taken by all the joint auditors under audit planning phase concerning the nature, timing and extent of the audit procedure to be performed by each of the auditor;
- (iii) Matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (iv) Examining that the financial statements of the entity comply with the requirements of the relevant statute;
- (v) Presentation and disclosure of financial statements as required by the applicable financial reporting framework;
- (vi) Ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI;

The joint auditors shall also discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas of audit to be performed by each of the joint auditors and the same shall be communicated to those charged with governance. After identification and allocation of work among the joint auditors, the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.

Hence, in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures.

In the instant case. Dice Ltd. appointed two CA Firms MN & Associates and PQ & Co. as joint auditor for conducting audit. As observed during the course of audit that there is a major understatement in the value of inventory and the inventory valuation work was looked after by MN & Associates.

In view of SA 299 MN & Associate will be held responsible for the same as inventory valuation work was looked after by MN & Associates only. Further, there is violation of SA 299 as the division of work has not been documented.

Study Material

3. KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2018-19. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr.

Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

- (a) You are required to briefly explain the responsibilities of auditors when they are jointly and severally responsible in respect of audit conducted by them and also guide Mr. Z in such situation.**
- (b) Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.**

Answer

(a) Difference of Opinion Among Joint Auditors: SA 299 on, "Joint Audit of Financial Statements" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

- (i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;**
- (ii) in respect of decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors;**
- (iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;**
- (iv) for examining that the financial statements of the entity comply with the requirements of the relevant statute;**
- (v) for ensuring presentation and disclosure of the financial statements as required by**

the applicable financial reporting framework;

- (vi) for ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.
- (vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;
- (vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;
- (viii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Where, in the course of the audit, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

Normally, the joint auditors are required to issue common audit report, however, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s). Further, separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading "Other Matter Paragraph" as per Revised SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

In the instant case, there are three auditors, namely, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd. For the valuation of gratuity scheme of the Company they referred their own known Actuaries. Mr. Z (one of the joint auditor) is not satisfied with the report submitted by Mr. Y's referred actuary. He is not agreed with the matters to be covered by the report whereas Mr. X agreed with the same.

Hence, as per SA 299, Mr. Z is suggested to express his own opinion through a separate report whereas Mr. X and Mr. Y may provide their joint report for the same.

(b) Using the work of an Auditor's Expert: As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial

calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert.

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on found faulty. Further, Mr. Z is not agreed with this report therefore he submitted a separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

Mr. X and Mr. Y will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.

SA 315 - Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Descriptive Questions

1. Nov 18 Qn no 6(a) 4 Marks

The identified risks are assessed by Auditor as to its significance on account of its likely impact, by way of material misstatement appearing in financial statements or by affecting internal control system. What may be the points of indication that may direct the Auditor to judge that the risks identified may be significant?

Answer

Points of Indication that may direct the Auditor to Judge that the Risks Identified may be Significant: As per SA 315“Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment”, as part of the risk assessment the auditor shall determine whether any of the risks identified are, in the auditor’s judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- Whether the risk is a risk of fraud;
- Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- The complexity of transactions;
- Whether the risk involves significant transactions with related parties;
- The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity’s controls, including control activities, relevant to that risk.

2. MTP-Apr-19 Qn No 4(a) 5 Marks:

Compute the overall Audit Risk if looking to the nature of business there are chances that 40% bills of services provided would be defalcated, inquiring on the same matter management has assured that internal control can prevent such defalcation to 75%. At his part the Auditor assesses that the procedure he could apply in the remaining time to complete Audit gives him satisfaction level of detection of frauds & error to an extent of 60%. Analyse the Risk of Material Misstatement and find out the overall Audit Risk.

Answer:

According to SA-200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, the Audit Risk is a risk that Auditor will issue an inappropriate opinion while Financial Statements are materially misstated.

Audit Risk, has two components: Risk of material Misstatement and Detection Risk. The relationship can be defined as follows.

$$\text{Audit Risk} = \text{Risk of material Misstatement} \times \text{Detection}$$

Risk of material Misstatement: - Risk of Material Misstatement is anticipated risk that a material Misstatement may exist in Financial Statement before start of the Audit. It has two components Inherent risk and Control risk. The relationship can be defined as

$$\text{Risk of material Misstatement} = \text{Inherent risk} \times \text{control}$$

Inherent risk: it is a susceptibility of an assertion about account balance; class of transaction, disclosure towards misstatements which may be either individually or collectively with other Misstatement becomes material before considering any related internal control which is 40% in the given case.

Control risk: it is a risk that there may be chances of material Misstatement even if there is a control applied by the management and it has prevented defalcation to 75%.

Hence, control risk is 25% (100%-75%)

Risk of material Misstatement: Inherent risk X control risk i.e. 40% X 25 % = 10%

Chances of material Misstatement are reduced to 10% by the internal control applied by management.

Detection risk: It is a risk that a material Misstatement remained undetected even if all Audit procedures applied, Detection Risk is 100-60 = 40%

In the given case, overall Audit Risk can be reduced up to 4% as follows: Audit Risk: Risk of Material Misstatement X Detection Risk = 10X.

SA 320- Materiality in Planning and Performing an Audit

Descriptive Questions

3. May 2018-1(c) – 5 Marks, MTP-Apr-19 Qn No 2(c) 5 Marks:

Y & Co., Chartered Accountants have come across in the course of audit of a company that certain machinery had been imported for production of new product. Although the Auditors have applied the concept of materiality for the Financial Statements as a whole, they now want to re-evaluate the materiality concept for this transaction involving foreign exchange. Give your views in this regard?

Answer:

Re-evaluation of the Materiality Concept: In the instant case, Y & Co., as an auditor has applied the concept of materiality for the financial statements as a whole. But they want to re-evaluate the materiality concept on the basis of additional information of import of machinery for production of new product which draws attention to a particular aspect of the company's business.

As per SA 320 "Materiality in Planning and Performing an Audit", while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for

which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Y & Co. can re-evaluate the materiality concepts after considering the necessity of such revision.

4. MTP-Aug-18 Qn No 2(d) 5 Marks:

Mr. X was appointed as the auditor of M/s Easygo Ltd. and intends to apply the concept of materiality for the financial statements as a whole. Please guide him as to the factors that may affect the identification of an appropriate benchmark for this purpose.

Answer:

SA 320 “Materiality in Planning and Performing an Audit” prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- (i) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- (ii) Whether there are items on which the attention of the users of the particular entity’s financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- (iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- (iv) The entity’s ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity’s earnings); and

- (v) The relative volatility of the benchmark.

Study Material

5. As an auditor of RST Ltd. Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please, guide him.

Answer

Re-evaluation of the Materiality Concept: In the instant case, Mr. P, as an auditor of RST Ltd. has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept on the basis of additional information of significant contractual arrangements which draws attention to a particular aspect of the company's business.

As per SA 320 "Materiality in Planning and Performing an Audit", while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Mr. P can re-evaluate the materiality concepts after considering the necessity of such revision.

SA 330 – The Auditor's Responses to Assessed Risks

Multiple Choice Questions

1. RTP May 2019 Qn no 3,

1. KJA Ltd is in the business of manufacturing of tiles and sanitaryware. The company has a large inventory every year. Annual turnover of the company is INR 3000 crores. The company has 7 plants across India. The management of the company carries out physical verification of inventory every year at the time of reporting date. During the year ended 31 March 2018, it was found by the management that the inventory sheets of 31 March 2017 did not include five s containing details of inventory worth INR 24.5 crores. Management has included this inventory in the valuation of inventory as of 31 March 2018. Management has also explained that considering the size of the company this may happen at times as the inventory is huge and lying at various locations. Moreover, the amount of the inventory is insignificant if considered as a percentage of revenue or inventory. State how you will deal with this matter as an auditor in the accounts of the company (towards substantive audit procedures and excluding the impact on auditor's assessment under Internal Financial Control Framework) for the year ended 31 March 2018.
 - a. Since the matter is not relevant/ material to current period figures, no reporting in respect of this matter would be required in the auditors report for the year ended 31 March 2018.
 - b. Management should restate the financials to adjust the error. Otherwise auditor may modify his opinion on current year's financial statements considering the materiality.
 - c. Considering the matter is not relevant/ material to current period figures, the management may include a note in the financial statements and basis that no reporting in respect of this matter would be required in the auditors report for the year ended 31 March 2018.
 - d. Include an emphasis of matter because of the effects or possible effects of the error in the auditors report for the year ended 31 March 2018.

Answer: Option B

Descriptive Questions

1. RTP Nov 18 Qn no. 1(a), MTP-Oct-19 Qn No 2(a) 4 Marks:

In the course of audit of ZED Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.

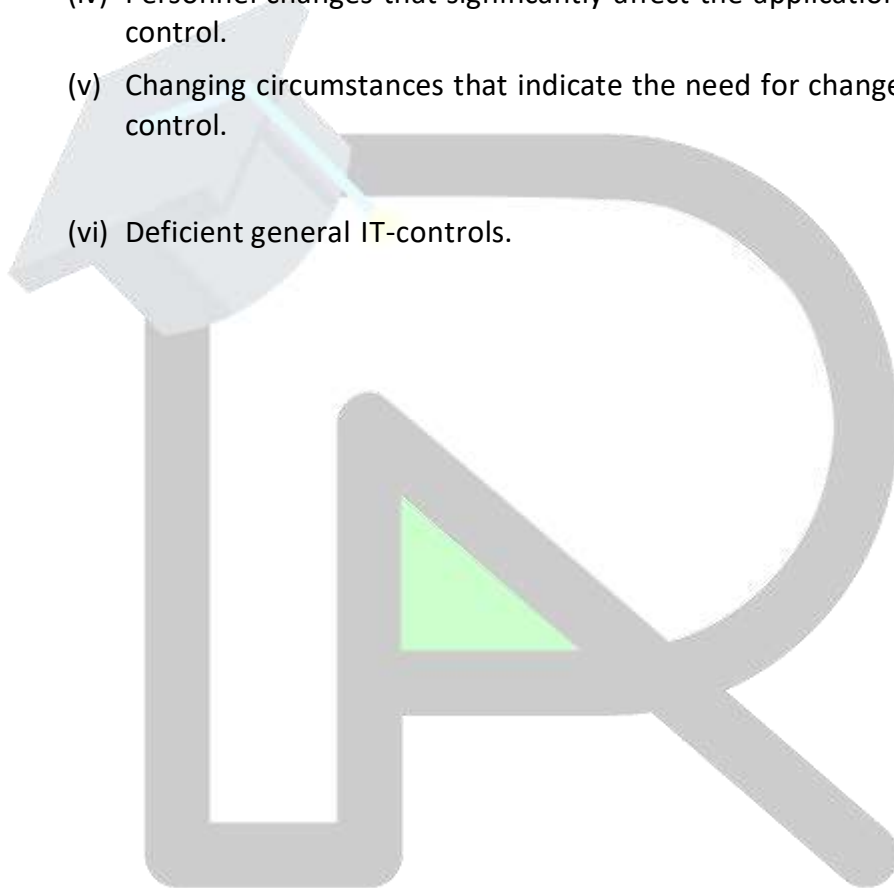
Answer

As per SA 330 on “The Auditor’s Responses to Assessed Risks”, changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor’s decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.

Factors that may warrant a re-test of controls are-

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT-controls.



SA 402 - Audit Considerations Relating to an Entity Using a Service Organisation

Descriptive Questions

1. MTP-Oct-19 Qn No 1(a) 4 Marks:

RTP Nov 18 Qn no.2(a)

JIO Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of JIO Ltd. as to how he can obtain an understanding of how JIO Ltd. uses the services of the outsourced agency in its operations.

MTP-OCT-18 Qn No 6(a) 4 Marks:

Ganpati Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of Ganpati Ltd. as to how he can obtain an understanding of how Ganpati Ltd. uses the services of the outsourced agency in its operations.

ANSWER

As per SA 402 on “Audit Considerations Relating to an Entity Using a Service Organisation”, when obtaining an understanding of the user entity in accordance with SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment”, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity’s operations, including:

- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity’s internal control;
- (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
- (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and

- (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

2.RTP Nov 2020 Q No 13 (b)

ENN Limited is availing the services of APP Private Limited for its payroll operations. Payroll cost accounts for 65% of total cost for ENN Limited. APP Limited has provided

the type 2 report as specified under SA 402 for its description, design and operating effectiveness of control.

APP Private Limited has also outsourced a material part of payroll operation M/s SMP & Associates in such a way that M/s SMP & Associates is sub-service organization to ENN Limited. The Type 2 report which was provided by APP Private Limited was based on carve-out method as specified under SA 402.

CA Raman while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA Raman hence asked his assistant to remove such reference and modify report accordingly. Comment whether CA Raman is correct in removing the reference of the work done by service auditor?

Answer

Reporting by the User Auditor: As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation", the user auditor shall modify the opinion in the user auditor's report in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organisation relevant to the audit of the user entity's financial statements.

The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion.

Thus, in view of above, contention of CA. Raman in removing reference of the work done by service auditor is in order as in case of unmodified audit report, user auditor cannot refer to the work done by service auditor.

Study Material

2. When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls. The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization?

Answer

Controls at a Sub-Service Organisation: In accordance with SA 402 "Audit Considerations relating to an Entity Using a Service Organisation", a user entity may use a service organisation that in turn uses a sub-service organisation to provide some of the services provided to a user entity that are part of the user entity's information system relevant to financial reporting. The sub-service organisation may be a separate entity from the service organisation or may be related to the service organisation.

A user auditor may need to consider controls at the sub-service organisation. In situations where one or more sub-service organisations are used, the interaction between the activities of the user entity and those of the service organisation is

expanded to include the interaction between the user entity, the service organisation and the sub-service organisations. The degree of this interaction, as well as the nature and materiality of the transactions processed by the service organisation and the sub-service organisations are the most important factors for the user auditor to consider in determining the significance of the service organisation's and sub-service organisation's controls to the user entity's controls.

Further, the user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding by application of the following two methods of presenting description of internal controls i.e. (i) Type 1 report; or (ii) Type 2 report. If a service organisation uses a subservice organisation, the service auditor's report may either include or exclude the subservice organisation's relevant control objectives and

related controls in the service organisation's description of its system and in the scope of the service auditor's engagement. These two methods of reporting are known as the inclusive method and the carve-out method respectively.

In either method, the service organisation includes in its description of controls a description of the functions and nature of the processing performed by the sub-service organisation.

If the Type 1 or Type 2 report excludes the control at a subservice organization and the services provided by the subservice organization are relevant to the audit of the user entity's financial statements, the user auditor is required to apply the requirements of the SA 402 in respect of the subservice organization.

The nature and extent of work to be performed by the user auditor regarding the services provided by a subservice organization depend on the nature and significance of those services to the user entity and relevance of those services to the audit.

SA 450-Evaluation of Misstatements identified during the audit

Descriptive Questions

1.RTP Nov 18 Qn no. 1(b)

In audit plan for TELCO Ltd, as the audit partner you want to highlight the sources of misstatements arising from other than fraud to your audit team and caution them. Identify the sources of misstatements.

Answer According to SA 450 “Evaluation of Misstatements identified during the Audit”, the following are the sources of misstatements arising from other than fraud -

- (i) An inaccuracy in gathering or processing data from which the financial statements are prepared;
- (ii) An omission of an amount or disclosure;
- (iii) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and

Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate

SA – 500 Audit Evidence

Multiple Choice Questions

1. MTP Mar 2019 Qn no.19 (2 Marks)

You are an audit senior at Ghaisas & Co and are currently performing the final audit of Bingham Co. for the year ended 31 March 2018. The company is a manufacturer and retailer of table lamps. The current audit senior is ill, and you have been asked to complete the audit of payroll in their absence. On arrival at the head office of Bingham Co, you determine the following data from a review of the current year and prior year audit files:

- As at 31 March 2017, the company had 350 employees
- On 1 April 2017, 10% of staff were made redundant, effective immediately, due to discontinuation of a product line
- On 1 June 2017, all remaining staff received a 5% pay rise
- Over the course of the year, sales levels met performance targets which resulted in a fixed bonus of Rs.8,000 being paid to each employee on 31 March 2018.

The following audit evidence has been gathered relating to the accuracy of wages and salaries for Bingham Co.

- (1) Proof in total calculation performed by an audit team member
- (2) Written representation from the directors of Bingham Co confirming the accuracy of wages and salaries
- (3) Verbal confirmation from the finance director of Bingham Co confirming the accuracy of wages and salaries
- (4) Recalculation of the gross and net pay for a sample of employees by an internal audit team member of Bingham Co.

What is the order of reliability of the audit evidence starting with the MOST RELIABLE first?

- (a) Audit evidence - 1, 2, 3, 4
- (b) Audit evidence - 1, 4, 2, 3
- (c) Audit evidence - 4, 1, 2, 3

(d) Audit evidence - 4, 1, 3, 2

Answer: (b) Audit evidence - 1, 4, 2, 3

Descriptive Questions

1. May 2018-2 (C) - 5 Marks

CA. Needle had been appointed as an Auditor of M/s Fabric Ltd. In the course of audit, it had been observed that inventory including work-in-process had been valued by Management by using experts hired by them. Analyse relevant factors to decide as to whether or not to accept the findings from the work of Management expert in valuation of inventories.

Answer

Evaluating the Work of Management's Expert: As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes-

- Evaluate the competence, capabilities and objectivity of that expert;
- Obtain an understanding of the work of that expert; and
- Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert; discussions with that expert; discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert.

Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.

The auditor may also consider the following while evaluating the appropriateness of the

Management's expert's work as audit evidence for the relevant assertion:

- (i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether

- they have been appropriately reflected in the financial statements;
- (ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
 - (iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

MTP Apr 18 Qn no.1(b) 5 Marks

2. The auditor of CROX Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age to 65 years. Comment.

Answer

Evaluating the Work of Management's Expert: As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes,-

- (a) Evaluate the competence, capabilities and objectivity of that expert;
- (b) Obtain an understanding of the work of that expert; and
- (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert; discussions with that expert; discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert.

Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.

The auditor may also consider the following while evaluating the

appropriateness of the management's expert's work as audit evidence for the relevant assertion:

- (i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- (ii) If that expert's work involves use of significant assumptions and

methods, the relevance and reasonableness of those assumptions and methods; and

- (iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

In the instant case, CROX Ltd. accepted the gratuity liability valuation based on the certificate issued by an expert i.e., a qualified actuary who is management's expert. Here basis for computation and valuation is taken as age 65 years by the actuary, which is not correct as company is considering proposal to increase the retirement age from existing age to 65 years. Therefore, assumptions and methods used by the management's expert are not appropriate for financial reporting purposes. Hence, auditor may qualify the report accordingly.

MTP-OCT-18 Qn No 6(c) 4 Marks:

3.MIM & Co. wants to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by MIM & Co. to examine the projected financial statements and give report thereon. What audit evidence will be obtained for reporting on projected financial statements?

Answer:

Audit evidence to be obtained for Reporting on Projected Financial Statements:

The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

- (1) the sources of information,
- (2) basis of forecasts,
- (3) the assumptions made in arriving the forecasts,
- (4) hypothetical assumptions, evidence supporting the assumptions,
- (5) management representations regarding the intended use and distribution of the information, completeness of material assumptions,
- (6) management's acceptance of its responsibility for the information,
- (7) audit plan,
- (8) the nature, timing and extent of examination procedures performed, and,
- (9) in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.

SA 501- Special Considerations for Selected Items

Descriptive Questions

1.May 2018 RTP Qn no.2

XYZ Ltd. supplies navy uniforms across the country. The company has 4 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. XYZ Ltd. appointed M/s MNO & Co. to conduct its audit for the financial year 2016-17. Mr. O, partner of M/s MNO & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

Answer

Special Consideration with Regard to Inventory: As per SA 501 “Audit Evidence-Specific Considerations for Selected Items”, when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

- (a) Attendance at physical inventory counting, unless impracticable, to:
 - (1) Evaluate management’s instructions and procedures for recording and controlling the results of the entity’s physical inventory counting;
 - (2) Observe the performance of management’s count procedures;
 - (3) Inspect the inventory; and
 - (4) Perform test counts; and
- (b) Performing audit procedures over the entity’s final inventory records to determine whether they accurately reflect actual inventory count results.

Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for

example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation

2. RTP Nov 2019 Qn no 11(b)

Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 2018-19. While verification of company's inventories as on 31st March 2019, you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of

the inventories maintained by other parties. What is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be held and the stock as disclosed in company's records actually belongs to them?

Answer

Inventory under the Custody and Control of a Third Party: As per SA 501, "Audit Evidence—Specific Considerations for Selected Items" when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- (i) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- (ii) Perform inspection or other audit procedures appropriate in the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include:
 - Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
 - Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
 - Inspecting documentation regarding inventory held by third

- parties, for example, warehouse receipts.
- Requesting confirmation from other parties when inventory has been pledged as collateral

3. RTP May 2020 Qn no 11(b)

RIM Private Ltd is engaged in the business of manufacturing of water bottles and is experiencing significant increase in turnover year on year. During the financial year ended 31 March 2019, the company carried out a detailed physical verification of its inventory and property, plant and equipment.

You are the auditor of RIM Private Ltd. The inventory as at the end of the year was Rs. 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order?

Answer:

As per SA 501 “Audit Evidence – Additional Considerations for Specific Items”, the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his attendance at physical inventory counting. SA 501 is additional guidance to that contained in SA 500, “Audit Evidence”, with respect to certain specific financial statement amounts and other disclosures.

If the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and where necessary, perform alternative audit procedures to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded. The auditor would also verify the procedure adopted, treatment given for the discrepancies noticed during the physical count. The auditor would also ensure that appropriate cut off procedures were followed by the management. He should also get management’s written representation on (a) the completeness of information provided regarding the inventory, and (b) assurance with regard to adherence to laid down procedures for physical inventory count.

SA - 505 External Confirmation

Multiple Choice questions

1.MTP Mar 2019 QN no 20

You are an audit senior of Pendse Accountants and are currently conducting the audit of Stalwart Co for the year ended 31 March 2018. Below is an extract from the list of supplier statements as at 31 March 2018 held by the company and corresponding payables ledger balances at the same date along with some commentary on the noted differences:

	Supplier Statement balance ledger balance Rs.	Payables Rs.
AB Co	90,000	70,000
CD Co	1,85,000	1,15,000

AB Co: The difference in the balance is due to an invoice which is under dispute due to faulty goods which were returned on 29 March 2018.

CD Co: The difference in the balance is due to the supplier statement showing an invoice dated 27 March 2018 for Rs. 70,000 which was not recorded in the financial statements until after the year end. The payables clerk has advised the audit team that the invoice was not received until 3 April 2018.

The audit manager has asked you to review the full list of trade payables and select balances on which supplier statement reconciliations will be performed. Which of the following statement is correct in respect of including or excluding from your sample?

- (a) Exclude with material balances at the year-end.
- (b) Exclude suppliers which have a high volume of business with Stalwart Co
- (c) Include major suppliers with nil balances at the year-end.
- (d) Include suppliers where the statement agrees to the ledger.

Answer: (c) Include major suppliers with nil balances at the year-end.

MTP APR 2019 Qn no 2(1 Mark)

2. The audit team has obtained the following results from the trade receivables circularization of Oak Co for the year ended 31 March 2018.

Customer	Balance as per sales ledger Rs.	Balance as per customer confirmation Rs.	Comment
M Co	2,25,000	2,25,000	
N Co	3,50,000	2,75,000	Invoice raised on 28 March 2018
O Co	6,20,000	4,80,000	Payment made 30 March 2018
P Co	5,35,000	5,35,000	A balance of Rs.45,000 is currently being disputed by P Co.
R Co	1,78,000	No reply	

Which of the following statements in relation to the results of the trade receivables circularisation is TRUE?

- (a) No further audit procedures need to be carried out in relation to the outstanding balances with M Co. and P Co.
- (b) The difference in relation to N Co. represents a timing difference and

- should be agreed to a pre- year-end invoice
- (c) The difference in relation to O Co. represents a timing difference and should be agreed to pre- year-end bank statements
- (d) Due to the non-reply, the balance with R Co. cannot be verified and a different customer balance should be selected and circularised

Answer : Option (b) The difference in relation to N Co. represents a timing difference and should be agreed to a pre- year-end invoice

Descriptive Questions

3. May 2018- 5 (d) 4 Marks

Never permit Limited refuses to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that at least outstanding above a threshold limit needs to be confirmed and reconciliation is to be carried out before finalising the audit. If the Company does not relent, how will you respond?

Answer

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 send a confirmation request, the auditor shall:

- Inquire as to Management’s reasons for the refusal, and seek audit evidence as to their validity and reasonableness,
- 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
- 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 in accordance with SA 260 “Communication with Those Charged with Governance” and also determine its implication for the audit and his opinion in accordance with SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”.

A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is

therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

4. May 2018 RTP Qn no. 1(c)

During the course of audit of Moon Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet

through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one old outstanding of ` 25 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.

External Confirmation: As per SA 505, "External Confirmation", Negative Confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ` 25 lacs has not

sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

5. RTP May 2020 Question no 11(A)

Your firm has been appointed as the statutory auditors of AGM Private Limited for the financial year 2018-19. While verification of company's trade receivables as on 31st March 2019, accountant of AGM Ltd. has requested you, not to send balance confirmations to a particular group of trade receivables since the said balances are

under dispute and the matter is pending in the Court. As a Statutory Auditor, how would you deal in this situation?

Answer:

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 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.

Study Material

6. During the course of audit of Star Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one, old outstanding of 15 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.

External Confirmation: As per SA 505, "External Confirmation", Negative Confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or

verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of 15 lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may

examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative confirmation request does not mean that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

Study Material

7. Mr. Z who is appointed as auditor of Elite Co. Ltd. wants to use confirmation request as audit evidence during the course of audit. What are the factors to be considered by Mr. Z when designing a confirmation request? Also state the effects of using positive external confirmation request by Mr. Z.

As per SA 505, "External Confirmation", factors to be considered when designing confirmation requests include:

- (i) The assertions being addressed.
- (ii) Specific identified risks of material misstatement, including fraud risks.
- (iii) The layout and presentation of the confirmation request.
- (iv) Prior experience on the audit or similar engagements.
- (v) The method of communication (for example, in paper form, or by electronic or other medium).
- (vi) Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
- (vii) The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total

balance).

A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

SA 510 Initial Audit Engagements – Opening Balance

Descriptive Questions

1. MTP-Aug-18 Qn No 4(b) 4 Marks:

You have been appointed as the auditor of Good Health Ltd. for 2017-18 which was audited by CA Trustworthy in 2016-17. As the Auditor of the company state the steps you would take to ensure that the Closing Balances of 2016-17 have been brought to account in 2017-18 as Opening Balances and the Opening Balances do not contain misstatements.

Answer:

As per SA 510 "Initial Audit Engagements—Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Being new assignment audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities some audit evidence can ordinarily be obtained as part of audit procedures during the current period. For example, the collection/payment of opening balances of receivables and payables will provide audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as fixed assets, investments long term debt, the auditor will examine the records relating to opening balances. The auditor may also be able to get confirmation from third parties (e.g., balances of long-term loan obtained from banks).

2. Nov 2019 Qn no 5(C) 4 Marks

Mr. X has been appointed as an auditor of M/s ABC Ltd., Mr. X wants to be satisfied about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements. Lay down the audit procedure, Mr. X should follow, in the initial audit engagement of M/s ABC Ltd. Also suggest the approach to be followed regarding mention in the audit report if Mr. X is not satisfied about the correctness of 'Opening Balances'?

Answer

Audit Procedures to be followed in case of initial audit engagement: As per SA 510, the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- (i) Determining whether the **prior period's closing balances** have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- (ii) Determining whether the **opening balances reflect the application of appropriate accounting policies**; and
- (iii) Performing one or more of the following:
 - (1) Where the prior year financial statements were audited, **perusing the copies of the audited financial statements** including the other relevant documents relating to the prior period financial statements;
 - (2) Evaluating whether **audit procedures performed** in the current period provide evidence relevant to the opening balances; or
- (iv) Performing **specific audit procedures** to obtain evidence regarding the opening balances.

Approach to be followed regarding mention in the Audit Report: If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

3. MTP Apr 18 Qn no.1(d) 5 Marks, MTP-Oct-19 Qn No 1(b) 6 Marks:

In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow, when financial statements are audited for the first time. If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances', what approach you will adopt in drafting your audit report?

Answer

Audit Procedure for ensuring correctness of Opening Balances: As per SA 510 "Initial Audit Engagements-Opening Balances", the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by -

- (i) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate,

any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;

- (ii) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (iii) By evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Approach for drafting Audit Report: SA 705 establishes requirements and provides guidance on circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor's report:

- (a) A qualified opinion or a disclaimer of opinion, as is appropriate in the circumstances; or
- (b) Unless prohibited by law or regulation, an opinion which is qualified or

disclaimed, as appropriate, regarding the results of operations, and cash flows, where relevant, and unmodified regarding State of Affairs.

If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

4. RTP Nov 18 Qn no 1(C)

CA. Ashutosh has been appointed as an auditor of Awesome Health Ltd. for the financial year 2017-18 which was audited by CA. Amrawati in 2016-17. As the Auditor of Awesome Health Ltd., state the steps that CA. Ashutosh would take to

ensure that the Closing Balances of the financial year 2016-17 have been brought to account in 2017-18 as Opening Balances and the Opening Balances do not contain any misstatements.

ANSWER

Obtaining sufficient appropriate audit evidence while conducting Initial Audit Engagement: According to SA 510 on "Initial Audit Engagements- Opening Balances", the objective of the Auditor while conducting an initial audit engagement with respect to opening balances is to obtain sufficient appropriate audit evidence so that the-

- (i) opening balances of the preceding period have been correctly brought forward to the current period;
- (ii) opening balances do not contain any misstatement that materially affect the current period's financial statements; and
- (iii) appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Being a new assignment, audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection/ payment of opening accounts receivable/ accounts payable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as property plant and equipment, investments, long term debts, the auditor will examine the records relating to opening balances. The auditor may also be able to get the confirmation from third parties (e.g., balances of long term loan obtained from banks can be confirmed

from the Bank Loan statement).

5. MTP-OCT-18 Qn No 1(d) 5 Marks:

CA. Mack, a recently qualified practicing Chartered Accountant got his first audit assignment of Captura (P) Ltd. for the financial year 2017-18. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA. Mack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting Rs. 145 lakhs, continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year. CA. Mack, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor. Comment.

Answer:

Verification of Accounts Receivable: As per SA 510 “Initial Audit Engagements – Opening Balances”, while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-

- (i) Opening balances contain misstatements that materially affect the current period’s financial statements; and
- (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period’s financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of 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.

For current assets and liabilities, some audit evidence about opening balances may be

obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 580 "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

In the given case, the management of Captura (P) Ltd. has restrained CA. Mack, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Mack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Mack should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

Study Material

6. In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow, when financial statements are audited for the first time. If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances', what approach you will adopt in drafting your audit report?

Answer

Audit Procedure for ensuring correctness of Opening Balances: As per SA 510 "Initial Audit Engagements-Opening Balances", the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by –

- (i) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- (ii) Determining whether the opening balances reflect the application of appropriate accounting policies; and

(iii) By evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Approach for drafting Audit Report: If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705 and in case where the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

Multiple Choice Question

1. SKJ Private Ltd is engaged in the business of construction. The company has also got some real estate projects few years back on which it started the work in the last 2 years. The annual turnover of the company is INR 600 crores and profits of INR 40 crores.

The statutory auditors of the company got rotated by another audit firm due to mandatory audit rotation requirements as per the Companies Act 2013.

The new statutory auditors of the company started audit of the financial statements for the year ended 31 March 2019 in May 2019. The audit team also requested the client to provide certain information on the opening balances to perform their audit procedures.

Initially the management did not provide any information to the auditors on the opening balances thinking that this is not within the scope of their work, however, after going through the auditing standards, the management agreed and provided the required information.

Later on, the audit team also started requesting information for the period from 1 April 2019 to 31 May 2019. With this requirement, CFO of the company got very upset and angry and set up a meeting with the senior members of the audit team. CFO raised a concern that the audit team has not been doing the work properly and has been asking for unnecessary information like information on opening balances and then the information for the period after 31 March 2019. The audit partner explained to the

CFO that everything requested by the audit team has been as per the auditing standards, however, CFO said that in the earlier years, the previous auditors never asked for such information.

You are requested to give your view in respect of this matter.

- (a) The requirement of the auditors for opening balances was valid but for the period after 31 March 2019 is completely wrong as that is out of their scope for the current year's audit. They can ask for those details during the audit of next year.
- (b) The concern of the CFO was valid. He has seen the previous auditors not performing such audit procedures and hence the new audit team should also follow the same approach which was followed by previous auditors as that would lead to efficient in audit.
- (c) The audit team should set up a meeting with previous auditors wherein it should be assessed why different approach was followed by the previous auditors. On the basis of that discussion with the previous auditors, next course of action should be decided.
- (d) The requirement of the auditors for opening balances as well as for the period after 31 March 2019 is valid. After the requirements of SA 510 and SA 560, audit team is required to perform these procedures.

Answer: Option: (d) The requirement of the auditors for opening balances as well as for the period after 31 March 2019 is valid. After the requirements of SA 510 and SA 560, audit team is required to perform these procedures

SA 520 – Analytical Procedures

Descriptive Questions

1. Nov 2018 Qn no 4(b) 4 Marks

In audit of DEF Limited, the Auditor had made use of certain analytical procedures with regard to certain key data in the Statement of Profit and Loss. The results obtained showed inconsistencies with other relevant information. State the course of action that the Auditor should take to ensure that the risk of material misstatement would be contained to a low level fixed as per materiality level.

Answer

Investigating Results of Analytical Procedures: As per SA 520, "Analytical Procedures", if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or

that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- (i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and
- (ii) Performing other audit procedures as necessary in the circumstances.

Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

Multiple Choice Questions

1. ZOV is a private limited company engaged in the business of mining. The company's operations are fairly large and its turnover is INR 4,000 crores on an annual basis. Due to the nature of the business and the size of the company, the company has appointed a firm of Chartered Accountants as its statutory auditors who have the relevant experience of the industry in which the company has been operating.

During the course of the audit of the financial statements for the year ended 31 March 2019, the audit team had various observations which resulted in many adjustments in the financial statements of the company and that was also appreciated by the CFO of the company.

At the time of final reviews of the audit team, the audit partner requested working paper on final analytical procedures from the engagement team, however, the engagement team explained that they performed substantive testing procedures which also resulted in some adjustments and the same was incorporated in the final set of financial statements given to the audit partner for the review and accordingly there was no need to perform final analytical procedures. Audit partner was not convinced with this and requested the engagement team to perform this procedure. Considering that the timeline to conclude the audit was approaching, the audit partner also requested the CFO that the audit team would need some more time to perform final analytical procedures. CFO was very impressed with the engagement team and agreed for the time but he also told the audit partner that work of the team was excellent and hence the audit partner should avoid these additional procedures.

You are requested to give your view in respect of this matter as per SA 520.

- a) The explanation of the audit team was correct. After doing

substantive testing which also resulted in audit adjustments, there was no need to perform final analytical procedures.

- b) The suggestion of CFO should have been considered by the audit partner as the CFO was observing the work of the engagement team and hence he could assess that better than the audit partner.
- c) The requirement in view of the audit partner was valid. The conclusions drawn from the results of final analytical procedures are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements.
- d) The audit team did the right thing by not performing final analytical procedures, however, one additional procedure in that case should have been - obtain the document containing the

analysis performed by the client on the financial statements. This document is required to be assembled in the audit file.

Answer: Option :C The requirement in view of the audit partner was valid. The conclusions drawn from the results of final analytical procedures are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements

BDJ Private Ltd was established in 2001 and since then the company's operations have grown significantly. The company is based in Kanpur and has branch offices outside Kanpur.

The company is engaged in tours and travels business and because of the nature of the business, it has voluminous transactions. The annual turnover of the company is INR 700 crores.

During the audit of the financial statements of the company for the year ended 31 March 2019, the auditors observed wide variation in various details of sales and various expenses as compared to last year. Various balances of trade receivables, loans and advances, statutory liabilities showed significant increase and many balances were found to be non-moving which were aged for more than 3 years.

On the basis of the materiality and planned procedures, the audit team requested the client for testing of various samples for sales, expenses etc. The client observed that the number of samples that the team has requested increased as compared to last year and asked the team to cut down on the number of samples so that it is the same number of samples which were tested in the previous years.

The audit team did not agree with this and explained various factors which the team

had considered for sample selection and the reasons for changes in the samples and also explained the requirements of SA 530 to the client but the client still did not agree. Now there is a situation of deadlock and you are requested to provide your guidance to resolve this matter.

- a. The argument of the client is not valid. Sample selection is based on certain principles as per SA 530 and that is on the assessment of the audit team. It may change year on year and hence the client should provide the required information to the audit team.
- b. The explanation of the audit team is not valid. Referring SA 530 was not correct in this

case. The audit team should have explained their entire approach around risk assessment to the client before starting the fieldwork and should have formally shared that with the client in writing.

- c. In the given situation, the audit team instead of getting into any arguments should cut down the number of samples and should increase their procedures around analytical work. That would resolve the problem.
- d. The audit team should make a formal request in writing for these details from the client and if the client still refuses then they should report this matter to the audit partner. In that case, the auditing standards require audit partner to check some of the documents which may not be provided by the client to the audit team.

Answer: Option : a

SA 540- Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures”

Descriptive Questions

May 2018 2(d) 5 Marks

1. While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?

Answer

As per SA 540 “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures” , the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.

- (i) How Management identifies those transactions, events and

conditions that may give rise to the need for accounting estimates to be recognised or disclosed, in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management

about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.

- (ii) The estimation making process adopted by the management including-
- (1) The method, including where applicable the model, used in making the accounting estimates.
 - (2) Relevant controls.
 - (3) Whether management has used an expert?
 - (4) The assumption underlying the accounting estimates.
 - (5) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
 - (6) Whether and, if so, how the management has assessed the effect of estimation uncertainty.

2. RTP May 2019 Qn no.12(a)

A Pvt Ltd is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.
- Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.
- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.

However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.

In the given case, the management is not correct in refusing the relevant information to the auditor.

SA 550 Related Parties

Descriptive Questions

Nov 18 Qn no.1(a) 5 Marks

1. You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was ` 12,000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for ` 850 crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with Ind AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises.

Analyse this issue in finalizing the Audit Report.

Answer

Related Party Disclosures :As per Ind AS 24, "Related Party Disclosures", a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with (i) a government that has control or joint control of, or significant influence over, the reporting entity; and (ii) another entity that is a related party because the same

government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:

- (1) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);
- (2) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
 - (i) the nature and amount of each individually significant transaction; and
 - (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Further, as per SA 550 Related Parties, in forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In the instant case, Power Supply Corporation Limited, a Government Company has procured spares for transmitters for rupees 850 crore from abroad through a corporation namely Procurement and Supply India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Power Supply Corporation Limited has to disclose the matters specified above (i.e.name of Government, natures of its relationship with reporting entity, the nature and amount of transaction etc.). Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise in not tenable.

MTP-Aug-18 Qn No 1(a) 5 Marks :

2. A firm of a father and a son is receiving Rs. 2 lakhs towards job work done for XYZ Ltd. during the year ended on 31.03.16. The total job work charges paid by XYZ Ltd. during the year are over Rs. 50 lakhs. The father is Managing Director of XYZ Ltd. having substantial holding. The Managing Director told the auditor that since he is not involved in the activities of the firm and since the amount paid to it is insignificant; there is no need to disclose the transaction. He further contended that such a payment made in the last year was not disclosed. Advise whether Managing Director is right in his approach.

Answer: Related Party Disclosures: As per definition given in the AS 18 "Related Party Disclosures" parties are considered to be related if at any time during the

reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

In the instant case, the managing director of XYZ Ltd. is a partner in the firm with his son which has been paid Rs. 2 lakhs as job work charges. The managing director is having a substantial holding in XYZ Ltd. The case is squarely covered by AS 18. According to AS-18, in the case of related party transactions, the reporting enterprise should disclose the following:

- (i) the name of the transacting related party;
- (ii) a description of the relationship between the parties;
- (iii) a description of the nature of transactions;
- (iv) volume of the transactions either as an amount or as an appropriate proportion;
- (v) any other elements of the related party transactions necessary for an understanding of the financial statements;
- (vi) 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
- (vii) amounts written off or written back in the period in respect of debts due from or to related parties.”

Further, SA 550 on “Related Parties”, also prescribes the auditor’s responsibilities and audit procedures regarding related party transactions.

The approach of the managing director is not tenable under the law and accordingly all disclosure requirements have to be complied with in accordance with the AS 18. Auditor should insist to make proper disclosure as per the AS and if management refuses, the auditor shall have to modify his report. Also, it has to be seen whether section 184 of the Companies Act, 2013 regarding disclosure of interest by director has been complied with. If it is not complied with, the auditor needs to modify the report appropriately.

3.MTP-Mar-19 Qn No 5(a) 4 Marks:

JY & Co. is appointed as auditor of Breeze Ltd. JY & Co. seeks your guidance for reviewing the records and documentation of the company regarding ‘related party transactions in the normal course of business’. Describe the steps to be followed.

Answer:

Review of Records and Documentation Regarding Related Party Transaction:
According to SA 550 “Related Parties”, during the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.

In particular, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

- (a) Bank, legal and third party confirmations obtained as part of the auditor's procedures;
- (b) Minutes of meetings of shareholders and of those charged with governance; and
- (c) Such other records or documents as the auditor considers necessary in the circumstances of the entity.

The auditor may inspect records or documents that may provide information about related party relationships and transactions, for example entity income tax returns, information supplied by the entity to regulatory authorities, shareholder registers to identify the entity's principal shareholders, statements of conflicts of interest from management and those charged with governance, records of the entity's investments and those of its pension plans, contracts and agreements with key management or those charged with governance, significant contracts and agreements not in the entity's ordinary course of business, specific invoices and correspondence from the entity's professional advisors, life insurance policies acquired by the entity, significant contracts re-negotiated by the entity during the period, internal auditors' reports, documents associated with the entity's filings with a securities regulator etc.

4. MTP-OCT-18 Qn No 4(b) 5 Marks:

In the course of audit of QRT Ltd, its statutory auditor wants to be sure of the adequacy of related party disclosures? Kindly guide the auditor in identifying the possible source of related party information.

Answer:

Identification of possible sources for Related Parties' information: As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. However, it is the management, which is primarily responsible for identification of related parties. The duties of an auditor with regard to reporting of related party transaction as required by Accounting Standard 18 "Related Party Disclosures" is given in SA 550.

- SA 550 requires that to identify names of all known related parties, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example entity income tax returns, information supplied by the entity to regulatory authorities, shareholder registers to identify the entity's principal shareholders, statements of conflicts of interest from management and those charged with governance, records of the entity's investments and those of its pension plans, contracts and

agreements with key management or those charged with governance, significant contracts and agreements not in the entity's ordinary course of business, specific invoices and correspondence from the entity's professional advisors, life insurance policies acquired by the entity, significant contracts re-negotiated by the entity during the period, internal auditors' reports, documents associated with the entity's filings with a securities regulator (e.g., prospectuses).

- Some arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions as an arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as the establishment of a business relationship through appropriate vehicles or structures, the conduct of certain types of transactions under specific terms and conditions or the provision of designated services or financial support.

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include participation in unincorporated partnerships with other parties, agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business, guarantees and guarantor relationships etc.

- Obtaining further information on significant transactions outside the entity's normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and, where the applicable financial reporting framework establishes related party requirements, to identify the risks of material misstatement. In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Examples of transactions outside the entity's normal course of business may include complex equity transactions, such as corporate restructurings or acquisitions, transactions with offshore entities in jurisdictions with weak corporate laws, the leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged, sales transactions with unusually large discounts or returns, transactions with circular arrangements, for example, sales with a commitment to repurchase, transactions under contracts whose terms are changed before expiry etc.
- Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identification of related parties.

SA 560 Subsequent Events

Descriptive Questions

1. MTP Mar 2018 1(a) 5 Marks

A Co. Ltd. has not included in the Balance Sheet as on 31-03-2017 a sum of ` 1.50 crores being amount in the arrears of salaries and wages payable to the staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30-04-2017. The auditor wants to sign the said Balance Sheet and give the audit report on 31-05-2017. The auditor came to know the result of the negotiations on 15-05-2017. Advise.

ANSWER

Subsequent Events: This case requires attention to SA 560 "Subsequent Events", AS 4 "Contingencies and Events occurring after the Balance Sheet Date" and AS 29 "Provisions, Contingent liabilities and Contingent Assets".

As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. Similarly as per AS 29 "Provisions, Contingent liabilities and Contingent Assets", future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the will occur.

In the instant case, the amount of `1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. The facts have become known to the auditor before the date of issue of the Audit Report and Financial Statements.

The auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the financial statements i.e. 31 -3-2017 to the date of Auditors Report i.e. 31-05-2017. It will be observed that as a result of long pending negotiations a sum of ` 1.50 cores representing arrears of salaries of the year 2015-16 and 2016-17 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29.

As per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable

financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

So the auditor should request the management to adjust the sum of ` 1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the audit report.

2. Nov 18 Qn no 1(b) 5 Marks

Amudhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2018. The Audit Report for that year was signed by the Auditors on 04/05/2018. The Annual General Meeting was decided to be held during the month of August 2018. On 06/05/2018, the Company had received a communication from the Central Government that an amount of ` 5800 crore kept pending on account of incentives pertaining to Financial Year 2017-18 had been approved and the amount would be paid to the Company before the end of May 2018. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2018. On 08/05/2018, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2018. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

ANSWER

Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

- (i) Discuss the matter with management and, where appropriate, those charged with governance.
- (ii) Determine whether the financial statements need amendment and, if so,
- (iii) Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new

auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, XYZ Company Ltd. received an amount of rupees 5800 crore on account of incentives pertaining to year 2017-18 in the month of May 2018 i.e. after finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Amudhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2018.

After applying the conditions given in SA 560, Amudhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

SA570 Going Concern

Multiple Choice Questions

1. MTP Apr 2019 Qn no 20 2 Marks

The auditor has determined that there is a significant going concern uncertainty at PQR Ltd. due to the requirement to refinance the company's debt. Discussions with the management and the auditor's evaluation of management's plans for future actions in relation to its going concern assessment have revealed that plans to raise new equity finance are realistic and likely to deal with the problem. Is it appropriate for PQR Ltd. to prepare its financial statements on a going concern basis?

- a. No, PQR Ltd. cannot prepare its financial statements on a going concern basis because a significant uncertainty exists.
- b. Yes, PQR Ltd. can prepare its financial statements on a going concern basis. However, the auditor is required to express a qualified opinion.
- c. Yes, PQR Ltd. can prepare its financial statements on a going concern basis. No additional disclosure is necessary in the financial statements or the auditor's report.
- d. Yes, PQR Ltd. can prepare its financial statements on a going concern basis. However, disclosure of both the nature of the uncertainty and management's plan is required.

Answer: Option d Yes, PQR Ltd. can prepare its financial statements on a going concern basis. However, disclosure of both the nature of the uncertainty and management's plan is required.

Descriptive Questions

1.MTP-Mar 19 Qn No 1(c) 5 Marks:

Rathi Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31st March, 2018. The Financial Statements for the year ended 31/03/2018 had been prepared on the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above.

Answer:

Closure of Business: As per SA 570 “Going Concern”, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity’s ability to continue as going concern.

As per SA 570, if events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

Even when no material uncertainty exists, it requires the auditor to evaluate whether, in

view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.

Further, as per SA 701 “Communicating Key Audit Matters in the Independent Auditor’s Report”, when matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern is, by its nature, a key audit matter. SA 701 also emphasis on auditor’s responsibility to communicate key audit matters in the auditor’s report.

As per the facts given in the case, intention of the Mishti Limited had definite plan of its business being closed down within short period from 31st March, 2018. However, financial statements for the year ended 31.03.2018 had been prepared on the same basis as it had been in earlier periods with an additional note.

Thus, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity’s ability to continue as going concern is a key audit matter. Therefore, the auditor is required

to Communicate the Key Audit Matters in accordance with SA 570 in above stated manner. Simple reference as to a possible cessation of business and making of adjustments, if any, he made at the time of cessation only by the auditor in his report is not sufficient.

2.RTP May 2019

M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2018 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the

Answer

Reporting requirements in case of Uncertainty clamping on the Going Concern: As per SA 570 “Going Concern”, if the auditor concludes that management’s use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements :

(i)adequately disclose the principal events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and management’s plans to deal with these events or conditions; and (ii) disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor’s report shall include a separate section under the heading “Material Uncertainty Related to Going Concern” to:

- (i) Draw attention to the note in the financial statements that discloses the matters set out above; and
- (ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity’s ability to continue as a going concern and that the auditor’s opinion is not modified in respect of the matter.

In the instant case, M/s Aircraft Ltd. is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of its ability to continue in near future. Therefore, a committee has been constituted to study this aspect and

till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts. Therefore, the auditor should disclose about the material uncertainty and express an unmodified opinion and in his audit report shall include a separate section under the heading “Material Uncertainty Related to Going Concern” to draw attention to the note in the financial statements that discloses the matters set out above; and state that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity’s ability to continue as a going concern and that the auditor’s opinion is not modified in respect of the matter.

3. RTP Nov 2019 Qn no 11(a)

MNO Limited is one of the prominent players in the chemicals industry. The company is a public company domiciled in India and listed on BSE and NSE. The Company was facing extreme liquidity constraints and there were multiple indicators that casted doubt over the company’s ability to continue as a going concern.

The Company was led into insolvency proceedings by consortium of banks led by PNB and the NCLT ordered the commencement of corporate insolvency process against the Company on 31 August 2018. The company invited prospective lenders, investors and others to submit their resolution plans to the Resolution Professional (RP) latest by 1 January 2019. The RP reviewed the resolution plans and ensured conformity with Insolvency and Bankruptcy Code 2016. The compliant plans were presented to Committee on Creditors (CoC) on 2 February 2019 and the resolution

Answer

As per SA 570 Going Concern, if events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern (hereinafter referred to as “material uncertainty”) through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

- (i) Where management has not yet performed an assessment of the entity’s ability to continue as a going concern, requesting management to make its assessment.
- (ii) Evaluating management’s plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management’s plans are feasible in the circumstances.
- (iii) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future

outcome of events or conditions in -

- (1) Evaluating the reliability of the underlying data generated to prepare the forecast; and
 - (2) Determining whether there is adequate support for the assumptions underlying the forecast.
- (iv) Considering whether any additional facts or information have become available since the date on which management made its assessment.
- (v) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans

for future actions and the feasibility of these plans.

The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

In the instant case, the approval of the resolution plan is a significant mitigating factor to counter the going concern issues of MNO Ltd. PQR Ltd. has submitted a detailed plan and commitments that has been given as part of the resolution plan which includes clearance of all outstanding debts which were leading to negative cash flows. Therefore, it can be said that the events and conditions are mitigated effectively and there is no material uncertainty in relation to the ability of the company to continue as a going concern.

Study Material

4.ABC Company files a law suit against Unlucky Company for ` 5 crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements. As an auditor of Unlucky Company, how will you deal with the situation?

Existence of Contingent Liability: As per AS 29 "Provisions, Contingent liabilities and Contingent Assets", a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the

control of the enterprise.

Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

As per SA 570 “Going Concern”, there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event.

When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and management’s plans to deal with these events or conditions; and disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

In the instant case, ABC Company has filed a law suit against Unlucky Company for 5 crores. Though, the attorney of Unlucky Company feels that the suit is without merit so the company merely discloses the existence of law suit in the notes accompanying its financial statements. But the auditor may evaluate the source data on which basis the opinion is formed. If the auditor finds the uncertainty, he may request the management to adjust the sum of 5 crore by making provision for expenses as per AS 29. If the management does not accept the request the auditor should qualify the audit report.

SA 580 Written Representations.

Descriptive Questions

1.May 2018 RTP Qn 1(b), MTP-OCT-18 Qn No 1(C) 5 Marks:

In the course of audit of RKP Ltd., its auditor Mr. 'Noor' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'Noor' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'Noor'.

Auditor’s Responsibilities Relating to Fraud: As per SA 240 on “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”, the auditor

is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

As per SA 580 “Written Representations”, if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.

In the instant case, the auditor observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

It may be noted that, if management does not provide one or more of the requested written representations, the auditor shall discuss the matter with management; re- evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor’s report.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ` 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ` 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2020, 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.

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor shall:

- (i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- (iii) If the auditor withdraws:

- (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
- (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

2.RTP May 2019 Qn no 11(a)

PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2000 crores and profits are INR 190 crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of and period covered by written representation in view of SA 580.

Answer

As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what

they are.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

3.MTP-Mar 19 Qn No 1(a) 4 Marks:

Statutory auditor of O Ltd requested the management for a written representation in respect of obsolescence of inventory and warranty obligations recognized by the company in its financial statements. The management denied the representation on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report. Please comment.

Answer:

As per SA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures, the auditor shall obtain written representations from the management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

- About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.
- That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
- That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.

- That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

For those accounting estimates not recognised or disclosed in the financial statements, written representations may also include representations about:

- The appropriateness of the basis used by management for determining that the recognition or disclosure criteria of the applicable financial reporting framework have not been met.
- The appropriateness of the basis used by management to overcome the presumption relating to the use of fair value set forth under the entity's applicable financial reporting framework, for those accounting estimates not measured or disclosed at fair value.

Thus, management's contention on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report, for not providing written representation is not correct. The management should provide written representations to the auditor.

Further as per SA 580 Written Representation, if management does not provide one or more of the requested written representations, the auditor shall

- (a) Discuss the matter with management;
- (b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

4.Nov 2019 Qn no 1(a) 5 Marks

Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing.

Answer

Written Representations: As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

SA 580, "Written Representations" discusses the use of written representations. Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

- (i) About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.
- (ii) That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
- (iii) That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.
- (iv) That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

Study Material

5. An auditor of Sagar Ltd. was not able to get the confirmation about the existence and value of certain machineries. However, the management gave him a certificate to prove the existence and value of the machinery as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?

Validity of Written Representation: The physical verification of fixed assets is the primary responsibility of the management. The auditor, however, is required to examine the verification programme adopted by the management. He must satisfy himself about the existence, ownership and valuation of fixed assets. In the case of Sagar Ltd., the auditor has not been able to verify the existence and value of some machinery despite the verification procedure followed in routine audit. He accepted the certificate given to him by the management without making any further enquiry.

As per SA 580 "Written Representations", when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence from other sources inside or outside the entity.

He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. "Written Representations" cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.

If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter. Therefore, the approach adopted by the auditor is not right.

SA-600 Using the work of another auditor

Descriptive Questions

1.MAY 2018 -1(d) – 5 Marks

1. B is the Principal Auditor of ABC Co. Ltd., with 8 branches audited by 8 Branch Auditors. B wanted to ensure that the works of Branch Auditors were adequate for the purpose of his audit. Hence he insisted on Branch Auditors to get familiar with a check list he prepared for branches and, besides, required them to share the working papers compiled by them for his review and return. Is Principal Auditor within his right in asking for such sharing of working papers?

Answer

Using the Work of Another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor"**. It makes clear that 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, it requires that 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. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and
- advise the other auditor of the significant accounting, auditing

and reporting requirements and obtain representation as to compliance with them.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will

depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

Further, SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel."

In the light of aforesaid, principal auditor was not within his right for asking for such sharing of working papers. It depends upon the discretion of auditor

SA 610 Using the work of Internal Auditor

Descriptive Questions

1. May 2018 6 (c) 4 Marks

Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.

ANSWER

Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance: SA 610 'Using the work of Internal Auditor' Deals about the concept of direct assistance of internal auditor. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:

- (1) The amount of judgment involved in:
 - (i) Planning and performing relevant audit procedures; and
 - (ii) Evaluating the audit evidence gathered;
- (2) The assessed risk of material misstatement; and
- (3) The external auditor's evaluation of the existence and significance of threats to

the objectivity and level of competence of the internal auditors who will be providing such assistance.

If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.

The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

2.MTP-OCT-18 Qn No 5(b)(2) 4 Marks:

CA. Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA. Kishor, the statutory auditor of the Company, for his view and reporting. Can CA. Kishor rely on such report?

Answer:

Using the Work of Internal Auditor: As per SA 610 "Using the Work of Internal Auditors", while determining whether the work of the internal auditors can be used for the purpose of the audit, the external auditor shall evaluate-

- The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;
- The level of competence of the internal audit function; and
- Whether the internal audit function applies a systematic and disciplined approach, including quality control.

Further, the external auditor shall not use the work of the internal audit function if the external auditor determines that:

- The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
- The function lacks sufficient competence; or

- The function does not apply a systematic and disciplined approach, including quality control.

In the instant case, CA. Kishor should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible he should also test check few items and he can also observe the procedures performed by the internal auditors.

If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.

3.RTP May 2019 Qn no 22(b), MTP-Apr-19 Qn No 4(c) 4 Marks:, MTP-OCT-19 Qn No 4(b) 4 Marks:

OPQ Ltd is in the business of software consultancy. The company has had large balances of accounts receivables in the past years which have been assessed as area of high risk. For the year ended 31 March 2018, in respect of the valuation of accounts receivable, the statutory auditor has assigned the checking of the accuracy of the aging of the accounts receivables and provision based on ageing to the internal auditor providing direct assistance to him. Please advise

Answer

As per SA 610 Using the Work of Internal Auditor, the external auditor (Statutory Auditor) shall not use internal auditors to provide direct assistance to perform procedures that:

- (a) Involve making significant judgments in the audit;
- (b) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
- (c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
- (d) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

In the given case where the valuation of accounts receivable is assessed as an area of higher risk, the statutory auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance. However, because the evaluation of the adequacy of the provision based on the aging

would involve more than limited judgment, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

5.RTP May 2020 Qn no 17

Mr. Anand is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhola as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

- (a) **Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhola, internal auditor as stated above in view of Standards on Auditing.**
- (b) **Will your answer be different, if Mr. Anand ask direct assistance from Mr. Bhola, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?**

Answer:

Direct Assistance from Internal Auditor: As per SA 610 “Using the Work of Internal Auditor”, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following:

- Assessing the risks of material misstatement;
- Evaluating the sufficiency of tests performed;
- Evaluating the appropriateness of management’s use of the going concern assumption;
- Evaluating significant accounting estimates; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor’s report.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

Direct Assistance from Internal Auditor in case of External Confirmation Procedures: SA 610 “Using the Work of Internal Auditor”, provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned.

Further, in accordance with SA 505, “External Confirmation” the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

SA 620 Using the Work of Auditor’s Expert

Descriptive Questions

1.Mar 2018 MTP 1(b) 5 Marks, RTP Nov 18 3(b)

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2015-16. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y’s actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y’s actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

You are required to decide the responsibility of auditors Mr. X and Mr. Z, in case, report made by Mr. Y’s actuary, later on, found faulty.

Answer

Using the work of an Auditor’s Expert: As per SA 620 “Using the Work of an Auditor’s Expert”, the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor’s use of the work of an auditor’s expert.

The auditor shall evaluate the adequacy of the auditor’s expert’s work for the auditor’s purposes, including the relevance and reasonableness of that expert’s findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert’s work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert’s work involves the use of source data that is significant to that expert’s work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

In the instant case, Mr. A, Mr. B and Miss C, jointly appointed as an auditor of PRS Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor’s expert as per SA 620. Mr. B’s referred actuary has provided the

gratuity valuation report, which later on found faulty. Further, Miss C being not agreed with Mr. B's report, submitted separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. A, Mr. B and Miss C, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

Mr. A and Mr. B will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Miss C will not be held liable for the same due to separate opinion expressed by her.

2.RTP May 2019 Qn no 12(b), MTP-OCT-18 Qn No 2(d) 4 Marks: MTP-Mar 2019 Qn No 6(c) 5 Marks:

X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were

working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise.

Answer

As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In certain situations, the need for a detailed agreement in writing is required like -

- The auditor's expert will have access to sensitive or confidential entity information.
- The matter to which the auditor's expert's work relates is highly complex.
- The auditor has not previously used work performed by that expert.
- The greater the extent of the auditor's expert's work, and its significance in the

context of the audit.

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.

3.Nov 18 Qn no.2(d) 5 Marks

State what may be the evaluative or review procedures that the Statutory Auditor may do before concluding as to relevance and reasonableness of Auditor's Expert work for using it for his audit purposes.

May 2019 Qn no 2(a) 5 Marks

CA Dabu has been appointed as an auditor of M/s MAP Technocraft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take

services of Mr. Jay, an engineering consultant. Mr. Jay performed his work and submitted details to CA Dabu. State the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay.

Answer

Evaluating the Adequacy of the Auditor's Expert's Work: As per SA 620 on "Using the Work of an Auditor's Expert", specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes may include:

- Inquiries of the auditor's expert.
- Reviewing the auditor's expert's working papers and reports.
- Corroborative procedures, such as:
 - Observing the auditor's expert's work;
 - Examining published data, such as statistical reports from reputable, authoritative sources;
 - Confirming relevant matters with third parties;
 - Performing detailed analytical procedures; and
 - Re-performing calculations.
- Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.
- Discussing the auditor's expert's report with management.

Therefore, as per SA 620 on “Using the Work of an Auditor’s Expert”, the auditor shall evaluate the adequacy of the auditor’s expert’s work for the auditor’s purposes, including:

- (i) The relevance and reasonableness of that expert’s findings or conclusions, and their consistency with other audit evidence;
- (ii) If that expert’s work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
- (iii) If that expert’s work involves the use of source data that is significant to that expert’s work, the relevance, completeness, and accuracy of that source

data.

If the auditor determines that the work of the auditor’s expert is not adequate for the auditor’s purposes, the auditor shall:

- (i) Agree with that expert on the nature and extent of further work to be performed by that expert; or
- (ii) Perform further audit procedures appropriate to the circumstances.

5.MTP-Apr-19 Qn No 1(c) 4 Marks:

O Ltd. is in the business of manufacturing of steel. The manufacturing process requires raw material as iron ore for which large stock was maintained by the company at year end – 31 March 2019. The nature of raw material is such that its physical verification requires involvement of an expert. Management hired their expert for stock take and auditors also involved auditor’s expert for the stock take.

The auditor observed that the work of the auditor’s expert was not adequate for auditor’s purposes and the auditor could not resolve the matter through additional audit procedures which included further work performed by both the auditor’s expert and the auditor.

Basis above, the auditor concluded that it would be necessary to express a modified opinion in the auditor’s report because the auditor has not obtained sufficient appropriate audit evidence. However, the auditor issued a clean report and included the name of the expert in his report to reduce his responsibility for the audit opinion. Comment.

Answer:

As per **SA 620, Using the work of an Auditor’s Expert**, if the auditor concludes that the work of the auditor’s expert is not adequate for the auditor’s purposes and the auditor cannot resolve the matter through the additional audit, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, it may be necessary to express a modified opinion in the auditor’s report in accordance with **SA 705** because the auditor has not obtained sufficient appropriate audit evidence

In addition, the auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the

audit opinion.

If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion.

In the given case, the auditor cannot reduce his responsibility by referring the name of auditor's expert and thereby issuing a clean report. Auditor should have issued a modified report and could have given reference to the work of an auditor's expert in that report if such reference was relevant to understanding of a modification to the auditor's opinion but even in that case the auditor should have indicated in his report that such reference of auditor's expert does not reduce his responsibility for that opinion.

SA –701 Communicating Key audit matters in the independent auditor's report

Multiple Choice Questions

1.MTP Apr 2019 QN no 1

While auditing the complete set of consolidated financial statements of Tulips Ltd., a listed company, using a fair presentation framework, M/s Pintu & Co., a Chartered Accountant firm, discovered that the consolidated financial statements are materially misstated due to the non- consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so. Thus, M/s Pintu & Co. decided to provide an adverse opinion for the same and further determined that, there are no key audit matters other than the matter to be described in the Basis for Adverse Opinion section. Comment whether M/s Pintu & Co. needs to report under SA 701 'Communicating Key Audit Matters in the Independent Auditor's Report'?

- (e) M/s Pintu & Co. have the option to follow SA 701, thus, need not to report any key audit matters.
- (f) SA 701 is mandatory in the case of audit of listed entities, however, as there are no key audit matters other than the matter to be described in the Basis

for Adverse Opinion section, no 'Key Audit Matters' para needs to be stated under audit report.

- (g) SA 701 is mandatory in the case of audit of listed entities, however, as there are no key audit matters other than the matter to be described in the Basis for Adverse Opinion section, M/s Pintu & Co. shall state, under 'Key Audit Matters' para, that 'except for the matter described in the Basis for Adverse Opinion section, we have determined that there are no other key audit matters to communicate in our report.'
- (h) M/s Pintu & Co. is under compulsion to follow SA 701 as the audit is of a listed company and shall report under 'Key Audit Matters' para the matter same as stated in 'Adverse Opinion' para regarding non- consolidation of a subsidiary.

Answer: Option C SA 701 is mandatory in the case of audit of listed entities, however, as there are no key audit matters other than the matter to be described in the Basis for Adverse Opinion section, M/s Pintu & Co. shall state, under 'Key Audit Matters' para, that 'except for the matter described in the Basis for Adverse Opinion section, we have determined that there are no other key audit matters to communicate in our report.'

2.RTP Nov'2020 Q No 12

Before concluding the audit, there was a difference of opinion between the audit committee and the auditors as to which among the following are the areas which the auditor should take into account to determine "Key Audit Matter" as per SA 701:

- (I) The effect on audit of significant transactions that took place in the FY.
- (II) Areas of high risk as assessed and reported by management's expert.
- (III) Significant auditor judgement relating to areas in the financials that involved significant management judgement.

As per SA 701- Communicating Key audit matters in the Independent auditor's Report, which among the above-mentioned areas should CA & Co. take into account to determine "Key Audit Matter"?

- (a) (I) & (III)
- (b) (II) only
- (c) (I) & (II)
- (d) (I), (II) & (III)

Answer: a) (I) & (III)

Descriptive Questions

MAY 2018- 1(a) -5 Marks

1. Toddle Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31st March, 2017. The Financial Statements for the year ended 31/03/2017 had been prepared on

the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above.

Answer:

Closure of Business: As per SA 570 “Going Concern”, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity’s ability to continue as going concern.

As per SA 570, if events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

Even when no material uncertainty exists, it requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.

Further, as per SA 701 “Communicating Key Audit Matters in the Independent Auditor’s Report”, when matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern is, by its nature, a key audit matter. SA 701 also emphasises on auditor’s responsibility to communicate key audit matters in the auditor’s report.

As per the facts given in the case, intention of the Toddle Limited had definite plan of its business being closed down within short period from 31 March, 2017. However, financial statements for the year ended 31.03.2017 had been prepared on the same basis as it had been in earlier periods with an additional note.

Thus, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity’s ability to continue as going concern is a key audit matter. Therefore, the auditor is required to Communicate the Key Audit Matters in accordance with SA 570 in above stated manner. Simple reference as to a possible cessation of business and making of adjustments, if any, be made at the time of cessation only by the auditor in his report is not sufficient.

2.RTP May 2018 Qn no. 20(d)

Key Audit Matters and Circumstances in Which a Matter Determined to Be a Key Audit

Matter Is Not Communicated in the Auditor's Report.

Answer

Key Audit Matters— As per SA 701, “Communicating Key Audit Matters in the Independent Auditor’s Report (New)”, those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters

communicated with those charged with governance.

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor’s Report: The auditor shall describe each key audit matter in the auditor’s report unless:

- (i) Law or regulation precludes public disclosure about the matter; or
- (ii) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor’s report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

3.MTP Apr 18 Qn no 6(a) 4 Marks

“The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the key factors”. You are required to define key audit matters and briefly discuss the factors determining the key audit matters.

Answer

Definition of Key Audit Matters : SA 701 “Communicating Key Audit Matters in the Independent Auditor’s Report”, define Key audit matters as matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Factors determining Key Audit Matters: As per SA 701 the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
- (ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high

estimation uncertainty.

The effect on the audit of significant events or transactions that occurred during the period.

4.RTP Nov 18 Qn no 20(a)

Write a short note on the purpose of communicating key audit matters.

Answer

Purpose of Communicating Key Audit Matters: The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

5.MTP-Oct-19 Qn No 1(c) 4 Marks:

AKY Ltd. is a listed company engaged in the business of software and is one of the largest companies operating in this sector in India. The company's annual turnover is Rs. 40,000 crores with profits of Rs. 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India. The company's contracts with its various customers are quite complicated and different. During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion. This matter was also discussed with management at various stages of audit. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner. After completion of audit for the year ended 31 March 2019, the audit partner was discussing significant matters with the management wherein they also communicated to the management that he plans to include revenue recognition as key audit matter in his audit report. The management did not agree with revenue recognition to be shown as key audit matter in the audit report. Comment.

Answer:

Determining Key Audit Matters: SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's

judgment as to what to communicate in the auditor's report and the form and content of such communication.

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

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

The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

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

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

SA 705 – Modifications to the opinion in the independent auditor's report.

Multiple Choice Questions

MTP Apr 2019 QN no 11 (2 Marks)

BC Ltd. is the business of manpower consulting. The company has a huge cash and bank balance including fixed deposits with banks. During the course of audit of the financial statements of the company for the year ended 31 March 2017,

auditors circulated independent bank balance confirmations. The auditors received all the balance (covering fixed deposits) confirmations independently. Auditors observed that the fixed deposits balances as per the independent balance confirmation did not match with the books balances in some cases. Management produced the fixed deposit certificates to the auditors wherein the balances of fixed assets matched with the balances as per the books. How should the auditor deal with this matter?

- (a) Auditor should qualify the audit report in respect of differences in book balances of fixed deposits vis a vis independent balance confirmations.
- (b) Auditor should consider the fixed deposit certificates produced by the management and basis that any differences in book balances of fixed deposits vis a vis independent balance confirmations should be ignored.
- (c) Auditor should consider the documentation provided by the management i.e. the fixed deposit certificates, however, independent balance confirmations is also required to be considered by the auditor which shows various difference. The auditor should obtain balance confirmations again.
- (d) Auditor should consider the documentation provided by the management i.e. the fixed deposit certificates, however, independent balance confirmations is also required to be considered by the auditor which shows various difference. The auditor should look to perform alternate procedures and basis that the matter should be looked at.

Answer: (d) Auditor should consider the documentation provided by the management i.e. the fixed deposit certificates, however, independent balance confirmations is also required to be considered by the auditor which shows various difference. The auditor

should look to perform alternate procedures and basis that the matter should be looked at.

MTP Apr 2019 QN no 12 (2 Marks)

SBC Private Limited appointed Mr. Vijay, Chartered Accountant as auditor of the company for the year 2017-18. While verifying the accounts Mr. Vijay noticed that the company has neither made any provision for accrued gratuity liability nor obtained the actuarial valuation thereon. Mr. Vijay obtained the actuarial valuation and includes the matter in his Audit Report to the Company's Board of Directors mentioning the amount of accrued liability not provided for. The Board agreed with the auditor's observation and the amount of liability quantified by him. But the auditor didn't disclose the same in his audit report to Member's. One of the members raised an objection on the audit report stating that it does not represent a true and fair view as even though the company has not maintained proper books of accounts as per accounting standards, the auditor has not qualified his report. Whether the auditor is require to give a qualified opinion in his report to members on non-provision of gratuity in company's accounts when the same has already been

included in the report to Company's Board of Directors?

- a) As the auditor has already disclosed the matter of non-provisioning in his report to Company's Board of Directors, there is no need to disclose the same in report to Member's u/s 143 of the Companies Act, 2013.
- b) Non-provisioning for accruing gratuity is in contravention to applicable Accounting Standard (AS-15), therefore the auditor should qualify his report to members through a paragraph on failure of management to quantify the amount of liability.
- c) The auditor should revise the accounts as per the actuarial valuation obtained by him and the revised accounts only should be presented before the Board of Directors and Members. The auditor is not required to qualify his report.
- d) U/s 143 of the Companies Act, 2013, the auditor should qualify his report to members only when the matter reported by the auditor is answered in the negative or with a qualification by the Board. In the above case the board agreed with the auditor's observation so he need not qualify his report.

Answer: (d) U/s 143 of the Companies Act, 2013, the auditor should qualify his report to members only when the matter reported by the auditor is answered in the negative or with a qualification by the Board. In the above case the board agreed with the auditor's observation so he need not qualify his report.

MTP Apr 2019 Qn no 13 (2 Marks)

AHKPL Ltd. is an unlisted company in the business of the real estate following Accounting Standards. The company recognizes revenue on the basis of percentage completion as per AS 7. The company has various residential and commercial projects at different locations for which separate profitability statements are prepared by the management. Profitability statements are based on estimated costs of the projects. While reviewing the profitability statements, statutory auditors observed that the profitability of the projects have been fluctuating significantly year on year and the prime reason for that is the change in the estimated costs. As per the auditors, frequent changes are made by the management in the estimated costs to increase the percentage completion and through which revenue and profit numbers are manipulated. The auditors are not satisfied with the profitability statements of two major projects which account for 50% of the total turnover of the company. Management tried to explain the auditors saying that the changes would happen because of the dynamics of the industry which have been changing significantly and are unfavourable to the industry as a whole. All of this is leading to changes in the estimated costs. How should the auditors deal with this matter?

- a. Management's view seems reasonable. Estimated costs are only estimates which are subject to changes and hence the auditors should drop this matter.

- b. The auditors view seems reasonable and if the management does not agree, the auditors should issue qualified report.
- c. The auditors should consider the impact of the adjustment on the financial statements and if the impact is pervasive, the auditor should issue adverse opinion.
- d. The auditors should consider the impact of the adjustment on the financial statements and may take the adjustment to unadjusted entry in the management representation letter and basis that issue a clean report.

Answer: (c) The auditors should consider the impact of the adjustment on the financial statements and if the impact is pervasive, the auditor should issue adverse opinion.

MTP Apr 2019 Qn no 14 (2 Marks)

OPP & Co LLP is the statutory auditor of ABBA Private Limited. The company has an annual turnover of INR 1000 crores and profits of INR 250 crores. The company is planning to get listed next year. The company appointed OPP & CO LLP as new auditors to have a fresh look on their financial systems so that the financial reporting can be improved wherever required.

During the course of audit, the auditors have been facing lot of challenges to obtain sufficient appropriate audit evidence and have discussed the same with the management. Now the auditors are determining the implications. Please suggest which one of the following should not be the implication in respect of this matter.

- (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion.
- (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall withdraw from the audit, where practicable and possible under applicable law or regulation.
- (c) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall withdraw from the audit, where practicable and possible under applicable law or regulation. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.
- (d) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall withdraw

from the audit, where practicable and possible under applicable law or regulation. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, report the matter to the Registrar of Companies.

Answer: (d) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall withdraw from the audit, where practicable and possible under applicable law or regulation. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, report the matter to the Registrar of Companies.

MTP Oct 2019 Qn no 16 (2 Marks)

While conducting the current year audit of Finco Ltd, the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements. This misstatement was related to recognition of research and development expenditure. The provisions of Ind AS 38 Intangible Assets relating to capitalisation of development expenditure was not applied properly. On this, unmodified opinion had been previously issued. The current auditor verified that the misstatement had not been dealt with as required under Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Accordingly, the current auditor will:

- (e) Express a qualified or an adverse opinion in the auditor's report on the current period financial statements modified with respect to the corresponding figures included therein.
- (f) Express an unmodified opinion in the auditor's report on the current period financial statements since it was related to the prior year.
- (g) Express a qualified opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
- (h) Express an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.

Answer: (a) Express a qualified or an adverse opinion in the auditor's report on the current period financial statements modified with respect to the corresponding figures included therein.

Descriptive Questions

1. Mar 2018 MTP 1 (c) 5 Marks

As an auditor of ABC Limited, in view of given circumstances, you are required to draft disclaimer of opinion and basis for disclaimer of opinion due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence about Multiple Elements of the Financial Statement.

- **Audit of a complete set of financial statements of an entity other than a company incorporated under the Companies Act, 2013, using a fair**

presentation framework. The audit is not a group audit (i.e., SA 600, does not apply).

- The financial statements are prepared by management of the entity in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements, that is, the auditor was also unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.
- The relevant ethical requirements that apply to the audit are ICAI's Code of Ethics and applicable law/regulation
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- A more limited description of the auditor's responsibilities section is required.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under relevant law/ regulation.

Answer

Disclaimer of Opinion: We were engaged to audit the financial statements of ABC & Associates ("the entity"), which comprise the balance sheet as at March 31, 20XX, the statement of Profit and Loss, (the statement of changes in equity)(where applicable) and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

We do not express an opinion on the accompanying financial statements of the entity. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after March 31, 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 20X0 and 20X1, which are stated in the Balance Sheets at ` xxx and ` xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ` xxx as at March 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded

inventories and accounts receivable, and the elements making up the statement of Profit and Loss (and statement of cash flows)(Where applicable).

2.Apr 18 MTP 1(C) 5 Marks

As an auditor of XYZ Limited, in view of given circumstances, you are required to draft Adverse Opinion and basis for adverse opinion due to a Material Misstatement of the Consolidated Financial Statements.

- Audit of a complete set of consolidated financial statements of a listed company (incorporated under the Companies Act, 2013) using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., SA 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the consolidated financial statements in SA 210.
- The consolidated financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so (i.e., an adverse opinion is appropriate).
- The relevant ethical requirements that apply to the audit are the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- SA 701 applies; however, the auditor has determined that there are no key audit matters other than the matter described in the Basis for Adverse Opinion section.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.

In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.

Adverse Opinion : We have audited the accompanying consolidated financial statements of XYZ Company Limited (hereinafter referred to as the "Holding Company") and its subsidiaries (the Holding Company and its subsidiaries together referred to as "the Group"), its associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2XXX, the consolidated statement of profit and Loss, (consolidated statement of changes in equity){where

applicable} and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the “consolidated financial statements”).

In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 20XX, of its consolidated profit/loss, (consolidated position of changes in equity)){where applicable} and the consolidated cash flows for the year then ended.

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary PQR Company that the Group acquired during 20XX because it has not yet been able to determine the fair values of certain of the subsidiary’s material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had PQR Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group, its associates and jointly controlled entities, in accordance with the Code of Ethics and provisions of the Companies Act, 2013 that are relevant to our audit of the consolidated financial statements in India under the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics and the requirements under the Companies act, 2013. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

3.MTP-Aug-18 Qn No 1(C) 5 Marks:

As an auditor of ABC Limited, in view of given circumstances, you are required to draft qualified opinion and basis for qualified opinion due to the departure from the applicable Financial Reporting Framework:

- **Audit of a complete set of financial statements of a company other than a listed company (registered under the Companies Act, 2013) using a fair presentation framework.**
- **The financial statements are prepared by management of the entity**

in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general-purpose framework).

- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- A departure from the applicable financial reporting framework resulted in a qualified opinion.
- The relevant ethical requirements that apply to the audit are the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.

Answer:

Qualified Opinion

We have audited the standalone financial statements of ABC Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches))².

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at March 31st, 2XXX and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

Basis for Qualified Opinion

The Company's short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but

has instead stated them at cost, which constitutes a departure from the Accounting Standards prescribed in section 133 of the Companies Act, 2013. The Company's records indicate that had management marked the marketable securities to market, the Company would have recognized an unrealized loss of Rs.xxx in the statement of comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at March 31, 20X1, and income tax, net income and shareholders' equity would have been reduced by Rs.xxx, Rs.xxx and Rs.xxx, respectively.

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI's Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with SA 701.

- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.

4.MTP-Apr-19 Qn No 1(b) 4 Marks:

ADKS & Co LLP are the newly appointed statutory auditors of PPK Ltd. During the course of audit, the statutory auditors have come across certain significant observations which they believe could lead to material misstatement of financial statements. Management has a different view and does not concur with the view of the statutory auditors. Considering this the statutory auditors are determining as to how to address these observations in terms of their reporting requirement. Please advise

Answer:

- (b) As per SA 705, if the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in his report.

The auditor in such a case needs to determine the modification as follows:

- (i) **Qualified Opinion:** The auditor shall express a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.
- (ii) **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements
- (iii) **Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity, and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

5.May 2019 Qn no 1(C)4 marks

After accepting the statutory audit of M/s All in One Ltd., a departmental store, you became aware of the fact that management of the company have imposed certain limitations on the scope of your assurance function which may adversely affect and result in your inability to obtain sufficient appropriate audit evidence to discharge your responsibility required by the statute. Indicate the consequences and your response to the limitations imposed by the management on your scope.

Answer

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement: As per SA 705, Modification to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the prescribed limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (i) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (ii) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 1. Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 2. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

If the auditor withdraws as discussed above, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

6.May 2019 Qn no 2(b) 4 Marks

ALM Associates has been appointed as auditor of M/s Hary Ltd. which acquired 55% shares-in M/s Sam Ltd. on 15th October, 2018. During audit of Harry Ltd., the auditors found that the company has not prepared consolidated financial statements because on the date of acquisition the fair value of certain assets & liabilities has not been ascertained which is significant and are accounted for on estimated basis only. Help ALM Associates in framing opinion paragraph of audit report.

Answer

Opinion Paragraph of Audit Report: In the instant case, M/s Hary Ltd. acquired 55% shares in M/s Sam Ltd. and the company did not prepare the consolidated financial statements because on the date of acquisition the fair value of certain assets and liabilities has not been ascertained. Therefore, accounting is done on estimate basis only which is not correct as the financial statements are materially misstated due to non-consolidation of subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. Thus, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidences, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Adverse Opinion

In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2019, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

Basis for Adverse Opinion is given below:

As explained in Note X, the M/s Hary Ltd. has not consolidated subsidiary M/s Sam Ltd. that the M/s Hary Ltd acquired during 2018 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on an estimate basis. Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had M/s Sam Ltd. been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

SA 706 Emphasis of Matter Paragraph and other matter paragraph

Multiple Choice Questions

MTP Apr 2019 Qn no 16 (2 Marks)

APP Ltd. is listed on National Stock Exchange in India. Post audit rotation, KYP & Co LLP

have been appointed as the statutory auditors of APP Ltd. The company has a pending litigation in respect of service tax matter which has been going on for long time now and exposure of the company towards that litigation is very significant.

The new auditors got the exposure of this case evaluated by involving their in-house tax experts who have shared a view that the exposure of the company would be medium. As per the requirements of accounting standards, medium exposure would be considered as a possible impact for which probability is 50%. The company has been disclosing this as a contingent liability in the previous years. However, the new auditors are of the view that this is a significant matter that requires user's attention by disclosing this in the financial statements and it is of such importance that it is fundamental to user's understanding of financial statements. Further there is a material uncertainty in respect of this matter (i.e. demand raised by service tax department).

Basis this, auditors want to include Emphasis of matter (EOM) in their report. Management is of the view that since this was not reported by previous auditors as EOM, hence it should not be included by new auditors also and also being a listed company, it is not appropriate to include EOM in the first year of audit by a new firm.

Please suggest which of the following is correct.

- EOM should be included by new auditors.
- EOM should not be included by new auditors if the previous auditors have not given that.
- EOM should not be given, however, there should be a disclosure of this matter in the financial statements and also the fact that auditors are in the first year of audit and this matter would require detailed evaluation.
- Auditors should qualify the report instead of EOM.

Answer: Option (a) EOM should be included by new auditors.

SA 710 Comparative Information – Corresponding Figures and Comparative Financial Statements

Descriptive Questions

1. MTP Mar 2018 1(d) 5 Marks

The audit report of P Ltd. for the year 2016-17 contained a qualification regarding non-provision of doubtful debts. As the statutory auditor of the company for the year 2017-18, decide how would you report, if :

- The company does not make provision for doubtful debts in 2017-18?
- The company makes adequate provision for doubtful debts in 2017-18?

Answer

Auditor's responsibilities in cases where audit report for an earlier year is qualified is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements". As per SA 710, When the auditor's report on

the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

- Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant Case, if P Ltd. does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

2.RTP Nov 18 Qn no 20(d)

Write Short note on the auditor's responsibilities regarding comparatives

Auditor's responsibilities regarding comparatives: SA 710, "Comparative Information – Corresponding Figures and Comparative Financial Statements", establishes standards on the auditor's responsibilities regarding comparatives.

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

- (i) The comparative information agrees with the amounts and other disclosures presented in the prior period; and
- (ii) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine

whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 (Revised).

As required by SA 580 (Revised), the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

SAE 3400 The Examination of Prospective Financial Statement

Descriptive Questions

1. Study Material

T & Co. wants to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by T & Co. to examine the projected financial statements and give report thereon. What things you will consider before accepting the audit engagement and what audit evidence will be obtained for reporting on projected financial statements?

Projected Financial Statements: As per SAE 3400, "The Examination of Prospective Financial Information", the answer is divided into two parts i.e. (i) the things to be considered before accepting the engagement and (ii) audit evidence to be obtained for reporting on projected financial statements.

(i) Acceptance of Engagement: As per SAE 3400, "The Examination of Prospective Financial Information", before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:

- (1) the intended use of the information;
- (2) whether the information will be for general or limited distribution;
- (3) the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
- (4) the elements to be included in the information; and
- (5) the period covered by the information.

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement.

Audit evidence to be obtained for Reporting on Projected Financial Statements: The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

- (6) the sources of information,
- (7) basis of forecasts,
- (8) the assumptions made in arriving the forecasts,
- (9) hypothetical assumptions, evidence supporting the assumptions,
- (10) management representations regarding the intended use and distribution of the information, completeness of material assumptions,
- (11) management's acceptance of its responsibility for the information,
- (12) audit plan,
- (13) the nature, timing and extent of examination procedures performed, and,
- (14) in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.

SA720 The Auditor's Responsibility in Relation to Other Information

Descriptive Questions

1.Nov 2019 Qn no 1(b) 5 Marks

LMP Associates, Chartered Accountants, conducting the audit of PQR Ltd., a listed Company for the year ended 31st March 2019 is concerned with the auditor's responsibilities relating to other information, both financial and non-financial, included in the Company's annual report. While reading other information, LMP Associates considers whether there is a material inconsistency between other information and the financial statements. As a basis for the consideration the auditor shall evaluate their consistency, compare selected amounts or other items in the other information with such amounts or other items in the financial statements. Guide LMP Associates with examples of "Amounts" or "other items" that may be included in the "other information" with reference to SA 720.

Examples of Amounts or Other Items that May Be Included in the Other Information: As per SA 720 "The Auditor's Responsibility in Relation to Other Information", the following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.

Amounts

- (i) Items in a summary of key financial results, such as net income, earnings per share, dividends, sales and other operating revenues,

and purchases and operating expenses.

- (ii) Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
- (iii) Special items, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
- (iv) Liquidity and capital resource information, such as cash, cash equivalents and marketable securities; dividends; and debt, capital lease and minority interest obligations.
- (v) Capital expenditures by segment or division.
- (vi) Amounts involved in, and related financial effects of, off-balance sheet arrangements.
- (vii) Amounts involved in guarantees, contractual obligations, legal or environmental claims, and other contingencies.
- (viii) Financial measures or ratios, such as gross margin, return on average capital employed, return on average shareholders' equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilable to the financial statements.

Other Items

- (i) Explanations of critical accounting estimates and related assumptions.
- (ii) Identification of related parties and descriptions of transactions with them.
- (iii) Articulation of the entity's policies or approach to manage commodity, foreign exchange or interest rate risks, such as through the use of forward contracts, interest rate swaps, or other financial instruments.
- (iv) Descriptions of the nature of off-balance sheet arrangements.
- (v) Descriptions of guarantees, indemnifications, contractual obligations, litigation or environmental liability cases, and other contingencies, including management's qualitative assessments of the entity's related exposures.
- (vi) Descriptions of changes in legal or regulatory requirements, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position, or will have a material impact on the entity's future financial prospects.
- (vii) Management's qualitative assessments of the impacts of new financial reporting standards that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.
- (viii) General descriptions of the business environment and outlook.
- (ix) Overview of strategy.
- (x) Descriptions of trends in market prices of key commodities or raw

materials.

- (xi) Contrasts of supply, demand and regulatory circumstances between geographic regions.
- (xii) Explanations of specific factors influencing the entity's profitability in specific segments.

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Chapter2 Audit Planning and Strategy Execution

Multiple Choice Questions

1.MTP Apr 2019 Qn no 17 (2 Marks)

NT 22 Group is a large group comprising of 22 subsidiary companies, 14 associate companies and 19 joint ventures. NT Ltd. is the holding company which is also listed on Bombay Stock Exchange and New York Stock Exchange. The Group prepares its consolidated financial statements every quarter for various reporting requirements – SEBI (Stock and Exchange Board of India), Stock Exchanges, Registrar of Companies in India and others. The turnover of the Group is INR 15,000 crores and many of its components have significant operations at standalone level.

The Group is audited by one audit firm, Seema & Co LLP. For the purpose of

group audit of the current year, the auditors have considered performing testing of journal entries across the group to address the significant risk, however, the auditors are facing challenges to perform this audit procedure across the group because of the volume and limitation of resources. Please suggest the correct options in respect of this matter.

- a. The Group auditors have a choice to test journal entries of the components which is also backed up by the auditing standards.
- b. The Group auditors must test journal entries of all components.
- c. The Group auditors need not test journal entries of components requiring analytical response at group level.
- d. The Group auditors need not test journal entries of components scoped with comprehensive approach.

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

2.MTP oct 2019 QN no 9 (1 Mark)

CA Sameer, after developing the audit strategy for Menka Ltd., develops an audit plan but finds a need to revise the materiality levels set earlier and therefore a deviation from the already set audit strategy is felt necessary. In this case, he should

- a) Continue with the Audit Plan without considering the Audit Strategy
- b) Drop the audit and withdraw from the engagement
- c) First Modify the audit strategy and thereafter prepare the audit plan according to the modified strategy.
- d) Devise a new audit plan and then, change the strategy as per the Revised Plan.

Answer: Option (c) First Modify the audit strategy and thereafter prepare the audit plan according to the modified strategy.

Descriptive Questions

1.RTP May 2018 Qn no.3

xLoud, a movie theatre complex, is the foremost theatre located in Delhi. Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe shops, pubs etc. located in the complex. Its 'other income' includes advertisements exhibited within/outside the premises such as hoarding, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises.

xLoud appointed your firm as the auditor of the entity. Being the head of the audit team, you are therefore required to draw an audit programme initially in respect of its revenue and expenditure considering the above mentioned facts along with other relevant points related to a complex.

Nov 2019 Qn no 3(b) 5 Marks

Cineplex, a movie theatre complex, is the foremost theatre located in Delhi.

Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe, shops, pubs etc. located in the complex. Its other income includes advertisements exhibited within/outside the premises such as hoardings, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises.

Cineplex appointed your firm as the auditor of the entity. Being the head of the audit team, you are, therefore, required to draw an audit programme initially in respect of its revenue and expenditure considering the above mentioned facts along with other relevant points relating to a complex.

Answer

Audit Programme of a Complex:

- (i) Peruse the Memorandum of Association and Articles of Association of the entity.
- (ii) Ensure the object clause permits the entity to engage in this type of business.
- (iii) In the case of income from sale of tickets:
 - (1) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
 - (2) Verify the system of relating to online booking of various shows and the system of realization of money.
 - (3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
- (iv) Verify the **internal control system** and its effectiveness relating to the income from café, shops, pubs, game zone etc., located within the multiplex.
- (v) Verify the system of control exercised relating to the **income receivable from advertisements** exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
- (vi) Verify the system of collection from the **parking areas** in respect of the vehicles parked by the customers.
- (vii) In the case of **payment to the distributors** verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
- (viii) Verify the system **of payment of salaries and other benefits to the employees** and ensure that statutory requirements are complied with.
- (ix) Verify the payments effected in respect of the **maintenance of the**

building and ensure the same is in order.

- (x) Verify the insurance premium paid and ensure it covers the entire assets.

2.MTP Apr 18 Qn no.2(d) 5 Marks

XY Ltd. is a manufacturing company, provided following details of wastages of raw materials in percentage, for various months. You have been asked to enquire into causes of abnormal wastage of raw materials. Draw out an audit plan.

Wastage percentage are

July 2017	2.5%
Aug 2017	2.7%
Sep 2017	2.4%
Oct 2017	8.1%

Answer

Audit Plan to locate the Abnormal Wastage of Raw Material: To locate the reasons for the abnormal wastage, the auditor should first of all assess the general requirements as under:

- (i) Procure a list of raw materials, showing the names and detailed characteristics of each raw material.
- (ii) Obtain the standard consumption figures, and ascertain the basis according to which normal wastage figures have been worked out. Examine the break-up of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.
- (iii) Examine the various records maintained for recording separately the various lots purchased and identification of each lot with actual material consumption and for ascertaining actual wastage figures therein.
- (iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrap work.
- (v) Assess whether personnel employed are properly trained and working efficiently.
- (vi) See whether quality control techniques have been consistent or have undergone any change.
- (vii) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.
- (viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months.

- (ix) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

In addition, some specific reasons for abnormal wastage in process may be considered by the auditor are as under:

- (i) Examine laboratory reports and inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.
- (ii) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.
- (iii) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors' reports in respect of inspection carried out on the completion of each stage of work or process.
- (iv) It is possible that the wastage may have occurred because the particular lot out of which issues were made was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures.
- (v) Abnormal wastage in storage and handling may arise due to the following reasons:
- (1) Write offs on account of reconciliation of physical and book inventories: In case of periodical physical inventory taking, such write offs will be reflected only in the month such reconciliation takes place.
 - (2) Accidental, theft or fire losses in storage: The auditor should examine the possibility of these for the purpose.
- (vi) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.

3.MTP-OCT-19 Qn No 5(a) 5 Marks:

INDO Bank appointed your firm of Chartered Accountants as a branch auditor for the financial year 2018-19. Being head-in-charge of the assignment, while planning, you distributed the work among your team members and assigned Mr. Pary for verification of bills payable. However, Mr. Pary, being fresh to the bank audits, needs your guidance. Kindly guide.

Answer:

Bills Payable: Evaluate the existence, effectiveness and continuity of internal controls over bills payable. Such controls should usually include the following-

- Drafts, mail transfers, traveller's cheques, etc. should be made out in standard printed forms.
- Unused forms relating to drafts, traveller's cheques, etc. should be kept under the custody of a responsible officer.

- The bank should have a reliable private code known only to the responsible officers of its branches, coding and decoding of the telegrams should be done only by such officers.
- The signatures on a demand draft should be checked by an officer with the specimen signature book.
- All the telegraphic transfers and demand drafts issued by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch.

Examine an appropriate sample of outstanding items comprised in bills payable accounts with the relevant registers. Reasons for old outstanding debits in respect of drafts or other similar instruments paid without advice should be ascertained.

Correspondence with other branches after the year-end (e.g., responding advices received from other branches, advices received from other branches in respect of drafts issued by the branch and paid by the other branches without advice) should be examined specially in so far as large value items outstanding on the balance sheet date are concerned.

4.RTP Nov 18 Qn no 3(A)

Key phases in the audit execution stage are Execution Planning, Risk and Control Evaluation, Testing and Reporting. Explain.

Answer

Execution Planning: Prior to commencement of an audit engagement, it is important to lay down the roadmap for audit execution to ensure timely and quality audit results. The auditors need to plan their work in order to carry out the audit in an effective, efficient and timely manner. A detailed audit program is prepared laying down the audit objectives, scope and audit approach. The manpower requirement, audit team qualifications, and the time element, etc. are some of the important considerations during execution planning. In order to plan effectively, the auditor may need some more information about the audit area. A preliminary survey would help in gathering the required information.

1. **Risk and Control Evaluation:** For each segment of audit, the auditors should conduct a detailed risk and control assessment i.e. list the risks that must be reviewed in that segment, capture for each risk the controls that exist or those that are needed to protect against the risk and show for each control, the work steps required to test the effectiveness of the controls. While making Risk & Control assessment it is necessary to borne in mind Materiality levels as the same is linked with Audit Risks.
- 3 **Testing:** Once a comprehensive understanding is gained of the key risks and the controls to be evaluated in a given audit area, the auditors should test the operating effectiveness of the

controls to determine whether controls are operating as designed. There are multiple test methods which can be used to arrive at the conclusions on the effectiveness of the controls

- 4 **Reporting:** SA 700, “Forming an Opinion and Reporting on Financial Statements” establishes standards on the form and content of the auditor’s report issued as a result of an audit performed by an auditor of the financial statements of an entity. The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements such as compliance of Provisions & Enactments of the Company Law, Accounting Standards framed by ICAI, latest Guidelines etc.

The auditor’s report should contain a clear written expression of opinion on the financial statements taken as a whole. A measure of uniformity in the form and content of the auditor’s report is desirable because it helps to promote the reader’s understanding of the auditor’s report and to identify unusual circumstances when they occur. A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report.

- 5 **Other Important Considerations:** In addition to above, there are certain other consideration which auditor is required to take care while executing the audit such as using the work of other auditor, using the work of an auditor’s expert etc.

Study Material

1. While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?

Answer

As per SA 540 “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures”, the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

- The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.
- How Management identifies those transactions, events and conditions that may

give rise to the need for accounting estimates to be recognised or disclosed, in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.

- The estimation making process adopted by the management including-
- The method, including where applicable the model, used in making the accounting estimates.
- Relevant controls.
- Whether management has used an expert?
- The assumption underlying the accounting estimates.
- Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
- Whether and, if so, how the management has assessed the effect of estimation uncertainty.

2. KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2018-19. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma. Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.

Answer

Using the work of an Auditor's Expert: As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert.

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances

must be verified by the auditor.

In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on found faulty. Further, Mr. Z is not agreed with this report therefore he submitted a separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

Mr. X and Mr. Y will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.

3. A & Co. was appointed as auditor of Great Airways Ltd. As the audit partner what factors shall be considered in the development of overall audit plan?

Answer

Development of an overall plan - Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:

- (i) Terms of his engagement and any statutory responsibilities.
- (ii) Nature and timing of reports or other communications.
- (iii) Applicable Legal or Statutory requirements.
- (iv) Accounting policies adopted by the clients and changes, if any, in those policies.
- (v) The effects of new accounting and auditing pronouncement on the audit.
- (vi) Identification of significant audit areas.
- (vii) Setting of materiality levels for the audit purpose
- (viii) Conditions requiring special attention such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- (ix) Degree of reliance to be placed on the accounting system and internal control.
- (x) Possible rotation of emphasis on specific audit areas.
- (xi) Nature and extent of audit evidence to be obtained.
- (xii) Work of the internal auditors and the extent of reliance on their work, if any in

the audit.

(xiii) Involvement of other auditors in the audit of subsidiaries or branches of the client and involvement of experts.

(xiv) Allocation of works to be undertaken between joint auditors and the procedures for its control and review.

(xv) Establishing and coordinating staffing requirements.

4. As an auditor of garment manufacturing company for the last five years, you have observed that new venture of online shopping has been added by the company during current year. What factors would be considered by you in formulating the audit strategy of the company?

Answer

Formulation of Audit Strategy: While formulating the audit strategy for a company, following factors may be considered -

Specific Factors for Online Shopping:

The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:

- (i) The classes of transactions in the entity's operations that are significant to the financial statements;
- (ii) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
- (iv) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;

Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments

5. AKJ Ltd is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and have their corporate office in Delhi. Recently the company appointed new firm of Chartered Accountants as their statutory auditors.

The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the

statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter?

Answer: As per SA 210 'Agreeing the Terms of Audit Engagements', the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- (i) The objective and scope of the audit of the financial statements;
- (ii) The responsibilities of the auditor;
- (iii) The responsibilities of management;
- (iv) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- (v) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Multiple Choice Questions

AK & Co, a firm of Chartered Accountants, have been operating for the last 6 years. Due to the quality of service offered by the firm, it has made its name and is quite renowned especially in Southern India where its head office is located. The firm has a staff size of 240 including graduates, Chartered Accountants, Management Consultants, Company Secretaries and lawyers.

The firm has 3 branches other than head office at Bangalore, Chennai and Pune. The firm has got many clients for statutory audit over the period and ensures that to maintain the quality of work, proper planning is done by each team before starting any engagement.

One of the engagement team, picked up for statutory audit of Sun Private Ltd, was involved in the process of planning of audit for the financial year ended 31 March, 2019.

The audit for the financial year ended 31 March, 2018 was conducted by a different engagement team. However, the engagement team of Sun Private Ltd for the current year has got the industry experience. The audit team is confused during the planning work and would like to have your views on following points. Please advise by answering one of them.

- (a) The engagement team should consult the previous year's engagement team during the course of their planning.
- (b) The engagement team should be independent and hence cannot consult the previous year's engagement team during the course of their planning.
- (c) The engagement team needs to maintain confidentiality and hence cannot consult the previous year's engagement team during the course of their planning.
- (d) Only the Partner who is going to sign the audit report may consult the previous year's audit team.

Answer: Option: (a)

Kshitij Private Ltd is a company based out of Kochi having operations primarily in Europe. Because of the nature of the operations of the company, it is required to prepare its financial statements as per International Standards for reporting to the local regulatory authorities over there.

Since the business is based in Europe, the audit team is also required to visit the locations wherever the company has offices and is accordingly required to perform certain audit procedures over there.

During the audit of this company for the financial year ended 31 March, 2019, the auditors, who had planned their work appropriately and had a large team for conducting the audit, were facing lot of challenges at various stages.

They were also required to revisit their materiality level during the course of the work.

However, at the time of final reviews when this was discussed with the Audit Partner (Audit Incharge), he was not convinced with the approach of the audit team wherein they reassessed their plans continuously resulting in waste of time.

In this situation, please advise which one of the following would be correct.

- (a) Audit Partner being the senior most team member is right and same thing should be considered by audit team by documenting it in the audit file.
- (b) Audit Partner's view is not correct as the audit team did the right thing.
- (c) Audit Partner was correct, however, during the course of an audit which required visits at various locations it was mandatory.
- (d) Audit Partner's view is not correct because the materiality was revised by the audit team which is a big thing and same should have been considered by the audit partner.

Answer: Option: (b)

RJ Private Limited having its office at Bangalore and operations spread across Southern India, had a discussion with its statutory auditors regarding the audit plan and the timelines.

In the past years, there have been significant delays in completion of audit work and the

management wanted that for the current year, audit should get completed on time. For doing this, the audit team suggested that the information for the purpose of audit should be ready on time and only then the timelines as agreed can be achieved.

On the basis of the discussions with the client & the auditors and internal discussions amongst the audit team members, a detailed audit programme was prepared by the audit team for the current year's audit. But the audit team discussed that they will not document this audit programme till the completion of the audit work because at various stages, the work may require changes. If the audit team documents the audit programme then it would create problems later on at the time of assembly of the audit file wherein the audit team would have to show the changes made by them in the audit programme during the course of the audit.

You are required to share your views in respect of this understanding and approach of the auditor.

- (a) The decision of audit team regarding not documenting the audit programme is very good as this would avoid unnecessary problems of documentation of changes made in the audit programme at the time of assembly of file.
- (b) Instead of considering the audit programme, the audit team could have prepared a checklist. In case of a checklist, such problem will not arise. Because in case of a checklist if any changes are made then the final checklist can be kept in the file along with old working checklist used during the audit.
- (c) The approach of the audit team not to document audit programme is not correct. The audit team needs to document it properly at the time of planning stage itself and any changes made after that should also be documented with explanations.
- (d) The decision of audit team not to document the audit programme is not correct. Their concern that the changes may arise in the audit programme is valid, however, to take care of that the audit team can take approval from the ICAI later on when those changes will be made. The audit team will have to document the changes and the approval note of the ICAI.

Answer:Option: (c)

KJ Private Ltd has a business of pharmaceuticals and has an annual turnover of INR 1,500 crores. During the last few years, considering the environment in which the company operates, its profit have reduced and are still reducing. Hence the management has been looking at various ways to cut the costs.

AD & Associates are the statutory auditors of the company and RM & Associates are the internal auditors of the company Initially the company did not want to appoint any internal auditors to save costs, however, at insistence of the statutory auditors, the company appointed the internal auditors.

During the course of the statutory audit for the financial year ended 31 March, 2019, the statutory auditors requested for the detailed working papers of the internal auditors which the internal auditors refused. However, the statutory auditors told the

management if the same are not provided then they would qualify their report.

In this situation, please advise which of the following would be correct.

(a) The statutory auditors should review the detailed working papers but they cannot qualify their report on this ground.

(b) The statutory auditors may review the detailed working papers and even after that they may qualify their report.

(c) The statutory auditors are not required to go to the extent of review of detailed working papers of internal auditors.

(d) The statutory auditors may review the detailed working papers of internal auditors but for that purpose they would require prior approval of the ICAI.

Answer: Option : (c)

RIM Private Ltd is engaged in the business of manufacturing of steel having annual turnover of INR 10,000 crores. The company is very capital intensive and has its plants at two locations – Mohali and Hosur.

During the year ended 31 March, 2019, the company carried out a detailed physical verification of its property, plant and equipment and also reassessed their useful lives by engaging a consultant. The consultant submitted its report to the management on 21 April, 2019.

The statutory auditors of the company started their audit work from May 2019 and when this information was given to them regarding the physical verification and the reassessment of the useful lives of property, plant and equipment, the auditors told the management that the consultant should have submitted its report to the auditors also independently. Further, in the absence of this direct communication of the report of the consultant to the auditors, the audit team would have to review the work of the consultant which is not efficient but it cannot be avoided now.

Management did not agree with both the points of the auditors that the consultant should have shared report with the auditors directly and that the auditors need to review the work of the consultant. The management would like to have your views on this matter.

(a) The view of the management seems to be correct because there is no such requirement that any consultant of the company should share his report directly with the auditor. Also when the consultant has already submitted a detailed report, no further review is required on that.

(b) Both the management and auditors are not correct. The auditor is not supposed to receive the report directly. Further, the auditor needs to review the work of the consultant irrespective of the fact whether he received the report directly or not.

(c) The auditor's requirements are reasonable because he carries duty in respect of audit of financial statements and by not getting report directly from the consultant he would not know whether it belongs to that consultant or not. And now only

because of this lack of proper communication the auditor would have to review the work of the consultant.

(d) Both management and auditors should find a solution to this problem. The management may request the consultant to send the report to the auditor directly now. On the basis of the same, the auditor can avoid unnecessary procedure related to review of report of the consultant.

Answer: Option : (b)

Chapter 3 Risk Assessment and Internal Control

Multiple Choice Questions

1.MTP Oct 2019 Qn no 18 (2 Marks)

You are the audit senior in charge of the audit of Swandive Co, and have been informed by your audit manager that during the current year a fraud occurred at the client. A payroll clerk sets up fictitious employees and the wages were paid into the clerk's own bank account. This clerk has subsequently left the company, but the audit manager is concerned that additional frauds have taken place in the wages department. Which of the following audit procedures would be undertaken during the audit of wages as a result of the manager's assessment of the increased risk of fraud?

- (1) Discuss with the payroll manager the nature of the payroll fraud, how it occurred and the financial impact of amounts incorrectly paid into the payroll clerk's bank account.
 - (2) Review the supporting documentation to confirm the total of the fraudulent payments made and assess the materiality of this misstatement.
 - (3) Review and test the internal controls surrounding setting up of and payments to new joiners to assess whether further frauds may have occurred.
 - (4) Review the legal action taken by the management against the payroll clerk who was involved in the fraud and see whether he is punished for his actions.
- (a) Audit procedures 1,2,3
 - (b) Audit procedures 2,3,4
 - (c) Audit procedures 1,3,4
 - (d) Audit procedures 1,2,4

Answer: (a) Audit procedures 1,2,3.

Descriptive Questions

1.RTP May 2018 Qn no.4

(a) While commencing the statutory audit of Alex Co. Ltd., what would you consider as an auditor to assess risk of material misstatement and responses to such risks?

(b) Prabhu Ltd., a manufacturing concern wants to develop internal control system. You are an expert in developing the internal control system, hereby called to brief about the same. In view of above, you are required to brief about internal control system and inherent limitations of the internal control?

Answer

Considerations of Auditor for Assessing the Risk of Material Misstatement: As per SA 315 “Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment”, the auditor shall identify and assess the risks of material misstatement at the financial statement level; and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor shall:

- (i) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
- (i) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- (ii) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
- (iii) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Auditor’s Responses to the Assessed Risk of Material Misstatement: According to SA 330 “The Auditor’s Responses to Assessed Risks”, the auditor shall design and implement overall responses to address the assessed risks of material misstatement. In designing the audit procedures to be performed, the auditor shall:

- (i) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:
 - (1) The likelihood of material misstatement due to the particular

- characteristics of the relevant class of transactions, account balance, or disclosure; and
- (2) Whether the risk assessment takes into account the relevant controls, thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively; and
- (ii) Obtain more persuasive audit evidence the higher the auditor's assessment of risk.

(b) Internal Control System and its Inherent Limitations: As per Guidance Note on Audit of Internal Financial Control over Financial Reporting, internal controls are a system consisting of specific policies and procedures designed to provide management with reasonable assurance that the goals and objectives it believes important to the entity will be met.

"Internal Control System" means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

To state whether a set of financial statements presents a true and fair view, it is essential to benchmark and check the financial statements for compliance with the framework. The Accounting Standards specified under the Companies Act, 1956 (which are deemed to be applicable as per Section 133 of the 2013 Act, read with Rule 7 of Companies (Accounts) Rules, 2014) is one of the criteria constituting the financial reporting framework on which companies prepare and present their financial statements under the Act and against which the auditors evaluate if the financial statements present a true and fair view of the state of affairs and the results of operations of the company in an audit of the financial statements carried out under the Act.

The fundamental therefore is that effective internal control is a process effected by people that supports the organization in several ways, enabling it to provide reasonable assurance regarding risk and to assist in the achievement of objectives.

Fundamental to a system of internal control is that it is integral to the activities of the company, and not something practiced in isolation.

An internal control system:

- ◆ Facilitates the effectiveness and efficiency of operations.
- ◆ Helps ensure the reliability of internal and external financial reporting.
- ◆ Assists compliance with laws and regulations.
- ◆ Helps safeguarding the assets of the entity.

Limitations of Internal Control - Internal control, no matter how effective, can

provide an entity with only reasonable assurance and not absolute assurance about achieving the entity's operational, financial reporting and compliance objectives. Internal control systems are subject to certain inherent limitations, such as:

- ◆ Management's consideration that the cost of an internal control does not exceed the expected benefits to be derived.
- ◆ The fact that most internal controls do not tend to be directed at transactions of unusual nature. The potential for human error, such as, due to carelessness, distraction, mistakes of judgement and misunderstanding of instructions.
- ◆ The possibility of circumvention of internal controls through collusion with employees or with parties outside the entity.
- ◆ The possibility that a person responsible for exercising an internal control could abuse that responsibility, for example, a member of management overriding an internal control.
- ◆ Manipulations by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

2.MTP-Aug-18 Qn No 5(b) 4 Marks:

XYZ Hospital Private Ltd. is engaged in running a hospital of 200 Beds since last 20 years. Revenue Track of the hospital for last 3 years is as under:

2015-16	-	20 Crores
2016-17		25 Crores
2017-18		35 Crores

Hospital has its own Pharmacy, Laboratory, Blood Bank, Radiology & General Stores. Its management suspects that leakages/theft is happening in Pharmacy, Radiology, Laboratory and General Stores departments. It seeks advice of RST & Co., Internal Auditors of the Company, as to how it can Institute/Improve its Internal Control. In this context, Management wants to understand the concept of components of Internal Control Structure in detail. Advise.

Answer:

The Internal Control structure in an organization is referred to as the policies and procedures established by the entity to provide reasonable assurance that the objectives are achieved. The control structure in an organization basically has the following components:

1. **Control Environment** - Control environment covers the effect of various factors like management attitude; awareness and actions for establishing, enhancing or mitigating the effectiveness of specific policies and procedures.
2. **Accounting System** - Accounting system means the series of task and records of an entity by which transactions are processed for maintaining financial records. Such system identifies, assemble,

analyze, calculate, classify, record, summarize and report transactions and other events.

3. **Control Procedure** - Policies and procedures means those policies and procedures in addition to the control environment and accounting systems which the management has established to achieve the entity's specific objectives.

In this regard, the management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent that they are appropriate to the size and nature of the business. There should be reasonable assurance for the auditor that the accounting system is adequate and that all the accounting information required to be recorded has in fact been recorded.

Internal controls normally contribute to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. Where the auditor concludes that he can rely on certain internal controls, he could reduce his substantive procedures which otherwise may be required and may also differ as to the nature and timing.

Specific Requirement under **SA 315 - "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment"** deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control.

3.RTP May 2019 Qn no 13

ST Ltd is a growing company and currently engaged in the business of manufacturing of tiles. The company is planning to expand and diversify its operations. The management has increased the focus on the internal controls to ensure better governance. The management had a discussion with the statutory auditors to ensure the steps required to be taken so that the statutory audit is risk based and focused on areas of greatest risk to the achievement of the company's objectives. Please advise the management and the auditor on the steps that should be taken for the same.

MTP-OCT-18 Qn No 4(b) 5 Marks:

ST Ltd is a growing company and currently engaged in the business of manufacturing of tiles. The company is planning to expand and diversify its operations. The management has increased the focus on the internal controls to ensure better governance. The management had a discussion with the statutory auditors to ensure the steps required to be taken so that the statutory audit is risk based and focused on areas of greatest risk to the achievement of the company's objectives. Please advise the management and the auditor on the steps that should be taken for the same.

Answer

Audit should be risk-based or focused on areas of greatest risk to the achievement of the audited entity's objectives. Risk-based audit (RBA) is an approach to audit that analyzes audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas.

RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable level and the reporting to auditee of audit results. These are achieved through the following:

Step 1 - Understand auditee operations to identify and prioritize risks: Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

Step 2 - Assess auditee management strategies and controls to determine residual audit risk: Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.

Step 3 - Manage residual risk to reduce it to acceptable level: Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.

Step 4 - Inform auditee of audit results through appropriate report: The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control

system, deficiencies in the design and operation of internal controls that affect the organization's ability to record, process, summarize and report financial data.

4.May 2019 Qn no.4(a) 5 Marks

A newly qualified professional has received his first appointment as auditor of a large company and is very much concerned about the effectiveness of internal control and wants to assess and evaluate the control environment as part of his audit program. Towards achieving his objective, he seeks your help in knowing the Standard Operating Procedures (SOPs) of assessment and evaluation of control.

Answer

Standard Operating Procedures (SOPs): A well-defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover.

- (i) **Enterprise Risk Management:** An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.
- (ii) **Segregation of Job Responsibilities:** A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person.
- (iii) **Job Rotation in Sensitive Areas:** Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example, if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.
- (iv) **Delegation of Financial Powers Document:** As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.
- (v) **Information Technology based Controls:** With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system instead of being human

dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example, at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

5.RTP Nov 2019 Qn no 13

BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2018-19. In order to review internal controls of the sales department of the company, you visited the department and noticed the work division as follows:

- (1) An officer was handling the sales ledger and cash receipts.**
 - (2) Another official was handling dispatch of goods and issuance of Delivery challans.**
 - (3) One more officer was there to handle customer/ debtor accounts and issue of receipts.**
- As an internal auditor you are required to briefly discuss the general condition pertaining to the internal check system.**
 - Do you think that there was proper division of work? If not, why?**

Internal Check System: The general condition pertaining to the internal check system may be summarized as under:

- (i)** no single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii)** Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iii)** Every member of the staff should be encouraged to go on leave at least once a year.
- (iv)** Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v)** There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
- (vi)** Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
- (vii)** Budgetary control should be exercised and wide deviations observed should be reconciled.
- (viii)** For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.

- (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
- (x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.
- (a) **Division of Work:** Company has not done proper division of work as:
 - (i) the receipts of cash should not be handled by the official handling sales ledger.
 - (ii) delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

6.Nov 2019 Qn no 2(a) 5 Marks

The Entity's Risk Assessment Process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of occurrence and decides upon actions to respond to and manage them and the results thereof. Elucidate the circumstances in which risks can arise or change.

Answer Entity's Risk Assessment Process: Risks can arise or change due to circumstances such as the following-

- (i) **Changes in operating environment:** Changes in the regulatory or operating environment can result in changes in competitive pressures and significantly different risks.
- (ii) **New personnel:** New personnel may have a different focus on or understanding of internal control.
- (iii) **New or revamped information systems:** Significant and rapid changes in information systems can change the risk relating to internal control.
- (iv) **Rapid growth:** Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- (v) **New technology:** Incorporating new technologies into production processes or information systems may change the risk associated with internal control.
- (vi) **New business models, products, or activities:** Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with internal control.
- (vii) **Corporate restructurings:** Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with internal control.
- (viii) **Expanded foreign operations:** The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal

control, for example, additional or changed risks from foreign currency transactions.

- (ix) **New accounting pronouncements:** Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements..

7.RTP May 2020 Qn no 12(a)

Navjeevan Hospital is a multi-speciality hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. According to you, which basis system of control has been violated? Also list down the other general conditions pertaining to such system which needs to be maintained and checked by the management.

Basic system of Control: Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof.

In the given case of Navjeevan Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.

The general condition pertaining to the internal check system may be summarized as under-

- (i) No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iv) Every member of the staff should be encouraged to go on leave at least once a year. Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v) There should exist an accounting control in respect of each class of

assets, in addition, there should be periodical inspection so as to establish their physical condition.

- (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
- (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
- (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
- (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
- (x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.

Study Material

1. Briefly describe the various stages of a Risk Assessment process.

Answer

Risk Assessment is one of the most critical components of Enterprise Risk Management. The risk assessment process involves considerations for qualitative and quantitative factors, definition of key performance and risk indicators, risk appetite, risk scores, scales and maps, use of data & metrics and benchmarking. The various stages in a Risk Assessment process are as follows:

- Define Business Objectives and Goals;
- Identify events that affect achievement of business objectives;
- Assess likelihood and impact;
- Respond and mitigate risks;

Assess residual risk.

2. What are the components of an internal control framework?

Answer

There are five components of an internal control framework. They are as follows:

- Control Environment;
- Risk Assessment;
- Information & Communication;

- Monitoring;
- Control Activities

3. During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

Answer

Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, “Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management”, the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and
- (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
- (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

4. SA 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” categorises the types of assertions used by the auditor to consider the different types of potential misstatements that may occur. Briefly explain with example.

Answer:

The major components of audit risk are described in the Table below

Nature	Description	Commentary
Inherent Risk	Susceptibility of an assertion to a misstatement that could be material, individually or when aggregated with other misstatements, assuming that	These are the business and other risks that arise from the entity's objectives, nature of operations and industry, the regulatory environment in which it operates and its size and complexity.
	there are no related controls. Inherent risk is addressed at both the financial statement level and at the assertion level. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement.	The risks of material misstatement will vary based on the nature of the account balance or class of transaction. Risks of particular concern to the auditor might include: <ul style="list-style-type: none"> • Complex calculations which could be misstated; • High value inventory; • Accounting estimates that are subject to significant measurement uncertainty; • Lack of sufficient working capital to continue operations; • A declining or volatile industry with many business failures; and • Technological developments that might make a particular product obsolete.
Control Risk (Do internal controls in place mitigate the inherent risks?)	Risk that the entity's internal control system will not prevent, or detect and correct on a timely basis, a misstatement that could be material, individually or when aggregated with other misstatements.	The entity should identify and assess its business and other risks (such as fraud) and respond by designing and implementing a system of internal control. Entity level controls such as board oversight, IT general controls, and HR policies are pervasive to all assertions whereas activity level controls generally, relate to specific

		<p>assertions. Some control risk will always exist because of the inherent limitations of any internal control system. The auditor is required to understand the entity's internal control and perform procedures to assess the risks of material misstatement at the assertion level.</p>
<p>detection Risk</p>	<p>This is the risk that the auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements. The acceptable level of detection risk for a given level of audit risk bears an inverse relationship to the risks of material misstatement at the assertion level</p>	<p>The auditor identifies assertions where there are risks of material misstatement and concentrates audit procedures on those areas. In designing and evaluating the results of performing procedures, the auditor should consider the possibility of:</p> <ul style="list-style-type: none"> • Selecting an inappropriate audit procedure; • Misapplying an appropriate audit procedure; or • Misinterpreting the results from an audit procedure.

Example:-. If the top accountant is not competent enough for the assigned tasks, it is quite possible that errors could occur in the financial statements. However, the nature of such errors will not often be confined to a single account balance, transaction stream or disclosure. In addition, the error is not likely be confined to a single assertion such as the completeness of sales. It could easily relate to other assertions such as accuracy, existence and valuation.

5. Explain briefly the Flow Chart technique for evaluation of the Internal Control system.

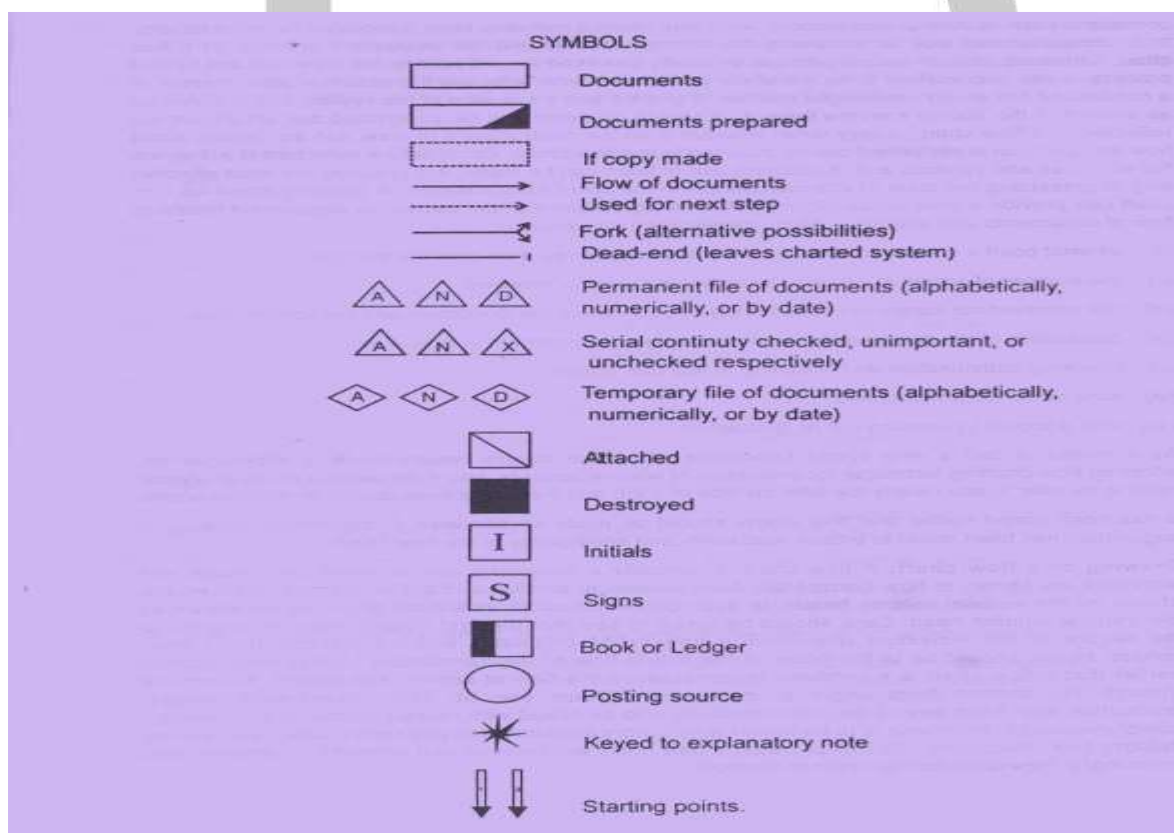
Answer:

The flow charting technique can also be resorted to for evaluation of the internal control system. It is a graphic presentation of internal controls in the organisation and is normally drawn up to show the controls in each section or sub-section. As distinct from a narrative form, it provides the most concise and comprehensive way for reviewing the internal controls and the evaluator's findings. In a flow chart, narratives, though cannot perhaps be totally banished are reduced to the minimum and by that process, it can successfully bring the whole control structure, specially the essential parts thereof, in a condensed but wholly

meaningful manner. It gives a bird's eye view of the system and is drawn up as a result of the auditor's review thereof. It should, however, not be understood that details are not reflected in a flow chart. Every detail relevant from the control point of view and the details about how an operation is performed can be included in the flow chart. Essentially a flow chart is a diagram full with lines and symbols and, if judicious use of them can be made, it is probably the most effective way of presenting the state of internal controls in the client's organisation.

Drawing of a flow chart - A flow chart is normally a horizontal one in which documents and activities are shown to flow horizontally from section to section and the concerned sections are shown as the vertical column heads; in appropriate cases an individual also may be shown as the vertical column head. Care should be taken to see that the first column head is devoted to the section or the individual wherefrom a transaction originates and the placements of other column heads should be in the order of the actual flow of the transaction.

It has been started earlier that a flow chart is a symbolic representation the flow of activity and related documents through the section from origin to conclusion. These can be sales, purchases, wages, production, etc. Each one of the main functions is to be linked with related functions for making a complete course. Purchase is to be linked with trade payables and payments; sales with trade receivables and collections. By this process, a flow chart will become self contained, complete and meaningful for evaluation of internal controls.



6. Compute the overall Audit Risk if looking to the nature of business there are chances that 40% bills of services provided would be defalcated, inquiring on the same matter management has assured that internal control can prevent such defalcation to 75%.At his

part the Auditor assesses that the procedure he could apply in the remaining time to complete Audit gives him satisfaction level of detection of frauds & error to an extent of 60%. Analyse the Risk of Material Misstatement and find out the overall Audit Risk.

Answer:

According to SA-200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the Audit Risk is a risk that Auditor will issue an inappropriate opinion while Financial Statements are materially misstated.

Audit Risk, has two components: Risk of material Misstatement and Detection Risk. The relationship can be defined as follows. $\text{Audit Risk} = \text{Risk of material Misstatement} \times \text{Detection Risk}$

Risk of material Misstatement: - Risk of Material Misstatement is anticipated risk that a material Misstatement may exist in Financial Statement before start of the Audit. It has two components Inherent risk and Control risk. The relationship can be defined as

$\text{Risk of material Misstatement} = \text{Inherent risk} \times \text{control risk}$

Inherent risk: it is a susceptibility of an assertion about account balance; class of transaction, disclosure towards misstatements which may be either individually or collectively with other Misstatement becomes material before considering any related internal control which is 40% in the given case.

Control risk: it is a risk that there may be chances of material Misstatement even if there is a control applied by the management and it has prevented defalcation to 75%.

Hence, control risk is 25% (100%-75%)

Risk of material Misstatement: $\text{Inherent risk} \times \text{control risk}$ i.e. $40\% \times 25\% = 10\%$

Chances of material Misstatement are reduced to 10% by the internal control applied by management.

Detection risk: It is a risk that a material Misstatement remained undetected even if all Audit procedures applied, $\text{Detection Risk} = 100 - 60 = 40\%$

In the given case, overall Audit Risk can be reduced up to 4% as follows:

$\text{Audit Risk} = \text{Risk of Material Misstatement} \times \text{Detection Risk} = 10\% \times 40\% = 4\%$

7. Y Co. Ltd. has five entertainment centers to provide recreational facilities for public especially for children and youngsters at 5 different locations in the peripheral of 200 kilometers. Collections are made in cash. Specify the adequate system towards collection of money.

Answer:

The auditor's objective in a risk-based audit is to obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist in the financial statements.

This involves the following three key steps:

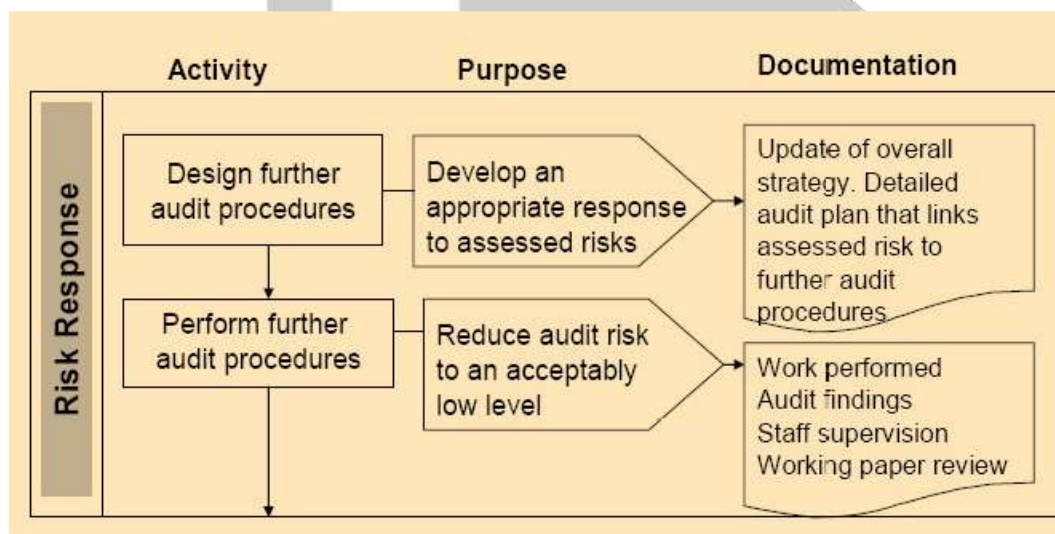
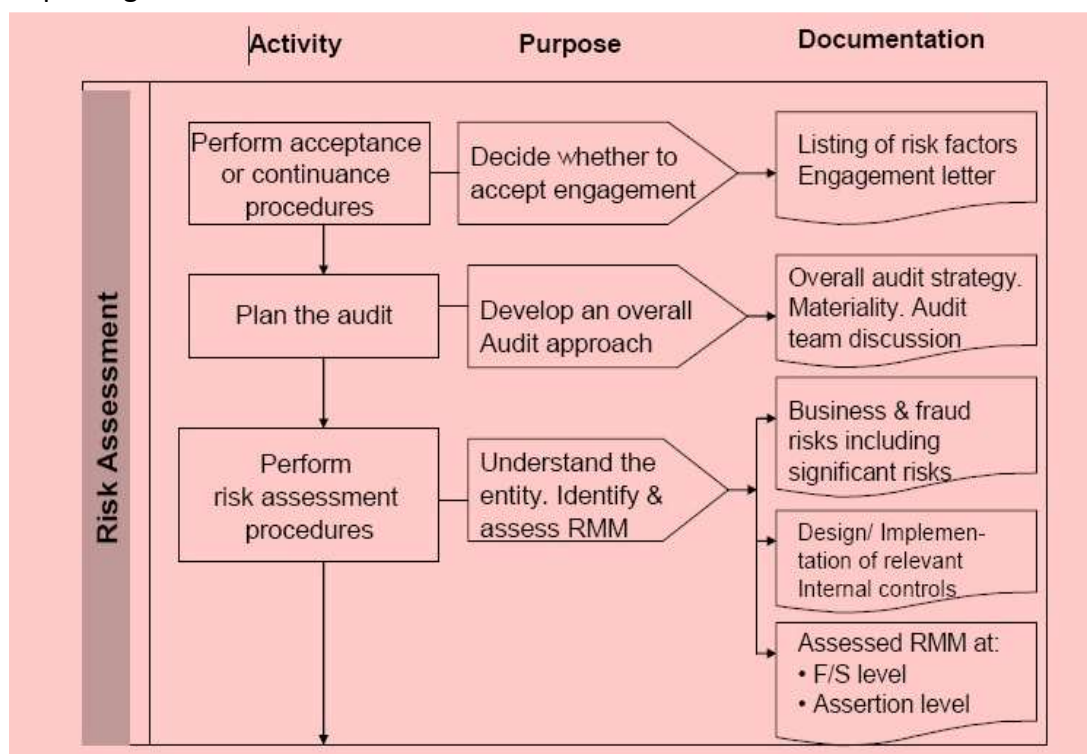
- Assessing the risks of material misstatement in the financial statements
- Designing and performing further audit procedures that respond to assessed risks and reduce the risks of material misstatements in the financial statements to an acceptably low level; and
- Issuing an appropriate audit report based on the audit findings.

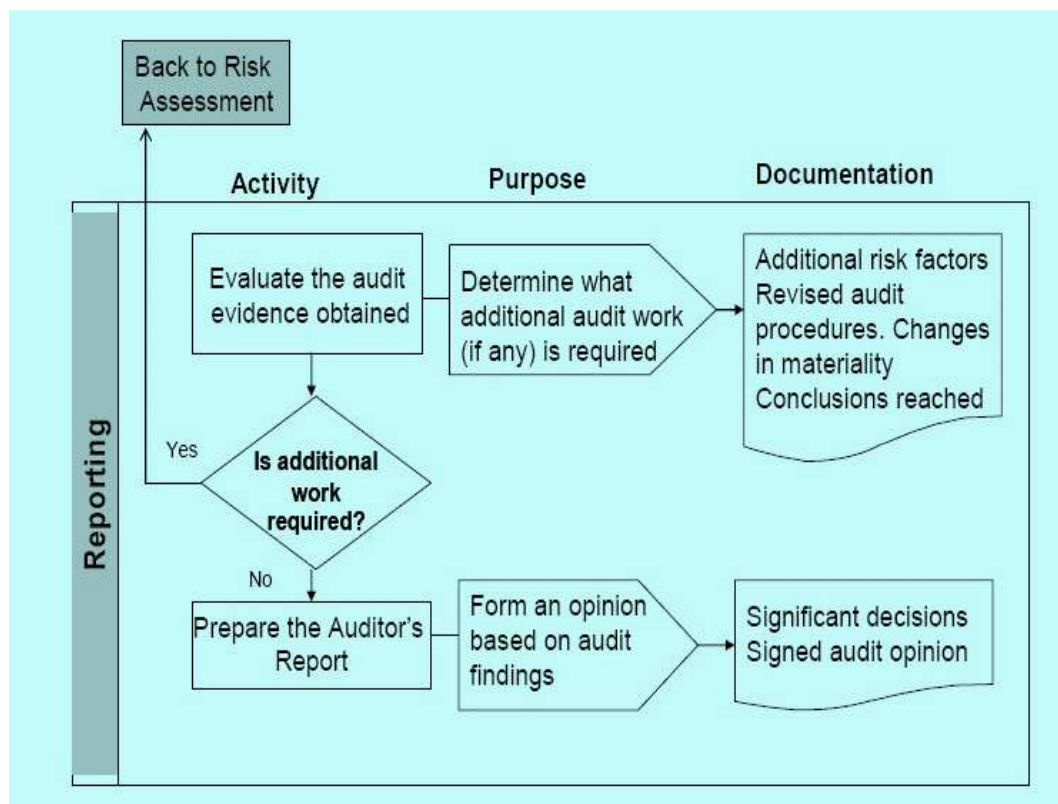
The risk-based audit process is presented in three distinct phases:

Risk assessment.

Risk response; and

Reporting.





8. The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Explain.

Answer:

Communication and enforcement of integrity and ethical values:

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the product of the entity's ethical and behavioral standards, how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.

9. Your engagement team is seeking advice from you as engagement partner regarding steps for risk identification. Elaborate.

Answer:

Steps for Risk Identification

- Assess the significance of the assessed risk, impact of its occurrence and also revise the materiality accordingly for the specific account balance.
- Determine the likelihood for assessed risk to occur and its impact on our

auditing procedures.

- Document the assertions that are effected.
- Consider the impact of the risk on each of the assertions
- (completeness, existence, accuracy, validity, valuation and presentation) relevant to the account balance, class of transactions, or disclosure.
- Identify the degree of Significant risks that would require separate attention and response by the auditor. Planned audit procedures should directly address these risks.
- Enquire and document the management's response.
- Consider the nature of the internal control system in place and its possible effectiveness in mitigating the risks involved. Ensure the controls :
 - ❖ Routine in nature (occur daily) or periodic such as monthly.
 - ❖ Designed to prevent or detect and correct errors.
 - ❖ Manual or automated.
- Consider any unique characteristics of the risk.
- Consider the existence of any particular characteristics (inherent risks) in the class of transactions, account balance or disclosure that need to be addressed in designing further audit procedures.
- Examples could include high value inventory, complex contractual agreements, absence of a paper trail on certain transaction streams or a large percentage of sales coming from a single customer

Multiple Choice Question

Raj Private Limited is engaged in the business of retail and has its retail outlets concentrated towards Northern India. Currently, the company has 59 outlets and the plan of the management is to take this to at least 100 over the next 2 years.

The company is audited by Raj & Associates, a firm of Chartered Accountants, who have been operating for over 20 years, however, they don't have much experience in the retail sector. Because of this fact the audit team decided to plan efficiently for the audit of the financial statements of the company for the year ended 31 March 2019, being their first year of audit.

During the course of risk assessment by the auditors, it was discussed that the company is operating in an industry where the operations are not very complicated and mostly the

processes are known to all. Considering the same they decided that assessment of inherent risk should not be done for this company as that would be inefficient. However, the auditors will take due care of the control risks. The same assessment was deliberated upon and after lot of discussions it was finalized like this.

In the given situation, please advise which one of the following would be correct.

- (a) The assessment of audit team is correct.
- (b) The assessment of audit team is wrong considering the fact that this is a private company wherein such assessment is not possible.
- (c) The assessment of audit team is wrong for this company.
- (d) The assessment of audit team is correct considering the fact that this has been thoroughly discussed.

Answer: Option : (c)

Kshitij Private Ltd is a company based out of Noida having operations in India and Dubai. The company's operations in Dubai have increase over the last 2 years and the management is earning very good profits.

Because of the profits, the management also planned that they should now focus on strengthening of internal controls of the company and for that purpose they have discussed with the statutory auditors to carry out the audit for the financial year ended 31 March 2019 very rigorously.

The report on internal financial controls is also applicable to the company and hence the auditors during the course of their work asked for Risk-control matrices from the company. During the year ended 31 March 2018, Risk-control matrix was not available with the company and was prepared in a draft manner and the same was shared with the audit team during that year and the auditors completed their work on the basis of that.

However, for the year ended 31 March 2019, the auditors would like to have robust documentation and are not ready to accept the same Risk-control matrices.

In the given situation, please suggest what should be the course of action.

- (a) The request of audit team is correct and the management should provide that.
- (b) The requirement of audit team is not justified considering the fact that last year same documentation was used by them.
- (c) The requirement of audit team is not justified considering the fact that it's a private company and auditor anyways is required to perform rigorous audit procedures.
- (d) In case of a private company on which internal financial controls report is required, the auditor is not allowed to take any Risk-control matrix from the management. Seems to be an ethical issue.

Answer: Option : (a)

SK Private Limited is a medium-sized company having operations in Jharkhand. The company manufactures some parts and sells that to various dealers on ex-works basis. The financial statements of the company are prepared as per Ind AS and internal financial controls report is also applicable on the same.

During the course of audit of the financial statements for the year ended 31 March 2019, the management of the company had a detailed discussion with the auditors for audit planning.

Further it was also decided that any observations of the auditors should also be discussed with the management before conclusion by the audit team which was not done in the past years.

Considering this, the auditors started the risk assessment and requested the management to share their documentation for the same on which the management said that they don't have any risks and if the auditors come across any such thing they can discuss that with the management.

But the auditors were not convinced with the view of the management and the same thing has happened in the past years as well.

You are required to provide your inputs to resolve this matter.

- (a) The requirement of the audit team is not correct.
- (b) The view of the management is correct because of the applicability of Ind AS.
- (c) The view of the management is correct because of the applicability of internal financial controls reporting.
- (d) The view of the management is not correct.

Answer: Option: (d)

AJ Private Ltd is in the business of telecom and have significant operations across India predominantly in Northern India.

The statutory auditors of the company have been continuing for the last 3 years and have been issuing clean report.

For the financial year ended 31 March 2019, the statutory auditors commenced their work in March 2019 as per discussions with the management and with a plan to complete the audit by first week of May 2019.

The audit team concluded the work as per the agreed timelines and the financial statements and audit report were signed on 5 May 2019 along with the engagement letter for the financial year ended 31 March 2019.

In the given situation, please advise which of the following would be correct.

- (a) The engagement letter should have been signed before commencing the audit work.
- (b) The engagement letter should have been signed at least a day before signing the audit report.
- (c) The engagement letter should have been signed at least a day before signing the financial statements.
- (d) The engagement letter is optional in case of a private company and hence can be signed anytime.

Answer:Option : (a)

RIM Private Ltd is engaged in the business of manufacturing of water bottles and is experiencing significant increase in turnover year on year. It is a subsidiary of RIM GmbH, based out of Germany.

During the financial year ended 31 March 2019, the company carried out a detailed physical verification of its inventory and property, plant and equipment.

During the year, various other activities were carried out to increase efficiency in operations and reductions of costs.

The statutory auditors of the company started their audit work from April 2019 and requested for a documentation on changes in processes and activities during the year as well as any resultant impact of the same on management controls.

The management of the company told the auditors that all such documentation is maintained by the parent company as this is a closely held private company and even though internal financial controls reporting is applicable on this company, the parent company is taking due care of each and every process.

The auditors did not agree with the views of the management. Please advise both the management and the auditors.

(a)The auditors should look for documentation as per Sarbanes Oxley in this case.

(b)The auditors are correct in this case and the management should provide the required documentation.

(c)The auditors are correct in this case and the management should provide the required documentation. However, in case the parent company is covered by Sarbanes Oxley then it can be ignored by the auditors.

(d)The management is correct.

Answer: Option : (b)

Test Series

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Chapter-4 Special Aspects of auditing in an automated environment

Multiple Choice Questions

1. RTP May 2019 Question No.7

You have only eight working hours for raw material inventory verification. Based on your observation during these eight hours, you have to form an opinion with respect to the correctness of inventory value calculated by the management. The company uses ERP system for updating and recording raw material inventory. The ERP system of the company has passed all the ITGC checks and inventory rates are calculated by ERP on moving average price (MAP) basis. The company has done ABC analysis of all raw material inventory items and has vast number of items in each category. You will form your opinion based on

- a. Based on ABC analysis, check physical inventory of all “A” class items during allotted time and matching it with ERP stock.
- b. Understand the process of recording of inventory in ERP to ascertain potential weaknesses and checking physical inventory of mostly “A” class items, some “B” class items and some “C” class items.
- c. Check physical inventory of “A” class items as much as possible along with certain “B” class items and certain “C” class items on sample basis in value wise descending order, compare the physical stock with ERP system, and tabulate the result. The exercise should be continued till the end of allotted eight hours.
- d. Check physical stock of only those items, which have standard packaging so that verification is faster considering the eight hour time limit.

Answer: Option C

2. RTP May 2019 Qn no 9

Which of the following is an example of Direct Entity level control

- a. Ethics policy
- b. Human resource policy
- c. Business performance reviews
- d. Job roles & responsibilities of employees

Answer:C Business performance reviews

3.RTP Nov 2019 Qn no 3

KJ Private Ltd. is engaged in the business of e-commerce wherein most of the operations are automated. The company has SAP at its ERP package and is planning to upgrade the SAP version.

Currently, the version of SAP being used is fine but the higher version would lead to increased efficiencies and hence the company is considering this plan which will also involve a huge outlay.

KPP & Associates, were appointed as the statutory auditors of this company for the year ended 31 March 2019 and the statutory audit firm has been working in this industry for long but most of the work which the firm did was more of risk advisory or internal audit.

For the first time, this audit will be conducted and that's why the audit team started obtaining understanding of the operations of the company which included understanding of the SAP system of the company.

However, the management of the company was not comfortable with this approach of the audit team particularly because audit team was spending good time on understanding of the IT systems of the company.

The management suggested that the auditors should limit their understanding and should perform audit procedures rather than getting into business/ operations.

But the auditors have a different view on this matter and because of which work has got stuck. In the given situation, please suggest what should be the course of action.

- a. The approach of audit team to obtain detailed understanding of the company before starting with the audit procedures is absolutely fine. If the auditors don't understand the systems properly the audit procedures may not be appropriate.
- b. The management's concern regarding the approach of the auditors seems reasonable. The auditors are spending time on understanding of the systems/ business and not performing their audit procedures.
- c. This being a private company and that too into the business of e-commerce, the auditors should have knowledge about the operations of the company through their understanding of the industry and hence should not get into this process of obtaining detailed understanding at the client place.
- d. The audit team could have planned their work differently. They should involve IT experts who would have knowledge of the systems of the company and hence lot of time can be saved. Further in case of such type of industry, involvement of IT experts is anyways required mandatorily as per the legal requirements.

ANSWER : Option A

Descriptive Questions

1. May 2018-4(d) – 4 Marks

While evaluating the risks and controls at entity level, the Auditor should take cognizance of the prevalent direct and indirect entity level controls operating in the entity. Explain what they pertain to, with few example.

ANSWER

Entity Level Risks and Controls: There are direct entity level controls and indirect entity level controls.

- (i) **Direct ELCs** operate at a level higher than business activity or transaction level such as a business process or sub-process level, account balance level, at a sufficient level of precision, to prevent, detect or correct a misstatement in a timely manner.

Examples Include:

- Business performance reviews;
 - Monitoring of effectiveness of controls activities by Internal Audit function;
- (ii) **Indirect ELCs** do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements. However, they contribute indirectly to the effective operation of direct ELC and other control activities.

Examples include:

- Company code of conduct and ethics policies;
- Human resource policies;
- Employee job roles & responsibilities.

2. RTP May 2018 Qn no.5, MTP Aug 2018 QN no 4(d)4 Marks

In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. You are required to briefly explain the relevant considerations of every phase in above audit approach in case of automated environment.

Answer

In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

Risk Assessment Process

- Identify significant accounts and disclosures.
- Qualitative and Quantitative considerations.

- Relevant Financial Statement Assertions (FSA).
- Identify likely sources of misstatement.
- Consider risk arising from use of IT systems.

Understand and Evaluate

- Document understanding of business processes using Flowcharts / Narratives.
- Prepare Risk and Control Matrices (RCM).
- Understand design of controls by performing walkthrough of end-to-end process.
- Process wide considerations for Entity Level Controls, Segregation of Duties.
- IT General Controls, Application Controls.

Test for Operating Effectiveness

- Assess Nature, Timing and Extent (NTE) of controls testing.
- Assess reliability of source data; completeness of population.
- Testing of key reports and spreadsheets.
- Sample testing.
- Consider competence and independence of staff /team performing controls testing.

Reporting

- Evaluate Control Deficiencies.
- Significant deficiencies, Material weaknesses.
- Remediation of control weaknesses.
- Internal Controls Memo (ICM) or Management Letter.
- Auditor's report.

3.MTP Mar 2018 Qn no.4(d) 4 Marks

Describe application controls and give three examples of automated application controls.

Answer

Application Controls are automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems.

Examples of automated applications include:

- Edit checks and validation of input data;
- Sequence number checks;
- User limit checks;
- Reasonableness checks;
- Mandatory data fields.

4.RTP Nov 18 Qn no. 5, MTP-OCT-18 Qn No 4(d) 5 Marks:

A real-time environment is a type of automated environment in which business operations and transactions are initiated, processed and recorded immediately as they happen without delay. It has several critical IT components that enable anytime, anywhere transactions to take place. You are required to name the components and its example of real-time environment.

Answer

Real Time Environment: IT Components: To facilitate transactions in real-time, it is essential to have the systems, networks and applications available during all times. A real-time environment has several critical IT components that enable anytime, anywhere transactions to take place. Any failure even in one component could render the real-time system unavailable and could result in a loss of revenue. IT Components include:

- (i) **Applications:** For example, ERP applications SAP, Oracle R12, Core banking applications.
- (ii) **Middleware.:** For example, Webservers like Apache, ATM switches.
- (iii) **Networks:** For example, Wide Area Networks, Internet hosting.
- (iv) **Hardware:** For example, Data centers, Backup and Storage devices, Power supply.

5.NOV 18 Qn no 4(d) 4 Marks

“The audit cycle consists of Planning, Execution and Completion. The automation in processing of business transactions has considerations to be weighed by Auditor at every phase of this cycle.” Enumerate the focal points of such considerations when auditing in automated environment

Answer

Consideration of Automated Environment at Each Phase of Audit Cycle: In a controls- based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

- ☐ during risk assessment, the auditor should consider risk arising from the use of IT systems at the company;
- ☐ when obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered;
- ☐ while assessing the entity level controls the aspects related to IT governance need to be understood and reviewed;
- ☐ pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed;

- ❑ during testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
- ❑ when testing of reports and information produced by the entity (IPE) generated through IT systems and applications;
- ❑ at completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

6.RTP May 2019 Qn no 14

In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for preparation of management information system (MIS) reports and electronic dashboards that give a high-level snapshot of business performance. In view of above you are required to briefly discuss the meaning of data analytics and example of circumstances when auditing in an automated environment, auditors can apply the concepts of data analytics.

Answer

Data Analytics: Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics. The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following:

- preliminary analytics;
- risk assessment;
- control testing;
- non-standard journal analysis;
- evaluation of deficiencies;
- fraud risk assessment.

7.May 2019 Qn no5(a)(i) 5 Marks

The volatility, unpredictability and pace of fast changes that exists in the automated environment today is far greater than in the past and consequently it throws more risk to business which requires them to have a need to continuously manage such risks. State various risks which an enterprise may have to face and manage.

Answer

Various Risk: Businesses today operate in a dynamic environment. The volatility, unpredictability and pace of changes that exist in the business environment today is far greater than in the past. Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because

of this dynamic environment the associated risks to business have also increased and companies have a need to continuously manage risks. Examples of risks include:

- Market Risks;
- Regulatory & Compliance Risks;
- Technology & Security Risks;
- Financial Reporting Risks;
- Operational Risks;
- Credit Risk;
- Business Partner Risk;
- Product or Project Risk;
- Environmental Risks.

8.RTP Nov 2019 14

“Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics and the data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs.” You are required to give a suggested approach to get the benefit from the use of CAATs

Answer

There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is given below:

- Understand Business Environment including IT;
- Define the Objectives and Criteria;
- Identify Source and Format of Data;
- Extract Data;
- Verify the Completeness and Accuracy of Extracted Data;
- Apply Criteria on Data Obtained;
- Validate and Confirm Results.

9.Nov 2019 Qn no 3(C) 4 Marks

In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. You are required to briefly explain the relevant considerations for every phase in above audit approach in case of an automated environment.

Answer

In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

- (i) during risk assessment, the auditor should consider **risk arising from**

- the use of IT systems** at the company;
- (ii) when obtaining an understanding of the business process and **performing walkthroughs** the use of IT systems and applications should be considered;
 - (iii) while assessing the entity level controls the aspects related to **IT governance** need to be understood and reviewed;
 - (iv) pervasive controls including **segregation of duties**, general IT controls and applications should be considered and reviewed;
 - (v) during **testing phase**, the results of general IT controls would impact the nature, timing and extent of testing;
 - (vi) when testing of reports and information produced by the entity (IPE) generated through **IT systems and applications**;
 - (vii) at **completion stage**, evaluation of control deficiencies may require using data analytics and CAATs.

Alternative Answer

In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

Risk Assessment Process

- Identify significant accounts and disclosures.
- Qualitative and Quantitative considerations.
- Relevant Financial Statement Assertions (FSA).
- Identify likely sources of misstatement.
- Consider risk arising from use of IT systems.

Understand and Evaluate

- Document understanding of business processes using Flowcharts / Narratives.
- Prepare Risk and Control Matrices (RCM).
- Understand design of controls by performing walkthrough of end-to-end process.
- Process wide considerations for Entity Level Controls, Segregation of Duties.
- IT General Controls, Application Controls.

Test for Operating Effectiveness

- Assess Nature, Timing and Extent (NTE) of controls testing.
- Assess reliability of source data; completeness of population.
- Testing of key reports and spreadsheets.

- Sample testing.
- Consider competence and independence of staff /team performing controls testing.

Reporting

- Evaluate Control Deficiencies.
- Significant deficiencies, Material weaknesses.
- Remediation of control weaknesses.
- Internal Controls Memo (ICM) or Management Letter.
- Auditor's report.

10.RTP May 2020 Qn no 20(d)

Understanding and documenting automated environment

Answer:

Understanding and Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

- The applications that are being used by the company;
- Details of the IT infrastructure components for each of the application;
- The organisation structure and governance;
- The policies, procedures and processes followed;
- IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230

Study Material

1. What are the components of an internal control framework?

Answer

There are **five components** of an internal control framework. **They are as follows:**

- Control Environment;
- Risk Assessment;
- Information & Communication;
- Monitoring;
- Control Activities.

2. Describe application controls and give three examples of automated application controls?

Answer

Application Controls are automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems. **Examples of**

automated applications include:

- Edit checks and validation of input data;
- Sequence number checks;
- User limit checks;
- Reasonableness checks;
- Mandatory data fields.

3. In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for preparation of management information system (MIS) reports and electronic dashboards that give a high-level snapshot of business performance. In view of above you are required to briefly discuss the meaning of data analytics and example of circumstances when auditing in an automated environment, auditors can apply the concepts of data analytics.

Answer:

Application Controls are automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems.

Examples of automated applications include:

- Edit checks and validation of input data;
- Sequence number check;
- Limit check;
- Reasonableness check;
- Format check;
- Mandatory data fields.

4. In a risk-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. You are required to briefly explain the relevant considerations for every phase in above audit approach in case of an automated environment.

Answer:

In a controls-based audit in an automated environment, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

- during risk assessment, the auditor should consider risk arising from the use of IT systems at the company;
- when obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered;
- while assessing the entity level controls the aspects related to IT governance need to be

understood and reviewed;

- pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed;
- during testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
- when testing of reports and information produced by the entity (IPE) generated through IT systems and applications;
- at completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

5. A Company is using ERP for all its business processes including Procurement, Sales, Finance and Reporting. You are required to explain the Statutory Auditor's approach to identify the risks associated with the IT systems.

Answer:

The Auditor should understand and document each of the business processes in form of narratives and / or flowcharts. The next process will be to identify areas / events that can lead to risks, viz. manual Invoicing and accounting once goods are dispatched could lead to incorrect Invoicing and accounting and hence is a 'risk'. The Auditor should also analyse the risks i.e. the impact it will have if materializes. Next will be prioritization in terms of probability of how often the risks will materialize.

6. Explain some of the International IT related Standards, Guidelines and Framework.

Answer:

Given below are some of the common standards and guidelines that are relevant in this context include:

Standards on Auditing issued by the Institute of Chartered Accountants of India, are required to be followed for an audit of financial statements.

Section 143 of Companies Act 2013 requires statutory auditors to provide an Independent Opinion on the Design and Operating Effectiveness of Internal Financial Controls Over Financial Reporting (IFC-FR) of the company as at Balance Sheet date. For this purpose, the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India, provides the framework, guidelines and procedures for an audit of financial statements.

Sarbanes Oxley Act of 2002, commonly known as SOX, is a requirement in America. Section 404 of this act requires public listed companies to implement, assess and ensure effectiveness of internal controls over financial reporting and auditors independent opinion on the design and operating effectiveness of internal controls over financial reporting (ICFR) – which is similar to the requirements of IFC-FR for Indian companies. Similar legal and statutory requirements over internal controls exist in several other countries including Japan, China, European Countries, etc.

ISO 27001:2013 is the Information Security Management System (ISMS) standard issued by the International Organization for Standardization (ISO). This standard provides the

framework, guidelines and procedures for implementing information security and related controls in a company. For example, this standard covers password security, application security, physical security, backup and recovery, that are relevant when auditing in an automated environment.

ITIL (Information Technology Infrastructure Library) and ISO 20000 provide a set of best practice processes and procedures for IT service management in a company. For example, change management, incident management, problem management, IT operations, IT asset management are some of the areas that could be relevant to audit.

The Payment Card Industry – Data Security Standard or PCI-DSS, is the most widely adopted information security standard for the payment cards industry. Any company that is involved in the storage, retrieval, transmission or handling of credit card/debit card information are required to implement the security controls in accordance with this standard.

The American Institute of Certified Public Accountants has published a framework under the Statements on Standards for Attest Engagements (SSAE) No.16 for reporting on controls at a service organisation that include ❖ SOC 1 for reporting on controls at a service organization relevant to user entities' internal control over financial reporting (ICFR). ❖ SOC 2 and SOC 3 for reporting on controls at a service organization relevant to security, availability, processing integrity, confidentiality or privacy i.e., controls other than ICFR. ❖ While SOC 1 and SOC 2 are restricted use reports, SOC 3 is general use report.

Control Objectives for Information and Related Technologies (CoBIT) is best practice IT Governance and Management framework published by Information Systems Audit and Control Association. CoBIT provides the required tools, resources and guidelines that are relevant to IT governance, risk, compliance and information security.

The Cybersecurity Framework (CSF) published by the National Institute of Standards and Technology is one of the most popular framework for improving critical infrastructure cybersecurity. This framework provides a set of standards and best practices for companies to manage cybersecurity risks.

7. Explain Application Controls and General IT Controls.

Answer:

Application Controls: Application controls include both automated or manual controls that operate at a business process level. Application controls can be preventive as well as detective in nature and are designed to ensure the integrity of the accounting records. application controls relate to procedures used to initiate, record, process and report transactions or other financial data. The se controls help ensure that transactions occurred, are authorised, and are completely and accurately recorded and processed. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems. Examples of automated applications include edit checks and validation of input data, sequence number check, limit check, format check, range check, reasonableness check, mandatory data fields, existence check etc.

Multiple Choice Question

KPL Private Limited is a large software company based out of Hyderabad. The annual turnover of the company is INR 2,100 crores. The company sells software and is also involved in the implementation of those softwares for its clients.

The major chunk of the revenue though comes from sale of software only. The company works on a completely paper-less office and accordingly, most of the documents are available in soft copy.

During the financial year ended 31 March 2019, the auditors during the course of their audit obtained various audit evidences some of which were in hard copy but mostly in soft copy.

On conclusion of the audit, the auditors are in a dilemma whether to maintain their documentation entirely in hard copy or soft copy or can it be mixed of both.

After consultations with various persons, the auditors stood that the documentation for this company, being operated in fully automated environment should be in soft copy only.

Please advise whether this understanding is correct.

- (a) This is a matter of documentation of audit evidence for a client working in fully automated environment and hence it should be in soft copy only.
- (b) As per the requirements of auditing standards, this documentation can be in a mix of both soft and hard copy.
- (c) Since the client is operating in a fully automated environment, it would be important to check with them because all this documentation has come from the client only.
- (d) As per the requirements of auditing standards, documentation is not required in case of a client working in automated environment because everything is automated and can be accessed easily at any point of time.

Answer: Option: (b)

KJ Private Ltd is engaged in the business of e-commerce wherein most of the operations are automated. The company has SAP at its ERP package and is planning to upgrade the SAP version.

Currently, the version of SAP being used is fine but the higher version would lead to increased efficiencies and hence the company is considering this plan which will also involve a huge outlay.

KPP & Associates, were appointed as the statutory auditors of this company for the year ended 31 March 2019 and the statutory audit firm has been working in this industry for long

but most of the work which the firm did was more of risk advisory or internal audit.

For the first time, this audit will be conducted and that's why the audit team started obtaining understanding of the operations of the company which included understanding of the SAP system of the company.

However, the management of the company was not comfortable with this approach of the audit team particularly because audit team was spending good time on understanding of the IT systems of the company.

The management suggested that the auditors should limit their understanding and should perform audit procedures rather than getting into business/ operations.

But the auditors have a different view on this matter and because of which work has got stuck. In the given situation, please suggest what should be the course of action.

- (a) The approach of audit team to obtain detailed understanding of the company before starting with the audit procedures is absolutely fine. If the auditors don't understand the systems properly the audit procedures may not be appropriate.
- (b) The management's concern regarding the approach of the auditors seems reasonable. The auditors are spending time on understanding of the systems/ business and not performing their audit procedures.
- (c) This being a private company and that too into the business of e-commerce, the auditors should have knowledge about the operations of the company through their understanding of the industry and hence should not get into this process of obtaining detailed understanding at the client place.
- (d) The audit team could have planned their work differently. They should involve IT experts who would have knowledge of the systems of the company and hence lot of time can be saved. Further in case of such type of industry, involvement of IT experts is anyways required mandatorily as per the legal requirements.

Answer:Option: (a)

AR Private Limited is a medium-sized company engaged in the business of trading of electronic equipments. The company has various warehouses where all of these equipments are kept and has an inventory levels of generally 2-3 months.

The internal environment of the company is driven by various processes some of them are manual and some automated. Accordingly, the management has also set up various controls both manual and automated and is comfortable with their design and operating effectiveness.

During the course of audit of the financial statements for the year ended 31 March 2019, the auditors raised various queries regarding various processes where the controls were operating effectively. This was because of the fact that auditor was considering either only manual controls or only automated controls in a process.

As per the auditor, the management should have adopted the same approach and hence he would like to increase the substantive audit procedures because they had a view that as per the current approach of the management, controls should be considered as ineffective irrespective of the fact that the testing which the audit team had performed resulted in the controls being effective.

Currently, the concern was regarding the approach on which management was also stuck on their point.

You are required to provide your inputs to resolve this matter.

(a)The approach of the management doesn't seem to be correct because of the nature of the operations of the company. The current approach which the management has followed can be accepted only in case of manufacturing industry.

(b)The management should have discussed their approach with the auditors before appointing them. The Companies Act 2013 provide specific guidance on these matters wherein the management of the company can follow such approach by taking pre- approval from their auditors and in such a case, the report of the auditors is always clean.

(c)The approach of the management is completely fine. The auditors need to correct their understanding of the internal controls and the application of internal controls. A process can not be limited to have either only manual control or automated control.

(d)Considering the size of the company, such matters should be ignored by the auditors. Even if the approach of the management is not correct, it would not have any impact on the work of the auditors because all such matters get resolved at the time when auditors perform final analytical procedures.

Answer:Option: (C)

AJ Private Ltd is in the business of construction and infrastructure having an annual turnover of INR 1,100 crores. The operations of the company are run efficiently driven by the well laid out policies and procedures. The processes of the company are very strong and are well documented and properly communicated to its employees, as required.

The management had also done a detailed risk assessment in the earlier years and currently the risk management system of the company is considered to be very effective. The internal controls include both automated and manual.

During the course of the audit of the financial statements of the company for the financial year ended 31 March 2019, the statutory auditors did their risk assessment and also reviewed the general IT controls which were found to be effective.

Considering the same, one of the senior audit team members asked the team to start performing the substantive audit procedures taking the approach that controls are effective.

However, the audit team did not find this approach correct and discussed that they should also check the effectiveness of other manual and automated controls by testing them and then move on to substantive testing.

The audit team recently had a training on the internal controls and hence their understanding was different from the audit senior.

This led to a conflicting situation between the audit senior and remaining audit team. In the given situation, please advise which of the following would be correct.

(a)The audit senior is correct because general IT controls were found to be effective and hence no further work may be required on controls.

(b)The view of the audit team looks fine because without testing of internal controls covering all types of controls (manual and automated), those controls can not be said to be operating effectively.

(c)The audit senior seems reasonable in his approach because general IT controls were found to be effective. However, it would be more appropriate to also test application controls before concluding on the effectiveness of the controls.

(d)The argument of the audit team looks better because every audit requires significant time to be spent on testing of internal controls and by only covering general IT controls, it would be difficult to justify this requirement later on in the audit file.

Answer: Option: (b)

RIM Private Ltd is engaged in the business of manufacturing of cranes and other construction equipments. The nature of the operations are such that purchases are quite significant even though the sales may or may not be very significant, in terms of number of transactions during the year.

The company's statutory auditors, have also obtained certain audit tools to help the audit team on various audit procedures to bring efficiency in various audits.

During the course of the audit of the financial statements for the financial year ended 31 March 2019, the auditors used those audit tools (also known as computed assisted audit techniques) for sampling procedures and data analytics.

The outcome of the tools resulted in some analysis and requirements which the audit team

requested from the client. However, the client refused to provide any such information.

because as per the client all these tools were those of the auditor and any outcome of the same needs to be handled by themselves instead of asking the management.

The auditors have suggested that such an attitude of non-cooperation would not help the either party and would defeat the objective of the audit. The management of the company is, however, ready to provide any other information to the auditors.

In this situation, please advise both the management and the auditors.

(a)Since the management is ready to provide any other information, the auditor should obtain this information as well by not disclosing the management that it is outcome of any audit tool.

(b)The view of the management is correct because audit tools are there to support the auditors and not to lead to increased work for the management.

(c)The auditors are correct because by using audit tools they are performing their audit procedures.

(d)The auditors should ignore all these tools and plan their audit procedures accordingly.

Answer:Option: (C)

Chapter – 5 Company Audit

Multiple Choice Questions

1.RTP May 2019 Qn no 5

WCO Private Ltd is a joint venture of WCO GmbH and MSON Ltd. WCO GmbH is a company based out of Germany and is also listed in Germany. WCO GmbH prepares its financial statements as per IFRS. MSON Ltd is a company based out of India and is also listed in India. MSON Ltd prepares its financial statements as per Ind AS. For the purpose of reporting of financial information to WCO GmbH and MSON Ltd for consolidation purposes, WCO Private Ltd uses reporting package (which comprises of balance sheet, profit and loss and other notes to accounts). WCO Private Ltd prepares its financial statements as per Ind AS.

WCO Private Ltd has taken useful life of some fixed assets in its Ind AS financial statements based on their useful lives which is different from the useful lives of similar nature fixed assets taken by WCO GmbH (in line with their accounting policies). The reporting package of WCO Private Ltd is audited before reporting to WCO GmbH. The auditor audits the reporting package which is prepared in line with the Group accounting policies of WCO GmbH and mentions in his report that the reporting package has been prepared as per the Group accounting policies of WCO GmbH.

WCO Private Ltd makes an adjustment for changes in useful lives in the reporting package on the basis of Group accounting policies of WCO GmbH. The auditor has asked the management to take same useful lives of fixed assets in the reporting package which have also been taken by them in its Ind AS financial statements. Management has not agreed with the view of the auditor. Please suggest the right course of action.

- a. Position taken by the management is correct.
- b. Position suggested by the auditor is correct and if the management does not agree then auditor may have to modify his report on the basis of materiality.

- c. The matter relates to an estimate (i.e. useful life) which may be subject to changes under different GAAPs and hence auditor should ignore this point.
- d. The report would be for special purpose which should always be a clean report

Answer:Option(a)

RTP MAY 2019 QN NO6

DCHI Ltd is in the business of optics and imaging products. It is a wholly owned subsidiary of Japanese company, DCHJ Ltd. DCHI Ltd has many expatriates (Expats) working in the company whose tenure range from 2 to 5 years. During the course of audit of financial statements of the company, the statutory auditors observed that the company has not been deducting and depositing the TDS (tax deducted at source) on salaries of expats. The auditors assessed that the impact of this can be significant as the company has many expats and salary amount is significant. Management explained that TDS on salary of expats would lead to unnecessary hassles to the expats and they serve the company only for a short period. How should the auditors of DCHI Ltd deal with this matter?

- a. Considering this as a statutory non-compliance, the auditor should look at the significance of the matter and accordingly should report the same in CARO.
- b. Considering this as a statutory non-compliance, the auditor should look at the significance of the matter and accordingly should consider reporting this in the main report along with CARO.
- c. The auditor should agree to the management's view as the expats are temporary workers and this may not be convenient for the management.
- d. Since the matter relates to statutory liability only, the reporting requirements do not arise till the time this becomes disputed.

Answer: Option B

RTP May 19 Qn no 8

ABC Pvt Ltd had turnover of ` 39 crores as at 31 March 2018. The Company had taken a loan of ` 39 crores from various banks and financial institutions during the year ended 31 March 2018. These loans were paid by the Company before 31 March 2018. The Company is of the view that the auditors' reporting on adequacy and operating effectiveness of internal financial controls (IFC) under Section 143(3)(i) of the Companies Act, 2013 would not be required. The auditors of the Company have a different view. What should be correct option?

- a. The turnover of ABC Pvt Ltd is below required threshold and hence IFC will not be applicable.
- b. The turnover of ABC Pvt Ltd is below required threshold and loan amount was fully paid before year end i.e. 31 March 2018. Hence IFC will not be applicable.
- c. The turnover of ABC Pvt Ltd is below required threshold but loan amount was above required threshold. Irrespective of the fact that loan was outstanding

as at 31 March 2018 or not, IFC would be applicable.

- d. In the given case because of the repayment of the loan before year end
i.e. 31 March 2018, applicability of IFC becomes optional.

Answer: Option C

MTP Mar 2019 Qn no 11 (2 Marks)

XY & Co. is a chartered firm with two partners Mr. X and Mr. Y. The firm was appointed auditor for 35

companies in the year 2017 and Mr. X was having total 19 audits in his name. Mr. Y was also partner in EFY & Co. Where he was appointed auditor in 4 companies. On 4th August 2017, Mr. X met with an accident and died. The firm was reconstituted with Mr. Y as the proprietor of new firm and the audits of the new firm reduced to 16. The new firm, in which Mr. Y is the proprietor, accepted the audit of a Private Limited Company having paid up capital of Rs. 52 crores on 30th August 2017. EFY & Co., another chartered firm, contended that Mr. Y cannot accept the appointment of Private Limited Company as he has already crossed the ceiling of 20 company audits in that year. Do you think that EFY & Co.'s claim is valid?

- (e) EFY & Co.'s claim is valid as MR. Y has already been appointed auditor for 20 companies i.e. 16
in the reconstituted firm and 4 in EFY & Co.
- (f) Mr. Y cannot accept the audit of Private Limited Company in the year in which there is change in the constitution of firm, therefore the claim of EFY & Co. is valid.
- (g) Mr. Y can accept the audit as the ceiling of 20 company audits is applicable for each firm in which the chartered accountant is a partner or proprietor.
- (h) EFY & Co.'s claim is void as the ceiling of 20 company audits doesn't include audit of private company having paid up capital less than Rs. 100 crores.

Answer: (d) EFY & Co.'s claim is void as the ceiling of 20 company audits doesn't include audit of private

company having paid up capital less than Rs. 100 crores.

MTP Apr 2019 Qn no 7 (1 Mark)

One afternoon in the first week of June 2018, there was a heated discussion between the audit engagement partner of Shah & associates and the finance director of Pecker & Co. The discussion was mainly on non-co-operation of the company staff to provide the relevant information to the auditors. The staff thought that the auditors were a hindrance in their routine work. The finance director called an urgent meeting to discuss the removal of the auditor Shah & Associates. Within the next week the partner of Shah & Associates was called and informed that they are no more the auditors of Pecker & Co. Comment if the removal of the auditor was proper in accordance with the Companies Act, 2013.

- a) Yes, the finance director was correct in the procedure of the removal of auditors by a simple board meeting discussion.
- b) No, the removal of auditors before the expiry of the term should be done

with the prior permission from the Central Government.

- c) Once appointed, the board of directors cannot remove the present auditors of the company.
- d) Yes, Pecker & Co is not a government company, hence the board of directors can remove the auditors by themselves.

Answer: (b) No, the removal of auditors before the expiry of the term should be done with the prior permission from the Central Government.

MTP Apr 2019 Qn no 8 (1 Mark)

Garg Ltd. has declared dividend of 9% on 15 April 2018, for the year ended 31 March 2018. The company has not paid or the warrant in respect thereof has not been posted till date 30 June 2018 to any shareholder whose is entitled to the payment of the dividend. Which of the following is correct in respect of the effect of non-payment of dividend?

- (a) Garg Ltd. shall be liable to pay simple interest of 15% p.a. during the period for which the default continues.
- (b) Garg Ltd. shall be liable to pay simple interest of 18% p.a. during the period for which the default continues.
- (c) Garg Ltd. can still make the payment of dividend by 31 July 2018, with no interest applicable.
- (d) Garg Ltd. can still make the payment of dividend by 15 July 2018, with no interest applicable.

Answer: (b) Garg Ltd. shall be liable to pay simple interest of 18% p.a. during the period for which the default continues.

MTP Apr 2019 Qn no 9 (1 Mark)

TSV & Co, Chartered Accountants is an audit firm having two partners CA T and CA V. The firm TSV & Co. is already holding an appointment as auditors of 36 public companies and none of the partners hold any company audits in their personal capacity or as partners with another firm. TSV & Co. has been offered the appointment as auditors of 7 more private limited companies. Of the seven, one is a company with a paid up share capital of Rs. 150 crores, five are "Small Companies" as per the Companies Act and one is a "Dormant Company". Determine the number of companies out of 7 for which TSV & Co. can accept the appointment as an auditor.

- (a) 5
- (b) 6
- (c) 7
- (d) 1

Answer: (c) -7

MTP Apr 2019 QN no 5 (1 Mark)

FAC Chartered Accountants was appointed as statutory auditors by KMG Ltd. for the audit of their financial statements. During the course of audit the auditors noticed a fraud of Rs. 120 lakhs done by an officer of the company. The officer sanctioned and made the payment to fake vendors for purchase of fixed assets; however the assets were not entered in the Fixed Assets Register. The auditor reported the fraud in his audit report to the shareholders of the company presented in the Annual General Meeting, but did not mentioned the name of the parties involved. The Board of Directors of the company asked ICAI to take necessary action against the auditor as he has not complied with his duty to report fraud as per Section 143(12) of the Companies Act, 2013. What is the duty of the auditor as per Companies Act in reporting the fraud done by officers or employees of the company?

- a) As per Companies Act, 2013, as the amount of fraud is more than 100 lacs; the auditor should have reported the matter within 2 days of his knowledge to the Board of Directors/ Audit committee of the company seeking their reply or observations within 45 days. After completion of 45 days the auditor should forward his report to the Central Government along with the reply if any received from Board/ Audit Committee.
- b) As per Companies Act, in the course of audit if the auditor has reason to believe that a fraud has been conducted by the officers or employees of the company, the auditor shall report the matter to the Central Government immediately.
- c) The auditor's duty is restricted to reporting the fraud to shareholders and he is not required to report the matter to Board of Directors/ Audit Committee/ Central Government.
- d) The auditor can submit his report on fraud to shareholders but is required to mention the name of the parties involved in fraud, as per Section 143(12) of the Companies Act, 2013.

Answer: Option (a) As per Companies Act, 2013, as the amount of fraud is more than 100 lacs; the auditor should have reported the matter within 2 days of his knowledge to the Board of Directors/ Audit committee of the company seeking their reply or observations within 45 days. After completion of 45 days the auditor should forward his report to the Central Government along with the reply if any received from Board/ Audit Committee.

MTP Oct 2019 QN no 3 (1 Mark)

OPE Ltd issued a prospectus in respect of an IPO which had the auditor's report on the financial statements for the year ended 31 March 2019. The issue was fully subscribed. During this year, there was an abnormal rise in the profits of the company for which it was found later on that it was because of manipulated sales in which there was participation of Whole-time director and other top officials of the company. On discovery of this fact, the company offered to refund all moneys to the subscribers of the shares and sued the auditors for the damages alleging that the auditors failed to examine and ascertain any satisfactory explanation for steep increase in the

rate of profits and related accounts. The company emphasized that the auditor should have proceeded with suspicion and should not have followed selected verification. The auditors were able to prove that they found internal controls to be satisfactory and did not find any circumstance to arouse suspicion.

The company was not able to prove that auditors were negligent in performance of their duties. Which of the following is correct:

- a) The stand of the company was correct in this case. Considering the nature of the work, the Auditors should have proceeded with suspicion and should not have followed selected verification.
- b) The approach of the auditors look reasonable in this case. The auditors found internal controls to be satisfactory and also did not find any circumstance to arouse suspicion and hence they performed their procedures on the basis of selected verification.
- c) In the given case, the auditors should have involved various experts along with them to help them on their audit procedures. Prospectus is one area wherein management involves various experts and hence the auditors should also have done that. In the given case, by not involving the experts the auditors did not perform their job in a professional manner. If they had involved experts like forensic experts etc, the manipulation could have been detected. Hence the auditors should be held liable.
- d) In case of such type of engagements, the focus is always on the management controls. If the controls are found to be effective then an auditor can never be held liable in respect of any deficiency or misstatement or fraud.

Answer: Option(b) The approach of the auditors look reasonable in this case. The auditors found internal controls to be satisfactory and also did not find any circumstance to arouse suspicion and hence they performed their procedures on the basis of selected verification.

MTP Oct 2019 QN no 12 (2 Marks)

KIC Ltd is a company engaged in the business of general insurance and has been in existence for over 15 years. The company has a subsidiary company, PIC Ltd, which is also engaged in the business of insurance other than general insurance.

The previous statutory auditors of PIC Ltd have completed their tenure as an auditor and accordingly have resigned and the management of PIC Ltd is looking for new statutory auditors.

KB & Associates, a firm of Chartered Accountants, have vast experience of audit of insurance companies and would like to get appointed as auditor of PIC Ltd. KB & Associates is a large firm and have also employed experts – engineers, valuers, lawyers for various client services. The firm is evaluating as to what should be the criteria for get appointed as auditors of PIC Ltd because in the past they have audited only the holding companies and considering a subsidiary company for the first time.

In this context, please help the firm by answering which of the following options would be correct?

- (a) KB & Associates, a firm of Chartered Accountants, should be appointed by the Board of Directors of PIC Ltd and should ensure that they don't take up audit of more than 2 insurance companies.
- (b) KB & Associates can take up the audit if the firm is appointed by the Comptroller and Auditor General of India and should ensure that they don't take up audit of more than 3 insurance companies.
- (c) KB & Associates cannot take audit of PIC Ltd because they have employed experts which is not permitted by the IRDAI Guidelines.
- (d) KB & Associates can take up audit of PIC Ltd by ensuring that they are eligible to be appointed as per the criteria laid down in the Companies Act 2013 for audit of subsidiary companies and they would need to submit a certificate in this respect to the ICAI.

Answer: (b) KB & Associates can take up the audit if the firm is appointed by the Comptroller and Auditor General of India and should ensure that they don't take up audit of more than 3 insurance companies.

MTP Oct 2019 Qn no 13 (2 Marks)

KJ Private Ltd has a business of pharmaceuticals and has an annual turnover of INR 1,500 crores. During the last few years, considering the environment in which the company operates, its profit has reduced and is still falling. Hence the management has been looking at various ways to cut the costs.

AD & Associates are the statutory auditors of the company and RM & Associates are the internal auditors of the company.

Initially the company did not want to appoint any internal auditors to save costs, however, at insistence of the statutory auditors, the company appointed the internal auditors.

During the course of the statutory audit for the financial year ended 31 March, 2019, the statutory auditors requested for the detailed working papers of the internal auditors which the internal auditors refused. However, the statutory auditors told the management if the same are not provided then they would qualify their report.

In this situation, please advise which of the following would be correct.

- a. The statutory auditors should review the detailed working papers but they cannot qualify their report on this ground.
- b. The statutory auditors may review the detailed working papers and even after that they may qualify their report.
- c. The statutory auditors are not required to go to the extent of review of detailed working papers of internal auditors.
- d. The statutory auditors may review the detailed working papers of internal auditors but for that purpose they would require

prior approval of the ICAI.

Answer: (c) The statutory auditors are not required to go to the extent of review of detailed working papers of internal auditors.

MTP Oct 2019 Qn no 20 (2 Marks)

AJ Private Ltd. was incorporated on 21 March, 2018 and has limited operations. However, the capital induction in the company was huge because it would be capital intensive. The company is in the process to set up a plant in Karnataka which should be completed by 31 May, 2019. The company's management prepared its financial statements for the year ended 31 March, 2019. The auditors were also called to start the work in April 2019. The auditors would be able to complete their work by 31 May, 2019 and accordingly would issue their audit report by 1st week of June, 2019 as per the plan agreed with the management. The auditors have some observations related to preparations of financial statements which are not in compliance with Schedule III and most importantly the point related to capitalization of the plant as Property, Plant and Equipment in the financial statements for the year ended 31 March, 2019. Please suggest which of the following statements would be correct.

- (a) The compliance of Schedule III shall start from 1 April 2019 for this company as per Companies Accounts (Amendment) Rules 2016.
- (b) The compliance of Schedule III shall start from first financial period, however, some exemptions would be applicable as per Companies Accounts Rules 2014.
- (c) There should be full compliance of Schedule III and plant should be kept as CWIP as per Schedule III.
- (d) There should be full compliance of Schedule III and plant should be shown as PPE as per Schedule III.

Answer: (c) There should be full compliance of Schedule III and plant should be kept as CWIP as per Schedule III.

RTP Nov 2019 Qn no 6

The audit of Selby & Co is at the last stage, where your team member is looking at the presentation of items in the financial statements. You have instructed the team member to follow the general instructions given under Schedule III of the Companies Act, 2013 for the preparation and presentation of financial statements. The team member has shown you the following list where the company has not adhered to the general instructions given in Schedule III. Which of the following from the list is **not** as per Division I of Schedule III.

- (a) The company had ₹ 32,500 in deferred tax liability and ₹ 12,500 in deferred tax asset arising from income taxes levied under the same governing taxation laws. The financial statements include both the above figures at non-current liabilities and non-current assets respectively.
- (b) The company had a loss in the current year, this debit balance of

statement of profit and loss was shown as a negative figure under the head “Surplus” in the notes to the financial statements.

- (c) In the current year the company had issued a performance guarantee and counter guarantees, but these were not disclosed as contingent liability in the notes in the financial statements.
- (d) The company has clubbed all other expenses under the head ‘Other expenses on the basis of one percent of the revenue from operations or ` 1,00,000 whichever is higher to be disclosed separately.

Answer: Option A

1.MAY 2018- 3(b) – 5 Marks

Beneathminerals Limited is a Public Sector Company engaged in extraction of minerals from land. It has to pump out water in the first layer of the soil if the minerals are to be excavated. The Company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. The cost of construction of water course amounted to ` 5.25 crores and the Company had disclosed this amount as CSR expenses in the Statement of Profit and Loss. Comment.

ANSWER

Corporate Social Responsibility Expenses: Company (Corporate Social Responsibility Policy) Rules, 2014 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

In the instant case, Beneathminerals Limited is a public sector company which is engaged in extraction of mineral from land, for that it has to pump out water in the first layer of the soil if the minerals are to be excavated. The company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. Company has disclosed the cost of construction of water course as CSR expenses in the statement of Profit and Loss, which is not correct as this expenditure incurred for the construction of water course is included in the ordinary course of activities of business.

Therefore, the treatment done by showing the cost of construction of water course as CSR expense is not correct.

2.May 2018 -6(b) 4 Marks, MTP-Apr-19 Qn No 3(b) 4 Marks:

Tee & Co., a firm of Chartered Accountants had been appointed by C & AG to

conduct statutory audit of M/s Rare Airlines Limited, a Public Sector Company. They would like to check certain mandatory propriety points as required under section 143(1) of the Companies Act, 2013. List the areas of check to meet these requirements.

RTP Nov 2019 Qn no 25(b)

Areas of propriety audit under Section 143(1) of the Companies Act, 2013

Answer:

Mandatory Propriety Points under section 143 (1) of the Companies Act, 2013: The requirement of the provisions of section 143(1) is essentially propriety-oriented as much as some specific dubious practices are required to be looked into by the auditor. Areas of propriety audit under the provisions of Section 143(1) may be following:

- (i) **Whether the terms on which secured loans and secured advances have been made are prejudicial to the interests of the company or its members**”: It may be appreciated that the terms of loans include such matters as security, interest, repayment period and other business considerations. The auditor has to inquire whether the terms are such that they can be adjudged as prejudicial to the legitimate interest of the company or of its shareholders. This is a process of judging a situation by reference to certain objective standards or reasonableness whether the terms entered into are prejudicial or not, not only to the company but also to the shareholders.
- (ii) **Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company**: This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards. It is also possible that some transactions may not adversely affect the interests of the company. The auditor has to judiciously consider what does and does not constitute the interest of the company.
- (iii) **Whether investment of companies, other than a banking or an investment company, in the form of shares, debentures and other securities have been sold at a price lower than the cost**: Apparently, this is a matter of verification by the auditor. The intention, however, is not known whether loss has occurred due to the sale. The auditor is required to inquire into circumstances of sale of investments that resulted in loss. Obviously, the duty cast on him is propriety based, i.e., reasonableness of the decision to sell at a loss. It involves exercise of judgment having regard to the circumstances in which the company was placed at the time of making the sale.

- (iv) Whether loans and advances made by the company have been shown as deposits. Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made:
- (v) **Whether personal expenses have been charged to revenue:** It is an accepted principle that expenses which are not business expenses should not be charged to revenue. The effect of charging personal expenses to the business is to distort the profitability of the company and to secure a personal gain at the cost of the company. Obviously, propriety is involved in this; charging personal expenses to business account is highly improper and abusive hence this provision.
- (vi) **In case it is stated in the books and papers of the company that shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash actually received, whether the position in books of account and balance sheet so stated is correct, regular and not misleading:** A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.

3.MTP-Aug-18 Qn No 3(C) 5 Marks:

Z Ltd changed its employee remuneration policy from 1st of April 2017 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy the employees can either utilize or encash it. As at 31st March 18 the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment.

Answer:

As per Para 11 of AS-15 on "Employee Benefits", issued by the Institute of Chartered Accountants of India, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences.

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Here, Z Ltd will accumulate the amount of leave encashment benefits as it is the

liability of the company to provide 12% PF on amount of leave encashment. Hence the contention of the auditor is correct that full provision should be provided by the company.

4.RTP May 2018 Qn no 6(a).

(a) Excellent Limited, a Company incorporated in India and listed with SEBI, has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for the class they are entitled to as per company rules and regulations. Employees are also entitled to claim a lump-sum payment to cover expenses on food and stay during the travel. The Company also gives option to employees that they can claim a lump-sum amount equal to three months pay last drawn.

Excellent Limited have following accounting policies to record these travel expenses:

- (i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the travel rule of the company therefore all travel expenses fall under the category of defined contribution plans.**
- (ii) Since it is not related to the length of service of the employees, it is difficult to estimate reliably and there is no present obligation to pay employees as per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", hence it is accounted for on claim basis.**

You are statutory auditor of Excellent Limited. What would be your guidance to audit team?

Answer

Treatment of Employee Benefits Expenses: The present case falls under the category of defined benefit scheme under AS 15 "Employee Benefits". The said scheme encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

- Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.
- A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.
- Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

5.RTP May 2018 Qn no. 6(b)

C Ltd. appointed CA Innocent as a statutory auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors.

Answer

Services not to be Rendered by the Auditor: Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

- (i) accounting and book keeping services;
- (ii) internal audit;
- (iii) design and implementation of any financial information system;
- (iv) actuarial services;
- (v) investment advisory services;
- (vi) investment banking services;
- (vii) rendering of outsourced financial services;
- (viii) management services; and
- (ix) any other kind of services as may be prescribed.

Further section 141(3)(i) of the Companies Act, 2013 also disqualify a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

In the given case, CA Innocent was appointed as an auditor of C Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

6.RTP May 2018 Qn no. 6(c)

Ram Ltd. is a private company. Its balance sheet shows paid up share capital of ` 5 crore and public borrowings of ` 100 crore. The company appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its annual general meeting held at the end of September, 2017 for 11 years.

You are required to state the provisions related to - rotation of auditors and cooling off period as per the section 139(2) of the Companies Act, 2013 in case of an individual auditor or an audit firm, both, and comment upon the facts of the case provided above with respect to aforesaid provisions.

Answer

- a) **Rotation of Auditor & Cooling Off Period Provisions:** The provision related to Rotation of Auditor & Cooling Off Period is newly inserted by section 139(2) of the Companies Act, 2013 read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014, which is discussed as under:

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies including Listed companies, but excluding one person companies and small companies, namely:-

- all unlisted public companies having paid up share capital of Rs.10 crore or more;
- all private limited companies having paid up share capital of Rs.50 crore or more;
- all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ` 50 crores or more.

As per Section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

- (a) an individual as auditor for more than one term of 5 consecutive years; and
- (b) an audit firm as auditor for more than two terms of 5 consecutive years.

In the given case, Ram Ltd. is a private company having paid up share capital of ` 5 crore and public borrowings of ` 100 crore. The company has appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2017 for 11 years.

The provisions relating to rotation of auditor will be applicable as the public borrowings exceeds ` 50 crore. Therefore, Ram (P) Ltd. can appoint M/s Shyam & Co. as an auditor of the company for not more than one term of five consecutive years twice i.e. M/s Shyam & Co. shall hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2022 and thereafter can be re-appointed as auditor for one more term of five years i.e. upto year 2027. The appointment shall be subject to ratification by members at every annual general meeting of the company. As a result, the appointment of M/s Shyam & Co. made by Ram Ltd. for 11 years is void.

7.MTP Mar 2018 2(C) 5 Marks/new study mat (just year difference)

The Balance Sheet of G Ltd. as at 31st March 16 is as under. Comment on the presentation

in terms of Schedule III.

Particulars	Note No.	31 st March, 16	31 st March, 15
Equity & Liabilities			
Share Capital	1	XXX	XXX
Reserves & Surplus	2	0	0
Employee stock option outstanding	3	XXX	XXX
Share application money refundable	4	XXX	XXX
Non-Current Liabilities		XXX	XXX
Deferred tax liability (Arising from Indian Income Tax)	5	XXX	XXX
Current Liabilities			
Trade Payables	6	XXX	XXX
Total		<u>XXXX</u>	<u>XXXX</u>
Assets			
Non-Current Assets			
Fixed Assets-Tangible	7	XXX	XXX
CWIP (including capital advances)	8	XXX	XXX
Current Assets			
Trade Receivables	9	XXX	XXX
Deferred Tax Asset (Arising from Indian Income Tax)	10	XXX	XXX
Debit balance of Statement of Profit and Loss		XXX	XXX
Total		<u>XXXX</u>	<u>XXXX</u>

Answer

- I. Share Capital & Reserve & Surplus are to be reflected under the heading “Shareholders’ funds”, which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities yet it must be shown under head “shareholders’ funds”. The heading “Shareholders’ funds” is missing in the balance sheet given in the question.
- II. Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head ‘Surplus’. The balance of ‘Reserves and Surplus’, after adjusting negative balance of surplus shall be shown under the head ‘Reserves and Surplus’ even if the resulting figure is in the negative.
- III. Schedule III requires that Employee Stock Option outstanding should be disclosed under the heading “Reserves and Surplus”
- IV. Share application money refundable shall be shown under the sub-heading “Other Current Liabilities”. As this is refundable and not pending for allotment, hence it is not a part of equity.

- V. Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown.
- VI. Under the main heading of Non-Current Assets, Fixed Assets are further classified as under:
 - i. Tangible assets
 - ii. Intangible assets
 - iii. Capital work in Progress
 - iv. Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Fixed Assets as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading “Long term loans and advances” under the heading Non-Current Assets.

V. Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability

Vi. Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, Trade Payables should be disclosed as follows:-

- (A) total outstanding dues of micro enterprises and small enterprises; and
- (B) total outstanding dues of creditors other than micro enterprises and small enterprises.”

8.MTP Mar 2018 Qn no.4(b) 4 Marks

The Managing Director of the Company has committed a “Teeming and Lading” Fraud. The amount involved has been however subsequently after the year end deposited in the company. As a Statutory Auditor, how would you deal?

Answer

Fraud Committed by Managing Director: The Managing Director of the company has committed a “Teeming and Lading” fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, “The Auditor’s responsibilities relating to Fraud in an Audit of Financial Statements”. First of all, as per SA 240, the auditor needs to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment. Secondly, the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. Thirdly, the auditor should communicate the matter

to the Chairman and Board of Directors. Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ` 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ` 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, 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.

9.MTP Apr 18 Qn no.3(d) 5 Marks

As a statutory auditor of a company, comment on the accounting policy on Revenue Recognition for a company engaged in manufacture and sale of chemical products was stated as "Revenue is recognized only when it can be reliably measured and it is reasonable to expect ultimate collection".

Answer

Revenue Recognition: As per AS 9 Revenue Recognition, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

- (i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
- (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Therefore, revenue from sales transactions should be recognised when the requirements as to performance set out above is satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim uncertainty regarding collection exist, then revenue recognition should be postponed.

In the instant case, the company is engaged in manufacturing and sale of chemical products, and made disclosure in accounting policy on recognition of revenue as per AS 1 stating that revenue is recognized only when it can be reliably measured and it is reasonable to expect ultimate collection, is not correct. As accounting policy

disclosed is not covering the aspect of transfer of risk and reward for the purpose of revenue recognition. Therefore, auditor should modify the report accordingly.

10.RTP Nov 18 Qn no 6

Miranda Spinning Mills Ltd. is a sick company and has accumulated losses of Rs.10 crores. The company has Rs.12 crores in its share Premium Account. The Management desires to adjust the accumulated losses against the share premium balance. Advise the company giving your reasons.

Answer

Application of Share Premium Account: Section 52 of the Companies Act, 2013 (herein after referred as the Act) deals with the application of premium received on issue of shares. Sub-section (1) of the said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to an account called "Securities Premium Account" and the provisions of this Act relating to reduction of share capital of a company except as provided in this section shall apply as if the securities premium account was the paid up share capital of the company. Sub-section (2) of the said section provides that notwithstanding anything contained in sub-section (1), securities premium account may be applied by the company for issue of bonus shares; writing off the preliminary expenses; writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; in providing for the premium payable on redemption of any redeemable preference shares or any debentures of the company; for the purchase of its own shares or other securities. In view of these provisions of the Companies Act, 2013, it is not permitted to adjust its accumulated losses against the securities premium account.

11.RTP Nov 18 Qn no.6(b)

Comment on the following with reference to Schedule III to the Companies Act, 2013:

- (i) **A company has disclosed performance guarantee and counter guarantees as Contingent Liabilities.**
 - (ii) **The parent company has recognized in the current year's financial statement, dividend declared by its subsidiary after the balance sheet date.**
- (I) A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.

However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent

liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due.

Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

- (II) The Schedule III does not prescribe to recognise dividend declared by subsidiary company as given in the scenario. Accordingly, dividend income from subsidiary companies should be recognised in accordance with AS-9, i.e. only when they have a right to receive the same on or before the Balance sheet date. Normally, the right to receive is established only when the dividend is approved by the shareholder at the AGM of the investee company. Therefore, treatment done by the company is not in order

13.MTP-Aug-18 Qn No 2(C) 5 Marks:

Comment on the following with reference to Schedule III to the Companies Act, 2013:

- (i) A company has disclosed performance guarantee and counter guarantees as Contingent Liabilities.
- (ii) A company has clubbed all other expenses under the head 'Other Expenses' on the basis of 1 percent of total revenue or Rs.5,000 whichever is higher.
- (iii) A company has shown Deferred Tax Liability under Non-Current Liabilities and Deferred tax assets under Non-Current Asset in balance sheet.

Answer:

- (i) A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.

However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-

guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

- (ii) All other expenses not classified under other heads will be classified under "Other Expenses". For this purpose, any item of expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000 whichever is higher, needs to be disclosed separately. The given treatment in the scenario is not in order.
- (iii) Deferred Tax Liability should be shown under Non-Current Liabilities. Deferred Tax Asset shall be shown under Non-Current Asset. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown. Thus, DTA and DTL shown separately in the balance sheet by the company is not correct.

A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.

However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

- (iv) All other expenses not classified under other heads will be classified under "Other Expenses". For this purpose, any item of expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000 whichever is higher, needs to be disclosed separately. The given treatment in the scenario is not in order.
- (v) Deferred Tax Liability should be shown under Non-Current Liabilities. Deferred Tax Asset shall be shown under Non-Current Asset. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability

or Asset is to be shown. Thus, DTA and DTL shown separately in the balance sheet by the company is not correct.

14.MTP-OCT-18 Qn No 3(c) 5 Marks:

Zed Ltd. has flexi deposit linked current account with various banks. Cheques are issued from the current account and as per the requirements of funds, the flexi deposits are encashed and transferred to current accounts. As of 31st March, 2018 certain cheques issued to vendors are not presented for payment resulting in the credit balance in the books of the company. The management wants to present the book overdraft under current liabilities and flexi deposits under cash & bank balances. Comment.

Answer:

Presentation of Book Overdraft as per Schedule III to the Companies Act, 2013: The instructions in accordance with which current assets being “cash and cash equivalents” should be made out to Part I of Schedule III to the Companies Act, 2013 states as follows:

- Cash and cash equivalents shall be classified as:
 - (a) Balances with banks;
 - (b) Cheques, drafts on hand;
 - (c) Cash on hand;
 - (d) Others (specify nature).
- Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
- Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- Bank deposits with more than 12 months maturity shall be disclosed separately.

From the facts of the case it is evident that in substance the position is that the composite bank balance including the balance in flexi deposit accounts are positive, even though physical set-off has not been made as on the balance sheet date. Further the bank has got the right to set off of flexi deposits against the cheques issued and hence it would be more informative and useful to the readers of the financial statements to disclose the book credit balance as a set -off from the flexi deposit accounts. The disclosure of the said book credit balance as book overdraft under the head current liabilities as proposed by the management is not correct.

15.Nov 18 Qn no.2(C) 5 Marks

During the financial year ended on 31/03/2018, LM Private Limited had borrowed from a Nationalized Bank, a term loan of ` 120 lakhs consisting of ` 100 lakhs for purchase of a machinery for the new plant and ` 20 lakhs for erection expenses. As on the date of 31st March, 2018, the total of capital and free reserves of the Company was ` 50 lakhs and turnover for the year 2017-18 was ` 750 lakhs. The Bank paid ` 100 lakhs to the vendor of the Company for the supply of machinery on 31/12/2017. The machinery had reached the yard of the Company. On 28/02/2018, the Company had drawn the balance of loan viz.Rs 20 lakhs to the credit of its current account maintained with the Bank and utilized the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction. Comment as to reporting issues, if any, that the Auditor should be concerned with for the financial year ended on 31/03/2018, in this respect.

Answer

Applicability of CARO , 2020 and Utilisation of Term Loan: CARO ,2020 specifically exempts a private limited company, not being a subsidiary company of a public company, having a paid up capital , reserves & surplus not more than rupees one crore as on balance sheet date and which does not have total borrowing exceeding rupees one crore from any bank or financial institution at any point of time during the year and which does not have a total revenue as disclosed in Schedule III to the companies Act 2013 exceeding Rs 10 crore during the financial year as per financial statements.

In the case of LM Pvt. Ltd, it has paid up capital of rupees 50 lacs which is below the specified limit of rupees 1 crore and turnover is rupees 7.5 crore which is also less than specified rupees 10 crore. However, there is total borrowing of rupees 1.20 crore which is more than rupees 1 crore and exceeding the specified limits of rupees 1 crore. Hence CARO, 2016 will be applicable to LM Pvt. Ltd.

As per clause (ix) of Para 3 of CARO, 2016, an auditor need to state in his report that whether the term loans were applied for the purpose for which the loans were obtained. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

The auditor should examine the terms and conditions subject to which the company has obtained the term loans. The auditor may also examine the proposal for grant of loan made to the bank. As mentioned above, normally, the end use of the funds raised by term loans is mentioned in the sanction letter or documents containing the terms and conditions of the loan. The auditor should ascertain the purpose for which term loans were sanctioned. The auditor should also compare the purpose for which term loans were sanctioned with the actual utilization of the loans. The auditor should obtain sufficient appropriate audit evidence regarding the utilization of the amounts raised. If the auditor finds that the funds have not been utilized for the purpose for which they were obtained, the auditor's report should state the fact.

In the present case, the term loan obtained by LM Private Ltd. amounting rupees 20

lakh have not been utilized for erection expenses instead its utilized for renovating its administrative office building. Further, assuming that erection work has not been done and machinery is not being installed, disclosure of the same as Capital Stock under construction is in order.

Here, the auditor should report the fact in his report that pending utilization of the term loan for erection expenses, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (ix) of Para 3 of CARO, 2016.

16.NOV 18 Qn no 3(c)

ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. The Financial year 2017-18 was so very bad for the Company that it was not possible for the Company to maintain the payment of consistent dividend as above. The Management, being hopeful of recovery of its performance in next year, felt that the depreciation of the year to the extent of 75% alone be charged to the Statement of Profit and Loss and the remaining 25% be kept in a separate account code in the Balance Sheet- 'Debit Balances Adjustable against Revenue account'. The Management was of the view that it would be in fair practice of accounting if the depreciation for asset is charged before the expiry of the lifes of assets and the amount parked in asset code as above would unfailingly be adjusted to Revenue before the close of next financial year anyway. Analyse the issues involved and state how the Auditor should decide on this matter.

Answer

Provision of Depreciation :Section 123(1) of the Companies Act, 2013 provides that dividend cannot be declared or paid by a company for any financial year except 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 out of the profits or the company for any previous financial year or years arrived at after providing for depreciation in the manner aforementioned and remaining undistributed, or out of both. Further, it is the duty of auditor to check whether the depreciation was provided according to provision of AS 10 / IND AS 16/Schedule II to the Act.

In the instant case, ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. Due to bad financial condition, company has not provided for dividend for the year 2017-18. In addition to this management has also taken decision to charge 75% of the depreciation in the statement of Profit and Loss whereas 25% of the depreciation amount kept in a separate account code in the Balance Sheet – ‘Debit Balances Adjustable against Revenue Account’.

Contention of management that it would be in fair practice of accounting where the depreciation of asset is charged before the expiry of the life of assets and the amount parked in asset code would unfailingly be adjusted to revenue before the close of next financial year is not tenable.

The practice of the company in not charging the depreciation and accumulating 25% of it in a debit balance for being written of in the next year is not an acceptable accounting treatment. If dividend is declared in such situation, it would mean payment out of capital.

Therefore, the auditor of the company should ensure the compliance of provisions of section 123 and Schedule II. In case the management does not comply with the provisions and does not charge the 100% depreciation the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

17.RTP May 2019 Qn no 15(a)

MKc LLP is a newly set up LLP (Limited Liability Partnership). The operations of the LLP have been picking up and management is currently in the process of setting up processes and procedures in place. As per the understanding of the management of the LLP, its accounts would not be required to be audited mandatory because of its operations but still the management has decided that they would get the accounts audited voluntarily. In this regard, the management would like to understand some of the aspects which they should consider not only limited to audit but also about the maintenance of books of accounts as per the relevant laws. Please advise.

An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs. The accounts of every LLP shall be audited in accordance with Rule 24 of LLP Rules 2009. Such rules, inter-alia, provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

Appointment of Auditor: The auditor may be appointed by the designated partners of the LLP –

1. At any time for the first financial year but before the end of first financial year,
2. At least thirty days prior to the end of each financial year (other than the first financial year),
3. To fill the causal vacancy in the office of auditor,
4. To fill the casual vacancy caused by removal of auditor.

The partners may appoint the auditors if the designated partners have failed to appoint them.

LLPs are required to maintain books of accounts which shall contain -

1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-

progress, finished goods and costs of goods sold,

4. Any other particulars which the partners may decide.

Auditor's Duty Regarding audit of LLP

- The auditor should get definite instructions in writing as to the work to be performed by him
- The auditor should mention-
 - (a) Whether the records of the firm appear to be correct and reliable
 - (b) Whether he was able to obtain all information & explanation necessary for his work.
 - (c) Whether any restrictions has been imposed upon him.
- The auditor should read the LLP agreement & note the following provisions
 - (a) Nature of the business of the LLP
 - (b) Amount of capital contributed by each partner
 - (c) Interest – in respect of additional capital contributed
 - (d) Duration of partnership
 - (e) Drawings allowed to the partners
 - (f) Salaries, commission etc payable to partners
 - (g) Borrowing powers of the LLP
 - (h) Rights & duties of partners
 - (i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
 - (j) Any loans advanced by the partners
 - (k) Profit sharing ratio.

18.RTP May 19 Qn no 15(b)

AARK Ltd is a large-sized listed company having annual turnover of INR 4000 crores. The company also has a plan to get listed on New York Stock Exchange next year. The company has paid good amount of dividend during the year to its shareholders which is significantly higher as compared to earlier years. The statutory auditors would like to focus on this aspect at the time of their statutory audit.

Please advise the relevant procedures that the statutory auditors should perform in respect of this area.

Answer

The auditor should obtain appropriate audit evidence as regard to audit of payment of dividends. The procedures include:

- (a) Check whether dividend was declared out of profits arrived at after providing for depreciation as per Section 123(2).
- (b) Check whether:
- (i) the depreciation was provided according to provisions of Schedule II to the Companies Act, 2013.
 - (ii) a board resolution recommending dividend was passed.
 - (iii) the dividend was declared only in the AGM.
 - (iv) the dividend declared in the general meeting does not exceed the amount recommended by the Board.
 - (v) register of members was closed as per the provisions of section 91 of the Companies Act, 2013.
 - (vi) dividend has been paid in the prescribed manner within 30 days of time to the registered holder or to their order (Section 127).
 - (vii) Amount of dividend deposited in a separate bank account within 5 days from the date of declaration of dividend.
 - (viii) intimation sent to stock exchange, in case of listed company.
 - (ix) were there any complaints regarding non-payment or delay in payment of dividend? If, so, whether corrective action was taken.
- (c) Examine that the accounting and disclosure procedures have been complied with related to the declaration and payment of dividend like depreciation has been provided before declaration, disclosure has been made by way of notes to the accounts etc.
- (d) Inspect that the dividend has been paid only out of “free reserves” i.e. the reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend except- any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in statement of profit and loss on measurement of the asset or the liability at fair value, as laid down under third proviso to Section 123(1) read with Section 2(43) of the Act.
- (e) If dividend has been paid out of accumulated profits, earned by it in previous years and transferred to the reserves, in case of inadequacy or absence of profits in any financial years, verify that the rules related to such distribution has been complied i.e. the maximum amount allowable to be distributed as a dividend in case of inadequate or no profit as required by second proviso to Section 123(1) of the Act.
- (f) Check the procedures that have been followed for the payment of unclaimed dividend out of unpaid dividend account.

- (g) Verify that, if any money transferred to Unpaid Dividend Account has remained unpaid or unclaimed for a period of 7 years from the date of such transfer then, whether it has been transferred by the company along with interest accrued, if any, thereon to the Investor Education and Protection Fund established under section 125(1) of the Act and a statement regarding such transfer has also been sent to the authority which administers such fund.
- (h) In case the company has outsourced the activity to the Service Organisation, check that all the compliances with laws, regulations, accounting and disclosure related to the dividends have been made appropriately.

19.May 2019 Qn no 4(b) 4 Marks

PQ & Co. is an audit firm with P and Q as partners. For the financial year 2018-19, the firm has been appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. The audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations in the course of travelling for their various professional assignments. Normally, payments for such stay are settled against quarterly bills raised by the company. Give your comment with respect to the Companies Act, 2013.

Answer

Indebtedness to the Company: According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding ` 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

Further a person or a firm who directly or indirectly has business relationship with a company or its subsidiary or its holding or associate company, is also not qualified to be appointed as auditor of the company. But here business relationship does not include commercial transactions which are in the ordinary course of the business of the company at arm's length price.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, PQ & Co., an audit firm with P & Q as partners is appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. and the audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations. They also settle the payments for such stay against quarterly bills raised by the company. Assuming the balance amount at any time during the year due to the hotel does not exceed the prescribed limits of rupees 5,00,000, PQ & Co., is not disqualified to be appointed as statutory auditor of M/s Mango Orchards Hotel Ltd as per section 141(3)(d)(ii), in the absence of the same the auditor shall be disqualified to act as an auditor and shall vacate his office of auditor when he incurs this disqualification subsequent to the appointment.

Since in term of section 141(3)(e) of Companies Act, 2013 PQ & Co. is not a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, the auditor shall not be disqualified to act as an auditor and shall not required to vacate his office of auditor.

20.May 2019 Qn no 6(a) 5 Marks

Pearl Ltd. is an exporter of precious and semi-precious stones. The turnover of the company is ` 150 crore, out of which ` 105 crore is from export business and remaining Rs 45 crore from domestic sales. Amount received from export business is all in foreign currency. Directors of Pearl Ltd. are of the opinion that cost audit is not applicable to their company as maximum revenue has been generated from export business. Give your opinion.

Answer

Cost Audit Rules not to apply in certain cases: The requirement for cost audit shall not be applicable to a company whose revenue from exports, in foreign exchange, exceeds seventy-five per cent of its total revenue, which is operating from SEZ and which is engaged in the generation of electricity for captive consumption through captive generating plant. (as per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014).

In the instant case, Pearl Ltd. is an exporter of precious and semi-precious stones and the turnover of the company is rupees 150 crore out of which rupees 105 crore i.e. 70% is from export business and remaining rupees 45 crore i.e. 30% from domestic sales. It is neither operating from SEZ nor involved in captive power generation.

Thus, opinion of director is not tenable as revenue from exports in foreign exchanges is below prescribed limit. Therefore, cost audit is applicable on Pearl Ltd. as per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014. Pearl Ltd. has to appoint cost auditor to get the cost accounts of the company audited.

21.RTP Nov 2019 Qn no 15, MTP Oct 2018 Qn no 2(C) 4 Marks

“ABC & Co.” is an Audit Firm having partners “Mr. A”, “Mr. B” and “Mr. C”, Chartered Accountants. “Mr. A”, “Mr. B” and “Mr. C” are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.

- (i) **Provide the maximum number of Audits remaining in the name of “ABC & Co.”**
- (ii) **Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.**
- (iii) **Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ` 100 crore which has not committed default in filing its financial statements under section 137 or annual return under section 92 of the Companies Act with the Registrar, 2 small companies and**

1 dormant company?

- (iv) **Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ` 110 crore each?**

Fact of the Case: In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

Provisions and Explanations: As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ` 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar). As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Conclusion:

- (i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

Total Number of Audits available to the Firm	= 20×3
	= 60 Number of
Audits already taken by all the partners	
In their individual capacity	= $4 + 6 + 10$
	= 20 Remaining
number of Audits available to the Firm	= 40

- (ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor. Hence (1) Mr. A can hold: $20 - 4 = 16$ more audits. (2) Mr. B can hold $20 - 6 = 14$ more audits and (3) Mr. C can hold $20 - 10 = 10$ more audits.
- (iii) In view of above discussed provisions, ABC & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than Rs.100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar), 2 small companies and 1 dormant company as these are excluded from the

ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.

- (IV) As per fact of the case, ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ` 100 crores (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar). In the given case, out of the 60 private companies ABC & Co. is offered, 45 companies having paid-up share capital of ` 110 crore each.

Therefore, ABC & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than ` 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.) and 40 private companies having paid-up share capital of ` 110 crore each in addition to above 20 company audits already holding.

22.MTP Oct 2019 Qn no 6(b) 5 Marks

As an auditor, how would you deal with the following situations:

- (i) **Nick Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nick Ltd. appointed Mr. Prem as its statutory auditor.**
- (ii) **Contravene Ltd. appointed CA Innocent as an auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors.**

Answer:

(i) According to Section 139(7) of the Companies Act, 2013, the auditors of a government company shall be appointed or re-appointed by the Comptroller and Auditor General of India (C&AG). As per section 2(45), a Government company is

defined as any company in which not less than 51% of the *total voting power* is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government Company as thus defined.

In the given case, Ajanta Ltd is a government company as its 20% shares have been held by Central Government, 25% by U.P. State Government and 10% by M.P. State Government. Total 55% shares have been held by Central and State governments, therefore, it is a Government company. Nick Ltd. is a subsidiary company of Ajanta Ltd. Hence, Nick Ltd. is covered in the definition of a government company. Therefore, auditor of Nick Ltd. can be appointed only by C&AG.

Consequently, appointment of Mr. Prem is invalid and he should not give acceptance to the Directors of Nick Ltd.

(ii) Services not to be Rendered by the Auditor: Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under the Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

- (i) accounting and book keeping services;
- (ii) internal audit;
- (iii) design and implementation of any financial information system;
- (iv) actuarial services;
- (v) investment advisory services;
- (vi) investment banking services;
- (vii) rendering of outsourced financial services;
- (viii) management services; and
- (ix) any other kind of services as may be prescribed.

Further section 141(3)(i) of the Companies Act, 2013 also disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

In the given case, CA Innocent was appointed as an auditor of Contravene Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

23.RTP Nov 2019 Qn no 15(b)

Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts for the year 2018-19. The decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company, held in April 2018, subject to shareholders' approval in AGM of the company scheduled to be held in June 2018. Meanwhile, the Principal Auditor of the company raised an objection that the branch auditor cannot be appointed without his consent. Advise, whether the objection raised by company auditor is valid.

Answer

Appointment of Branch Auditor: Section 143 (8) of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office,

the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.

In case of subsequent appointment of auditor, section 139(1) of the Act provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting.

In the instant case, Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts and the decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company subject to shareholders' approval in AGM of the company.

Thus, objection raised by company auditor is not valid as per section 143(8) of the companies Act, 2013 and the Board has authority to appoint branch auditor but should be approved by shareholders in General Meeting.

24.MTP-Apr-19 Qn No 2(b) 5 Marks:

Director (Finance) of Alpha Ltd. is of the opinion that total trade payables mentioned in the financial statement is sufficient disclosure in the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013. They did not mention details regarding Micro, Small and Medium Enterprises (MSME). Give your view as statutory auditor of the Company and state the details required to be disclosed in notes regarding MSME.

Answer:

Details required to be disclosed in Notes regarding MSME: Opinion of Director (Finance) of Alpha Ltd. that total trade payables mentioned in the financial statement is sufficient disclosure in the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013, is not correct. The following details relating to Micro, Small and Medium Enterprises shall be disclosed by Alpha Ltd. in the notes:

- (i) **the principal amount and the interest due** thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;
- (ii) **the amount of interest paid by the buyer** as per Micro, Small and Medium Enterprises Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;
- (iii) **the amount of interest due and payable** for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;

- (iv) **the amount of interest accrued** and remaining unpaid at the end of each accounting year; and
- (v) **the amount of further interest remaining due** and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure as per Micro, Small and Medium Enterprises Development Act, 2006.

25.Nov 2019 Qn no 2(b) 5 Marks

CA. G, was appointed by DP Ltd., as Statutory Auditor. While doing the audit of DP Ltd., CA. G observed that certain loans and advances were made without proper securities; certain trade receivables and trade payables were adjusted inter se; and personal expenses were charged to revenue. As a company auditor comment on the, reporting responsibilities of CA. G.

Answer

- (a) **Duty of Auditor to Inquire on certain matters: Section 143(1) of the Companies Act, 2013** requires the auditor to make an enquiry in respect of specified matters during the course of his audit. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. It is to be noted that the auditor is required to make only enquiries and not investigate into the matters referred to therein.

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) of the Companies Act, 2013 is worth considering and reproduced below:

“The auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor’s Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider his duties under section 143(1).”

Clause (a) of Section 143(1) requires the auditor to inquire: “Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members”.

If the auditor finds that the **loans and advances** have not been properly secured, he may enter an adverse comment in the report but cannot probably doubt the true view of the accounts by reference to this fact so long the loans and advances are properly described and presented in terms of Part I of Schedule III to the Companies Act. Further the auditor to inquire whether or not the terms on which the loans or advances have been made are prejudicial to the interests of the company or its members. If it is, he should qualify his report.

If **trade receivables and trade payables** are adjusted inter se, this amounts to merely book entries. The auditor, as per clause (b) of section 143(1), should enquire “whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company”. This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards”.

Regarding **Personal Expenses**, Clause (e) of section 143(1) requires the auditor to inquire: “Whether personal expenses have been charged to revenue account”. The charging to revenue of such personal expenses, either on the basis of the company’s contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon. It suffices to say that if the auditor finds that personal expenses have been charged to revenue and if the amounts are material, he should qualify his report also.

26.MTP-Aug-18 Qn No 1(b) 5 Marks:

As an auditor of a company registered under section 8 of the Companies Act, 2013 you find that as per the notification of the Ministry of Corporate Affairs regarding applicability of Indian Accounting Standards (Ind-AS), the company has to prepare its financial statements for the year ended 31st March, 2018 under Ind-AS. The management of the company is however of the strong view that being a section 8 company having charitable objects, Ind-AS cannot apply to the company. The financial statements are therefore prepared by the management under the earlier GAAP and a note for the same is given in the financial statements. How would you report on these financial statements?

MTP-OCT-18 Qn No 3(b) 5 Marks:,Nov 2019 Qn no 3(a) 5 Marks

As an auditor of a company registered under section 8 of the Companies Act, 2013, you find that as per the notification of the Ministry of Corporate Affairs regarding applicability of Indian Accounting Standards (Ind-AS), the company has to prepare its financial statements for the year ended 31st March, 2019 under Ind-AS. The management of the company is, however, of the strong view that being a section 8 company having charitable objects, Ind-AS cannot apply to the company. The financial statements are, therefore, prepared by the management under the earlier GAAP and a note for the same is given in the financial statements. How would you report on these financial statements?

Answer

Applicability of IND AS: Section 129(1) of the Companies Act, 2013, governs the requirements to be satisfied by financial statements. The provisions thereunder which should be complied with are:

- financial statements shall, give a true and fair view of the state of affairs of the company or companies as at the end of financial year, comply with the notified accounting standards under section 133 and be in such form or forms specified in Schedule III to the Companies Act, 2013 and
- the items contained in such financial statements shall be in accordance with the accounting standards.

Further, as per **section 133 of the Companies Act, 2013**, the Central Government has notified **Companies (Indian Accounting Standards) Rules, 2015 dated 16.02.2015** in exercise of the powers conferred by section 133. The said rules list the Indian Accounting Standards (Ind AS) and the class of companies required to comply with the Ind AS while preparation of their financial statements.

Here, it may be noted that the companies covered under Section 8 are required to comply the provisions of the Companies Act, 2013, unless and until any exemption is provided. Therefore, **companies registered under Section 8 are not exempted from the requirements of section 133 and section 129 of the Companies Act, 2013.**

In the given case, only contention of management that being a section 8 company having charitable object, Ind-AS cannot apply to the company, therefore financial statements prepared under the earlier GAAP and a note for the same is given, is not tenable.

However, **the auditor is required to ensure the applicable monetary limits w.r.t Ind- AS** and need to advise the management to prepare the financial statements as per Ind-AS accordingly. In case of non-compliance the auditor should report accordingly.

Study Material

1.The Balance Sheet of G Ltd. as at 31st March, 20 is as under. Comment on the presentation in terms of Schedule III.

Heading	Not e No.	31 st March, 20	31 st March, 19
Equity & Liabilities			
Share Capital	1	XXX	XXX
Reserves & Surplus	2	0	0
Employee stock option	3	XXX	XXX
outstanding Share application	4	XXX	XXX
money refundable Non-Current		XXX	XXX
Liabilities	5	XXX	XXX
Deferred tax liability (Arising from Indian Income Tax)			
Current Liabilities	6	<u>XXX</u>	<u>XXX</u>
Trade Payables		<u>XXXX</u>	<u>XXXX</u>
Total			
Assets			
Non-Current Assets	7	XXX	XXX
Fixed Assets-Tangible	8	XXX	XXX
CWIP (including capital advances)	9	XXX	XXX
Current Assets	10	XXX	XXX
Trade Receivables			
Deferred Tax Asset (Arising from Indian Income Tax)		<u>XXX</u>	<u>XXX</u>
Debit balance of Statement of Profit and Loss		<u>XXXX</u>	<u>XXXX</u>
Total			

Answer

Following Errors are noticed in presentation as per Schedule III:

- (i) Share Capital and Reserve & Surplus are to be reflected under the heading “Shareholders’ funds”, which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities yet it must be shown under head “shareholders’ funds”. The heading “Shareholders’ funds” is missing in the balance sheet given in the question.
- (ii) Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head ‘Surplus’. The balance of ‘Reserves and Surplus’, after adjusting negative balance of surplus shall be shown under the head ‘Reserves and Surplus’ even if the resulting figure is in the negative.

(iii) Schedule III requires that Employee Stock Option outstanding should be disclosed under the heading “Reserves and Surplus”.

(iv) Share application money refundable shall be shown under the sub-heading “Other Current Liabilities”. As this is refundable and not pending for allotment, hence it is not a part of equity.

(v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.

(vi) Under the main heading of Non-Current Assets, Property, Plant and Equipment are further classified as under:

- (a) Tangible assets
- (b) Intangible assets
- (c) Capital work in Progress
- (d) Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Property, Plant and Equipment as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading “Long term loans and advances” under the heading Non-Current Assets.

Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, the words “Fixed assets” shall be substituted with the words “Property, Plant and Equipment”.

(e) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.

(f) Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, Trade Payables should be disclosed as follows:-

- (A) total outstanding dues of micro enterprises and small enterprises; and
- (B) total outstanding dues of creditors other than micro enterprises and small enterprises.”

2.2 Ltd. changed its employee remuneration policy from 1st April, 2018 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy, the employees can either utilize or encash it. As at 31st March, 19, the company obtained an actuarial valuation for leave encashment

liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment

Answer

As per Para 11 of AS-15 on “Employee Benefits”, issued by the Institute of Chartered Accountants of India, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences.

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Here, Z Ltd. will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence the contention of the auditor is correct that full provision should be provided by the company.

3.K Ltd. had 5 subsidiaries as at 31st March, 2020 and the investments in subsidiaries are considered as long term and valued at cost. Two of the subsidiaries had their net worth eroded as at 31st March 19 and the prospects of their recovery are very bleak and the other three subsidiaries are doing exceptionally well. The company did not provide for the decline in the value of investments in two subsidiaries because the overall investment portfolio in subsidiaries did not suffer any decline as the other three subsidiaries are doing exceptionally well. Comment.

Answer

As per AS-13 “Accounting for Investments” issued by the Institute of Chartered Accountants of India, long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually Keeping in view the above, K Ltd. should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline.

4. While adopting the accounts for the year, the Board of Directors of Sunrise Ltd. decided to consider the Interim Dividend declared @15% as final dividend and did not consider transfer of Profit to reserves.

Answer

Declaration of Interim Dividend: Section 123(3) of the Companies Act, 2013 provides that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Statement of Profit and Loss and out of profits of the financial year in which such interim dividend is sought to be declared. The amount of dividend including interim dividend should be deposited in a separate bank account within five days from the declaration of such dividend for the compliance of Section 123(4) of the said Act.

Based on Section 2(35) of the Act, it can be said that since interim dividend is also a dividend, companies should provide for depreciation as required by Section 123 before declaration of interim dividend. However, the first proviso to Section 123(1) provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profit for that financial year as it may consider appropriate to the reserves of the company irrespective of the size of the declared dividend i.e. the company is not mandatorily required to transfer the profit to the reserves, it is an option available to the company to transfer such percentage.

In the instant case, the Board has decided to pay interim dividend @15% of the paid-up capital. Assuming that the company has complied with the depreciation requirement, the interim dividend can be declared without transferring such percentage of its profits to the reserves of the company.

5. MG Pvt. Ltd. seeks your advice while preparing the financial statements i.e. the general instructions to be followed while preparing Balance Sheet under Companies Act, 2013 in respect of current assets and liabilities.

Answer

General Instructions for Preparation of Balance Sheet:

(i) General Instruction in respect of Current Assets: An asset shall be classified as current when it satisfies any of the following criteria-

- (1) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;
- (2) it is held primarily for the purpose of being traded;
- (3) it is expected to be realized within twelve months after the reporting date; or
- (4) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

(iii) General Instruction in respect of Current Liabilities: A liability shall be classified as current when it satisfies any of the following criteria-

- (1) it is expected to be settled in the company's normal operating cycle;
- (2) it is held primarily for the purpose of being traded;
- (3) it is due to be settled within twelve months after the reporting date; or
- (4) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

6.As an auditor, how would you deal with the following situations:

(a)Ram and Hanuman Associates, Chartered Accountants in practice, have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2018-2019. Mr. Hanuman, a partner of Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.

(b)Nick Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nick Ltd. appointed Mr. Prem as its statutory auditor.

(c)Contravene Ltd. appointed CA Innocent as an auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors.

(d)Mr. Amar, a Chartered Accountant, bought a car financed at ` 7,00,000 by Chaudhary Finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to be even after taking the loan.

Answer

(a) Auditor Holding Securities of a Company: As per sub-section (3)(d)(i) of Section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Provided that the relative may hold security or interest in the company of face value not exceeding rupees one lakh.

Also, as per sub-section (4) of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., as per section 141(3)(d)(i), which is the holding company of Shiva Ltd., because Mr. Hanuman, one of the partners, is holding equity shares of its subsidiary.

- (b) According to Section 139(7) of the Companies Act, 2013, the auditors of a government company shall be appointed or re-appointed by the Comptroller and Auditor General of India (C&AG). As per section 2(45), a Government company is defined as any company in which not less than 51% of the *total voting power* is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government Company as thus defined.

In the given case, Ajanta Ltd is a government company as its 20% shares have been held by Central Government, 25% by U.P. State Government and 10% by M.P. State Government. Total 55% shares have been held by Central and State governments, therefore, it is a Government company.

Nick Ltd. is a subsidiary company of Ajanta Ltd. Hence, Nick Ltd. is covered in the definition of a government company. Therefore, auditor of Nick Ltd. can be appointed only by C&AG.

- (c) Services not to be Rendered by the Auditor: Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under the Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:
- (i) accounting and book keeping services;
 - (ii) internal audit;
 - (iii) design and implementation of any financial information system;
 - (iv) actuarial services;
 - (v) investment advisory services;
 - (vi) investment banking services;
 - (vii) rendering of outsourced financial services;
 - (viii) management services; and
 - (ix) any other kind of services as may be prescribed.

Further section 141(3)(i) of the Companies Act, 2013 also disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

In the given case, CA Innocent was appointed as an auditor of Contravene Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

- (d) According to section 141(3)(d)(ii) of the Companies Act, 2013, a person is not eligible for appointment as auditor of any company, if he is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh.

In the given case, Mr. Amar is disqualified to act as an auditor under section 141(3)(d)(ii) as he is indebted to Chaudhary Finance Ltd. for more than ` 5,00,000. Also, according to section 141(3)(d)(ii), he cannot act as an auditor of any subsidiary of Chaudhary Finance Ltd. i.e. he is also disqualified to work in Charan Ltd. & Das Ltd. Therefore, he has to vacate his office in Das Ltd. even though it is a subsidiary of Chaudhary Finance Ltd.

Hence audit work performed by Mr. Amar as an auditor is invalid, he should vacate his office immediately and Das Ltd. should appoint another auditor for the company

7. Astha Pvt. Ltd. has fully paid capital of ` 140 lakhs. During the year, the company had borrowed ` 15 lakhs each from a bank and a financial institution. It had the turnover (Net of GST ` 50 lakhs which is credited to a separate account) of ` 475 lakhs. Will Companies (Auditor's Report) Order, 2016 be applicable to Astha Pvt. Ltd.?

Answer

Applicability of CARO, 2016: The CARO, 2016 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the case of Astha Pvt. Ltd., it has outstanding loan of ` 30 lakhs (` 15 lakhs + ` 15 lakhs) collectively from bank and financial institution which is less than ` 1 crore rupees and turnover is ` 475 lakhs i.e. also less than ` 10crores and not exceeding the limit. However, it has paid capital of ` 140 lakhs i.e. more than ` 1 crore.

Thus, considering its paid up capital which is exceeding the prescribed limit for exemption, CARO, 2016 will be applicable to Astha Pvt. Ltd.

8. Under CARO, 2020, as a statutory auditor, how would you report on the following:

- (i) **A term loan was obtained from a bank for `80 lakhs for acquiring R&D equipment, out of which `15 lakh was used to buy a car for use of the**
- (ii) **Physical verification of only 40% of items of inventory has been conducted by the company. The balance 60% will be conducted in next year due to lack of time and resources.**

Answer

Utilisation of Term Loans: According to clause (ix) of Para 3 of CARO, 2020, the auditor is required to report “whether term loans were applied for the purposes for which those were obtained. If not, the amount of loan so diverted and the purpose for which it is used may be reported”.

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car which has no relation with R&D equipment.

Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report as per Paragraph 3 clause (ix) of the CARO 2020, that out of the term loan taken for R&D equipment, ` 15 lakhs was not utilised for the intended purpose of acquiring R&D equipment.

Physical Verification of Inventory: Clause (ii) of Para 3 of CARO, 2020 requires the auditor to report on whether physical verification of inventory has been conducted at reasonable intervals by the management. Physical verification of inventory is the responsibility of the management which should normally verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.

In the given case, the above requirement of CARO, 2020 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

9.T Pvt. Ltd.’s paid up capital & reserves are less than ` 50 lakhs and it has no outstanding loan exceeding ` 25 lakhs from any bank or financial institution. Its sales are ` 6 crores before deducting trade discount ` 10 lakhs and sales returns ` 95 lakhs. The services rendered by the company amounted to ` 10 lakhs. The company contends that reporting under Companies Auditor’s Reports Order (CARO) is not applicable. Discuss.

Applicability of CARO, 2020: The CARO, 2020 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the

Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the given case, paid up capital and reserves of T Pvt. Ltd. are less than `1 crore and has no loan outstanding exceeding ` one crore from any bank or financial institution.

Further, its total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) is not exceeding rupees ten crore during the financial year as per the financial statements.

Thus CARO 2020 will not be applicable to T Pvt. Ltd.

10. The financial statements of MP Ltd. as on March 31, 2020 are to be prepared under Division II of Schedule III to the Companies Act, 2013. Comment on the disclosure compliances for MP Ltd. from the following information in the financial statements which are required to be drawn up in compliance with Ind AS.

- (i) Property, Plant and Equipment include ` 2.50 crore for a boiler-plant under construction.**
- (ii) Cash and cash equivalents include ` 1.25 crore deposited with a nationalized bank on 31st March, 2020 for 18 months. It is shown under current assets.**
- (iii) Non-current assets include under caption "Biological assets other than bearer Plants" a sum of ` 1.50 crore being cost of cultivation for bringing to yield level, the cashewnut trees whose yield period, according to estimate shall not be less than 10 years.**

Answer:

(i) Disclosure of Boiler Plant under Construction: Boiler plant under construction should be shown under the heading 'Capital Work in Progress' instead of Property Plan and Equipment. Thus, inclusion of value of boiler plant under construction in Property Plan and Equipment is not in order.

(ii) Disclosure of Cash and Cash Equivalents deposited with Nationalised Bank: Bank deposits with more than 12 months maturity shall be disclosed under 'Other financial assets'. Therefore, disclosure of deposits rupees 1.25 crores in a nationalised bank for 18 months as Cash and Cash Equivalents is not in order as per Division II of Schedule III.

(iii) Disclosure of Cost of Cultivation for bringing to yield level the Cashewnut trees: Cost of 1.5 crore rupees for Cultivation for bringing to yield level, the cashewnut trees whose yield period is more than one period will form part of 'Bearer Plant'. Hence it will not be considered as 'Biological Assets other than bearer plant'. Therefore, it should be shown under the heading 'Property Plant and Equipment' as Bearer Plant as per Division II of Schedule III.

14. What are the reporting requirements in the audit report under the Companies Act, 2013 / CARO, 2020 for the following situations?

- (i) A fraud has been committed against the company by a vendor of the company.**
- (ii) The company has committed a major fraud on its customer and the case is pending in the court.**

Answer:

Reporting Requirements in the Audit Report under the Companies Act, 2013 / CARO

2020: According to Clause (xi) (a) of Para 3 of CARO 2020, the auditor is required to report whether any fraud by the company or any fraud on the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated; Further, as per Clause (xi) (b) of Para 3 of CARO 2020, whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

As per section 143(12)s of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is rupees 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than rupees 1 crore) within such time and in such manner as may be prescribed.

(i) Fraud committed against the company by a vendor of the Company: In case employees or management are involved in fraud committed by vendor, reporting has to be done in accordance with CARO 2020 and as per section 143 (12) of the Companies Act, 2013. Suspected fraud by vendors, customers and other third parties should be dealt with in accordance with SA 240. Therefore, reporting has to be done in accordance with SA 240, "The Auditor's Responsibilities relating to Fraud in an audit of Financial Statements".

(ii) Company has committed major fraud on its customer of which case is pending in the court: Major fraud committed by the company on its customer has to be reported in accordance with Clause (xi) of Para 3 of CARO 2020.

MCQ

1. **Re-opening of accounts on Court's or Tribunal's orders:** Section 130 of the Companies Act, 2013 states that a company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board of India (SEBI), any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that Jain Ltd. has an annual turnover of ` 350 crores and has been into losses for the last 2 years. The operations of the company are good. Due to some technology changes, the company started facing competition and hence started incurring losses. The company plans to revive in the next 1-2 years with the improvements in its processes. During the year ended 31 March, 2019, the management of the company came across certain transactions relating to the financial year ended 31 March 2018 which were erroneously missed to be accounted for. This would result into losses and hence the management is considering to take this to the right financial year and for that

purpose to re-open its accounts for the financial year ended 31 March 2018. Please advise.

- a. The position of the management is correct.
- b. The action of the management is correct, however, the reason behind reopening the accounts of last year does not seem to be correct.
- c. The action of the management would have been correct had it been advised by the auditors of the company and for the same management should have taken approval from SEBI.
- d. The action of the management is not correct.

Answer: Option: (d) The action of the management is not correct.

2. Rimmi Ltd. was set up initially as a private limited company. Subsequently, it got converted into a public company. The company's management has plans of expansion but the business was not growing in an organic manner. Therefore, the management decided to acquire the competitors. During the financial year ended 31 March, 2019, the company acquired two companies in India and France in September, 2018 and January, 2019 respectively. The company controls both of these companies as per the criterias laid down in the Companies Act 2013 as well as the applicable accounting standards.

The management started discussions with the auditors regarding the audit wherein it was also pointed out by the auditors that the management should also prepare consolidated financial statements (CFS), if they want. Management needs your advise on the same.

- a. Management must prepare the CFS as per the requirements of the Companies Act, 2013.
- b. Management has a choice not to prepare CFS but should go for that considering that its true performance and financial position can then be demonstrated.
- c. Management could have prepared CFS if the acquired companies would have completed at least one year post acquisition.
- d. Management must prepare CFS but it should include only the company acquired in India.

Answer: Option: (a) Management must prepare the CFS as per the requirements of the Companies Act, 2013.

3. K Pvt Ltd. has been providing marketing support services to its parent company based out of Ireland. The company's operations are not large and have remained stable over the last few years. Recently the parent company was acquired by another company and the new investor wanted to reassess whether the company in India should continue or should be shut down considering the legal compliances. It was advised to the new investor that the company should be converted into LLP. In December 2018, the new management decided that they would get the company converted into LLP and also discussed that

matter with their statutory auditors. The management is expecting that the LLP conversion would get completed by February 2019 and wants that the auditors should audit the financial statements of the LLP at the year end because conversion is only an administrative process and hence it would not impact their work.

- a. The management would need to get the financial statements audited from new auditor appointed by CAG in case of LLP.
- b. The management would need to appoint new auditor and the new auditor can audit LLP at year end in one go – both for the period it was a company and then when it became LLP.
- c. The auditor of the company should audit the company before its conversion and then the new auditor for LLP would audit LLP separately.
- d. The auditor of the company should audit the company before its conversion and then the new auditor for LLP would audit LLP separately. But this is a choice available to the auditor.

Answer:

Option: (c) The auditor of the company should audit the company before its conversion and then the new auditor for LLP would audit LLP separately

4.AJ Private Ltd. was incorporated on 21 March, 2018 and has limited operations. However, the capital induction in the company was huge because it would be capital intensive. The company is in the process to set up a plant in Karnataka which should be completed by 31 May, 2019. The company's management prepared its financial statements for the year ended 31 March, 2019. The auditors were also called to start the work in April 2019. The auditors would be able to complete their work by 31 May, 2019 and accordingly would issue their audit report by 1st week of June, 2019 as per the plan agreed with the management. The auditors have some observations related to preparations of financial statements which are not in compliance with Schedule III and most importantly the point related to capitalization of the plant as Property, Plant and Equipment in the financial statements for the year ended 31 March, 2019. Please suggest which of the following statements would be correct.

- a. The compliance of Schedule III shall start from 1 April 2019 for this company as per Companies Accounts (Amendment) Rules 2016.
- b. The compliance of Schedule III shall start from first financial period, however, some exemptions would be applicable as per Companies Accounts Rules 2014.
- c. There should be full compliance of Schedule III and plant should be kept as CWIP as per Schedule III.
- d. There should be full compliance of Schedule III and plant should be shown as PPE as per Schedule III.

Answer:Option: (c) There should be full compliance of Schedule III and plant should be kept as CWIP as per Schedule III.

5. SHRD Private Ltd is engaged in the business of software and consultancy. The company has an annual turnover of ₹ 2,000 crores but its profit margins are not very good as compared to the industry standards. For the financial year ended 31 March 2019, the company proposed appointment of its statutory auditors at its general meeting, however, the remuneration was not finalized. The statutory auditors completed the engagement formalities including the engagement letter between the company and the auditors and it was decided that the engagement letter be signed without fee i.e. with the clause that the fee to be mutually decided. Please provide your views on this.

- a. Such engagement letter is not valid.
- b. Engagement letter with such arrangement is valid.
- c. Engagement letter should specify the fee of last year, if applicable, if the fee for the current year is not yet finalized at the time of signing of the engagement letter.
- d. Engagement letter should specify 10% increase in the fee as compared to last year as per the norms of the ICAI, in case the fee is not finalized at the time of signing of the engagement letter.

Answer: Option: (b) Engagement letter with such arrangement is valid.

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CHAPTER 6 - AUDIT REPORTS

Multiple Choice Questions

1.MTP Mar 2019 QN no 1 (2 Marks)

One of your team members has recently qualified as a chartered accountant and joined your team to audit a portfolio of audit clients who are private companies. One of the clients Surrey Pvt. Ltd. is a hotel in the small town near Jaipur. The revenue generated for the current year ended is Rs.10.5 crores and the entity is not a holding or subsidiary of any public company. The owner of the business Mr. Hazelwood runs this family business from last 10 years. Your team member is keen to know whether Surrey Pvt. Ltd is required to comment on the matter prescribed under CARO 2020. Which of your explanations to him are correct?

- a) The entity's revenue exceeds Rs.10 crores. Hence, no need to comment on the matter prescribed under CARO 2020.
- b) The entity is not a holding or subsidiary of any public company, hence no need to comment on the matter prescribed under CARO 2020.
- c) The entity's revenue for the year is Rs.10.5 cr which exceed the limit of Rs.10 cr. Hence, the entity has to provide the comment on the matter prescribed under CARO 2020.
- d) The entity is not a holding or subsidiary of any public company, hence there is a need to comment on the matter prescribed under CARO 2020.

Answer: (c) The entity's revenue for the year is Rs.10.5 cr which exceed the limit of Rs.10 cr. Hence, the entity has to provide the comment on the matter prescribed under CARO 2020.

2.MTP Oct 2019 QN no 17 2 Marks

Honeywell Ltd, a listed company pays its key managerial persons the remuneration in excess of the limits which have been prescribed under 197 of the Companies Act, 2013 without obtaining the necessary approvals from the regulatory authority. In this circumstance, the auditor while reporting under CARO 2020, is required to state:

- a) Name of the managerial persons to whom the remuneration has been paid in excess of limits and the amount involved.
- b) Name of the managerial persons to whom the remuneration in excess of limits are paid and the steps taken by the company for securing refund of the same.
- c) The maximum remuneration payable and amount paid in excess of the maximum remuneration to the managerial persons.
- d) The amount involved and steps taken by the company for securing the refund of the same.

Answer: Option (d) The amount involved and steps taken by the company for securing the refund of the same.

Descriptive Questions

MAY 2018 1 (b) – 5 Marks

1.The Property, Plant and Equipment of ABC Ltd. Included Rs. 25.75 crores of earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected ten years back. As an Auditor, what may be your reporting concern as regards matters specified above?

Answer

Disclosure in Audit Report: The auditor is required to specifically include certain matters as per CARO, 2016 under section 143 of the Companies Act, 2013.

According to clause (i) (a) of CARO, 2016 the auditor has to comment whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; and as per clause (i) (b) whether these fixed assets have been physically verified 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;

In the given case, ABC Ltd. has intention to sale its earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down and these assets are appearing at residual value. Further, inspection of such machines (though it is a retired machine, however value is ` 25.75 crores which is material amount) was done 10 years back, is not in compliance with CARO, 2016.

Hence, this fact needs to be disclosed in the Audit Report as per clause (i) (a) and (b) of Paragraph 3 of CARO 2020.

2.RTP May 2018 Qn no. 7(a) and Study Material

Compare and explain the following:

- I. Reporting to Shareholders vs. Reporting to those Charged with Governance**
- II. Audit Qualification vs. Emphasis of Matter.**

ANSWER

(a) (i) Reporting to Shareholders vs. Reporting to those Charged with Governance:

REPORT	
Reporting to Shareholders	Reporting to those Charged with Governance
<ul style="list-style-type: none"> • Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to 	<ul style="list-style-type: none"> • Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.

the members.	
<ul style="list-style-type: none"> • Statutory Audit Report is on true and fair view and as per prescribed Format. 	<ul style="list-style-type: none"> • It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
<ul style="list-style-type: none"> • Statutory Audit Reports are in public domain. 	<ul style="list-style-type: none"> • Reporting to those Charged with Governance is an internal document i.e. private report.

(ii) Audit Qualification vs. Emphasis of Matter:

REPORT	
Audit Qualification	Emphasis of Matter
<ul style="list-style-type: none"> • Standard on Auditing 705 “Modifications to the Opinion in the Independent Auditor’s Report”, deals with the provisions relating to Audit Qualification. 	<ul style="list-style-type: none"> • Standard on Auditing 706 “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report” deals with the
	provisions relating to Emphasis of Matter.
<ul style="list-style-type: none"> • Audit Qualifications are also known as “subject to report” or “except that report”. 	<ul style="list-style-type: none"> • Emphasis of Matter is a paragraph which is included in auditor’s report to draw users’ attention to important matter(s) which are already disclosed in Financial Statements and are fundamental to users’ for understanding of Financial Statements.
<ul style="list-style-type: none"> • Audit Qualifications are given when auditor is having reservations on some of the items out of the financial statements as a whole i.e. Auditor’s Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements 	<ul style="list-style-type: none"> • Emphasis of Matter is a paragraph which is issued when there is a uncertainty relating to future outcome of exceptional litigation, regulatory action, etc.; or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the

relating to if the impact of material misstatements is not pervasive on the financial statements but is present at some levels of the financial statements, qualified report is issued.	financial statements in advance of its effective date.
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Study Material

ILLUSTRATIONS

1. CA Sameer is the statutory auditor of Tram Fram Ltd. for the FY 2020-21. While concluding the audit CA Sameer decided to issue an unmodified opinion, though he also concluded that a material uncertainty exists with respect to the company's ability to continue as a going concern on account of a pending litigation related to labour laws. He is of the view that the company has made appropriate disclosures with respect to such pending litigation in the notes to accounts annexed to the financial statements of Tram Fram Ltd. for the FY 2020-21. Explain how CA Sameer will deal with the above situation in his auditor's report (draft the relevant portion of the auditor's report.)

Solution:

Material Uncertainty Related to Going Concern

We draw attention to Note 10 in the financial statements, which indicates that the outcome of a litigation on account of labour laws is pending in case of the company during the year 31 March, 2021. As stated in Note 11, this event or condition, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

2. XYZ Ltd. is a company engaged in the manufacture of cranes. CA Sudhir is the statutory auditor of the company for the FY 2020-21. The company has taken long term funding for fixed capital requirements and short term funding for its working capital requirements. During the course of audit, CA Sudhir found that the company's financing arrangements are about to expire and the company is unable to re- negotiate or obtain the replacement financing. As such the company may be unable to realize its assets and discharge its liabilities in the normal course of business. Notes to accounts annexed to the financial statements discuss the magnitude of financing arrangements, the expiration and the total financing arrangements; however the financial statements do not include discussion on the impact or the availability of refinancing. Thus, the financial statements (and notes thereto) do not fully disclose this fact. What kind of opinion should CA Sudhir issue in case of XYZ Ltd.?

ANSWER:

In the present case, XYZ Ltd. is unable to re- negotiate or obtain the replacement financing for its long term and short term funding requirements. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore, XYZ Ltd. may be unable to realize its assets and discharge its liabilities in the normal course of business. Further, the financial statements of XYZ Ltd. do not disclose this fact adequately.

Thus, the financial statements of XYZ Ltd. are materially misstated due to the inadequate disclosure of the material uncertainty. CA Sudhir will express a qualified opinion as the effects on the financial statements of this inadequate disclosure are material but not pervasive to the financial statements.

The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion section of our report, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of XYZ Ltd. as at March 31, 2021, and profit/loss, for the year ended on that date.

Basis for Qualified Opinion

As discussed in Note 6, the Company's financing arrangements are about to expire and the Company has been unable to conclude renegotiations or obtain replacement financing. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this matter.

3 ABC Ltd. is a company engaged in the manufacture of iron and steel bars. PP & Associates are the statutory auditors of ABC Ltd. for the FY 2020-21. During the course of audit, CA Prakash, the engagement partner, found that the Company's financing arrangements have expired and the amount outstanding was payable on March 31, 2021. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. What opinion should CA Prakash express in case of ABC Ltd.?

SOLUTION:

In the present case based on the audit evidence obtained, CA Prakash has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and the entity is considering bankruptcy. The financial statements of ABC Ltd. omit the required disclosures relating to the material uncertainty.

In such circumstances, CA Prakash should express an adverse opinion because the effects on the financial statements of such omission are material and pervasive.

The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of the entity as at March 31, 2021, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

The financing arrangements of ABC Ltd. has expired and the amount outstanding was payable on March 31, 2021. The entity has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue

as a going concern. The financial statements do not adequately disclose this fact.

4

MNO Ltd. is a power generating company having its plants in the north eastern states of the country. For the FY 2020-21, M/s PRT & Associates are the statutory auditors of the company. During the course of audit, the audit team was unable to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment (in XYZ Ltd.) that represents over 90% of the entity's net assets. What kind of opinion should the statutory auditors issue in such case?

ANSWER:

M/s PRT & Associates are unable to obtain sufficient appropriate audit evidence about the financial information of a joint venture investment that represents over 90% of the entity's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are both material and pervasive to the consolidated financial statements.

Therefore, the statutory auditor should issue a disclaimer of opinion.

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of MNO Ltd. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

The Group's investment in its joint venture XYZ Company is carried at ` 95 crores on the Group's consolidated balance sheet, which represents over 90% of the Group's net assets as at March 31, 2021. We were not allowed access to the management and the auditors of XYZ Company, including XYZ Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, (and the elements making up the consolidated statement of changes in equity) and the consolidated cash flow statement

5.CA Yash is the statutory auditor of Laksmi Vardhan Limited for the FY 2020-21. In respect of loans and advances of ` 55,00,000/- given to Sarvagya Private Limited, the Company has not furnished any agreement to CA Yash and in absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms.

What kind of opinion should CA Yash give in such situation?

SOLUTION:

In the present case, with respect to loans and advances of ` 55,00,000/- given to Sarvagya Private Limited, the Company has not furnished any agreement to CA Yash. In absence of such agreement, CA Yash is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidences is the loan agreement. Therefore, the absence of such document in the present case, tantamount to a material misstatement in the financial statements of the company. However, the inability of CA Yash to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion.

Thus, in the present case, CA Yash should give a qualified opinion

The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

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In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Lakshmi Vardhan Limited give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2021 and profit/ loss for the year ended on that date.

Basis for Qualified Opinion

The Company is unable to furnish the loan agreement with respect to loans and advances of ` 55,00,000/- given to Sarvagya Private Limited. Consequently, in absence of such agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms

6:

In the financial year 2020-21, MSD Ltd. faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. These circumstances indicate material uncertainty on the company's ability to continue as going concern. Due to such event it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. The financial statement and notes to the financial statements of the company do not disclose this fact. What kind of opinion should the statutory auditor of MSD Ltd. issue in such circumstances?

SOLUTION:

In the present case, there exists a material uncertainty that cast a significant doubt on the company's ability to continue as going concern and the same is not disclosed in the financial statements of MSD Ltd.

As such, the financial statements of MSD Ltd. for the FY 2020-21 are materially misstated and the effect of the misstatement is so material and pervasive on the financial statements that giving only a qualified opinion will be insufficient and therefore the statutory auditor of MSD Ltd. should issue an adverse opinion.

The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of MSD Ltd. as at March 31, 2021, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

MSD Ltd. has faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. Due to such event it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statement and notes to the financial statements of the company do not disclose this fact.

7. CA Abhimanyu is the statutory auditor of PQR Ltd. for the FY 2020-21. During the course of audit CA Abhimanyu noticed the following:

1. With respect to the debtors amounting to ` 150 crores, no balance confirmation was received by the audit team. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of `25 Cr. during the year under audit. The Company has stated

that the provision is based on receivables which are older than 36 months, which according to the audit team is inadequate and as such the audit team is unable to ascertain the carrying value of trade receivables.

2. Further, in respect of Inventories (which constitutes 40% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. The audit team was unable to undertake the physical inventory count as such the value of inventory could not be verified.

Under the above circumstances what kind of opinion should CA Abhimanyu give?

SOLUTION:

In the present case, CA Abhimanyu is unable to obtain sufficient and appropriate audit evidence with respect to the following:

1. The balance confirmation with respect to debtors amounting to ` 150 crores is not available. Further there has been default in payment by the debtors and the provision so made is not adequate. The audit team is also unable to ascertain the carrying value of trade receivables.
2. With respect to 40% of the company's inventory, neither the physical verification has been done by the management nor are adequate inventory records maintained. The audit team is also unable to undertake the physical inventory count as such the value of inventory could not be verified.

In the above two circumstances the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Thus, CA Abhimanyu should give a Disclaimer of Opinion.

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of PQR Ltd. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We are unable to obtain balance confirmation with respect to the debtors amounting to ` 150 crores. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of `25 Cr. during the year under audit which is inadequate in the circumstances of the company. The carrying value of trade receivables could not be ascertained.

Further, in respect of Inventories (which constitutes 40% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. We were unable to undertake the physical inventory count and as such the value of inventory could not be verified.

8. In respect of the audit of BDS Ltd., the statutory auditor of the company noticed some matters. The statutory auditor wants to draw the user's attention towards such matters, though his opinion is not modified in respect of such matters. Draft the relevant paragraphs of the audit report for the following matters:

- i. The company has a plan to resume its construction activities with respect to one of its thermal power project, The activity of such power plant was suspended in the FY 2018-19. The thermal power project comprises of the plant and equipment amounting to ` 5.95 crore and capital work in progress of ` 147.50 crore.

ii ii. The financial statements of 5 branches are included in the Standalone Financial Statements of BDS Ltd. whose financial statements reflect total assets of ` 90 crores as at 31.03.2021 and total revenue from operations of ` 40 crores for the year ended on that date. The financial statements of these branches have been audited by the branch auditors.

SOLUTION:

Emphasis of Matter

We draw attention to the following note of the standalone financial statements:

Note 27 regarding the plans of the Company to resume construction/developmental activities of a thermal power project. The carrying amounts related to the project as at 31st March, 2021 comprise of plant and equipment of ` 5.95 crore and capital work in progress of ` 147.50 crore. Our opinion is not modified in respect of this matter.

Other Matter

We did not audit the financial statements of 5 branches included in the Standalone Financial Statements of the company whose financial statements reflect total assets of ` 90 crores as at 31.03.2021 and total revenue from operations of ` 40 crores for the year ended on that date. The financial statements of these branches have been audited by the branch auditors whose reports have been furnished to us, and our opinion in so far as it relates to the amounts and disclosures included in respect of these branches, is based solely on the report of the branch auditors. Our opinion is not modified in respect of this matter.

QUESTIONS

1. Write a short note on Certificate for Special Purpose vs. Audit Report.

Certificate for Special Purpose vs. Audit Report: A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. The term 'certificate' is, therefore, used where the auditor verifies the accuracy of facts. An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain figures and is in a position to vouch safe their accuracy as per his examination of documents and books of account. A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill. The 'report' involves expression of opinion which may differ from one professional to another. There is no question of exactitude in case of a report since the information contained therein is based on estimates and involves judgement element.

2. Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?

ANSWER:

Types of Modified Opinions as per SA 705:

- (i) Qualified Opinion
- (ii) Adverse Opinion

- (iii) Disclaimer of Opinion

The auditor shall modify the opinion in the auditor's report when: The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; **or**

The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement

3. Write a short note on Emphasis of matter paragraph in Audit Reports.

ANSWER:

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.. These circumstances may include: • When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation. • To alert users that the financial statements are prepared in accordance with a special purpose framework.

4. KPI Ltd is a joint venture of KPI Inc, a company based in US, and OPQ Ltd, a company based in Japan (hereinafter referred to as 'JV partners'). KPI Ltd was registered in India and is operating as a marketing support company for KPI Inc. All the costs of KPI Ltd are incurred in India and entire revenue of KPI Inc is generated in USD. The entire funding requirements of KPI Ltd are taken care of by the JV partners. Since KPI Ltd is based in India, hence it is also required to get its financial statements audited. The company appointed new auditors for the audit of the financial statements for the year ended 31 March 2020 after doing all appointment formalities wherein auditors are required to ensure compliance with Standards on Auditing and Internal Standards on Auditing. As an expert you are required to advise the auditor about the requirements regarding auditor's report for audits conducted in accordance with both Standards on Auditing issued by ICAI and International Standards on Auditing

ANSWER:

An auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

(a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:

(i) to form a different opinion, or

(ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; and (b) The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

5. TUV Ltd. is a company engaged in the business of manufacture of spare parts. Saroj & Associates are the statutory auditors of the company for the FY 2020-21. During the course of audit, CA Saroj noticed that the company had a major customer, namely, Korean Mart from South Korea. Owing to an outbreak of war and subsequent destruction leading to government ban on import and export in South Korea, the demand from Korean Mart for the products of TUV Ltd. ended for an unforeseeable time period. When discussed with the management, CA Saroj was told that the company is in the process of identifying new customers for their products. CA Saroj understands that though the use of going concern assumption is appropriate but a material uncertainty exists with respect to the identification of new customers. This fact is duly reflected in the financial statements of TUV Ltd. for the FY 2020-21. How should CA Saroj deal with this matter in the auditor's report for the FY 2020-21?

ANSWER:

As per SA 570, "Going Concern", loss of a major market or a key customer is one of the operating indicators that may cast significant doubt on the company's ability to continue as a going concern.

In the present case, TUV Ltd. has a key customer in South Korea from which the demand for its products has ended on account of outbreak of war, subsequent destruction and government ban on import and export in South Korea. Further, the company has not yet identified new customers and is in the process of doing the same. As such, the identification of new customer is a material uncertainty that cast a significant doubt on the company's ability to continue as a going concern.

However, this matter is duly disclosed by the management of TUV Ltd. in the financial statements for the year ended 31.03.2021.

As such, considering that the going concern assumption is appropriate but a material uncertainty exists with respect to identification of new customer, CA Saroj should:

- (1) Express an unmodified opinion and
- (2) Include in his audit report, a separate section under the heading "Material Uncertainty Related to Going Concern" to:

- (i) Draw attention to the note in the financial statements that discloses the matters and
- (ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Thus, CA Saroj should deal with this matter in his auditor's report in the above mentioned manner.

6. Sun Moon Ltd. is a power generating company which uses coal as raw material for its power generating plant. The company has been allotted coal blocks in the state of Jharkhand and Odhisa. During the FY 2020-21, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Sun Moon Ltd. This happened in the month of December 2020 and as such entire power generation process of Sun Moon Ltd, came to a halt in that month. As a result of such ban, and the resultant stop of the production process, many key managerial personnel of the company left the company. There were delays in the of payment of wages and salaries and the banks from whom the company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of the company. Further, when discussed with the management, the statutory auditor understood that the company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected the the financial statements of Sun Moon Ltd. What course of action should the statutory auditor of the company consider in such situation?

ANSWER:

SA 570- "Going Concern" deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report. The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

When the use of Going Concern Basis of Accounting Is Inappropriate i.e. if the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

Also when adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements the auditor shall:

- (i) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and
- (ii) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter. In the present case, the following circumstances indicate the inability of Sun Moon Ltd. to continue as a going concern:
 - Ban on the allotment of coal blocks
 - Halt in power generation
 - Key Managerial Personnel leaving the company.
 - Banks decided not to extend further finance and not to fund the working capital requirements of the company.
 - Non availability of sound action plan to mitigate such circumstances.

Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the company. Further, such circumstances are not reflected in the financial statements of the company. As such, the statutory auditor of Sun Moon Ltd. should:

- (1). Express an adverse opinion in accordance with SA 705 (Revised) and
- (2). In the Basis of Opinion paragraph of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

7.CA Omkar is the statutory auditor of Sabhyata Ltd. for the FY 2020-21. The company is engaged in the business of manufacture of floor tiles. During the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Discuss as to how CA Omkar should deal with the situation in the auditor's report.

ANSWER:

SA 705 deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Further, the auditor shall modify the opinion in the auditor's report when the auditor concludes that based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

In the present case, during the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Therefore, CA Omkar should modify his report in accordance with SA 705- "Modifications To The Opinion In The Independent Auditor's Report.

CA Omkar should issue either a qualified opinion or an adverse opinion depending upon the circumstances of the case:

- (a) CA Omkar shall express a qualified opinion when, having obtained sufficient appropriate audit evidence, he concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements
- (b) CA Omkar shall express an adverse opinion, when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Thus, since CA Omkar has obtained audit evidence which are inconsistent with the affirmations made in the financial statement, CA Omkar should modify his opinion as per the circumstances of the case.

Multiple Choice Question

KPI Ltd is a joint venture of KPI Inc, a company based in US, and OPQ Ltd, a company based in Japan (hereinafter referred to as 'JV partners'). KPI Ltd was registered in India and is operating as a marketing support company for KPI Inc. All the costs of KPI

Ltd are incurred in India and entire revenue of KPI Inc is generated in USD. The entire funding requirements of KPI Ltd are taken care of by the JV partners. Since KPI Ltd is based in India, hence it is also required to get its financial statements audited.

The company appointed new auditors for the audit of the financial statements for the year ended 31 March 2019 after doing all appointment formalities wherein auditors also confirmed their eligibility for appointment including independence.

The statutory auditors have completed their audit and did not come up any significant observations. Management of KPI Ltd was also very pleased with the working style of the auditors.

When the auditors issued their final audit report, the management observed that the auditors did not state anything related to their compliance in respect of ethical requirements regarding independence etc. Further, the audit report was also silent on the requirement related to auditor's communication with those charged with governance in respect of matters related to planned scope & timing of audit and any significant findings.

The management requested that the auditors should revisit their report and should include these points in their report, however, as per the auditors all these communications were already completed by them and hence they were not required to form part of the audit report. On the basis of above mentioned facts, please suggest which of the following should be correct.

- (a) The auditing standards do not require the auditors to comment on the points which the management is requesting i.e. ethical requirements or matters related to planned scope & timing of audit or any significant findings etc. However, if the auditor wants to include that on the basis of his agreed terms with the management, he may do so.
- (b) The auditing standards require the auditors to comment on the points which the management is requesting i.e. ethical requirements or matters related to planned scope & timing of audit or any significant findings etc. Hence, the auditors should issue rectified report.
- (c) The ethical requirements are already completed by the auditors at the time of appointment itself. Since the audit is completed, there is no need to comment on the planned scope & timing of audit. Since there are no significant findings so this communication is also not possible. Hence, the auditors need not revisit their report.
- (d) The ethical requirements are already completed by the auditors at the time of appointment itself and there are no significant findings, hence, there is no need to comment on these points. However, the auditors should state that they communicate with those charged with governance regarding the planned scope & timing of audit. Therefore, the auditors should revisit their report.

Answer:

LMN & Co LLP is a large firm of Chartered Accountants having its offices based in Delhi, Pune, Chandigarh and Bangalore.

The firm has staff of around 300 with 28 Partners. The firm has also created various departments for various services that it offers – statutory audit, risk advisory, mergers & acquisitions, indirect tax and direct tax, where dedicated teams are working who are specialized in those fields. The firm is also considering to create departments on the basis of industry sectors so that the staff can become specialized into specific industries as the same would help in the objective of the firm i.e. to offer best quality service to its various clients.

Statutory audit department of the firm has 13 partners across various offices in India out of which 6 are based in Delhi office.

The audit team of one of the prestigious clients, KSH Ltd, has concluded that audit where audit partner was AD Jain. As per the agreed timelines, the financial statements and the audit report were planned to be signed on 30 June, 2019, however, on 29 June, 2019, AD Jain was required to move out of India due to some exigency and would be back to India after a month's time. He was also not accessible during this period. The management of KSH Ltd discussed the matter with another partner of the audit firm, SK Gupta, who eventually signed the audit report on 30 June, 2019 even though he was not part of the audit team which was involved in the fieldwork.

We would like to understand your views in respect of this matter.

- (a) The management in such a case should have waited for AD Jain to come back and then get the report signed. The audit report in this case would be considered to be invalid.
- (b) SK Gupta signed the audit report considering the client was prestigious for the firm which was unethical.
- (c) Signing of the audit report as per the agreed timelines by SK Gupta was fine as he was also the audit partner of the firm.
- (d) Signing of audit report by any other person interferes with the concept of clarity of responsibility.

Answer: (B) SK Gupta signed the audit report considering the client was prestigious for the firm which was unethical

RBJ Ltd is a listed company engaged in the business of software and is one of the largest company operating in this sector in India. The company's annual turnover is INR 40,000 crores with profits of INR 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India.

Outside India, the company is focusing more on US and European markets and the company has been able to establish its good reputation in these markets as well.

During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion. The audit team for this engagement is generally very big i.e. a team of approx. 70-80 members. The company's contracts with its various customers are quite complicated and different. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner.

After completion of audit for the year ended 31 March 2019, the audit partner was discussing significant matters with the management wherein he also communicated to the management that he plans to include revenue recognition as key audit matter in his audit report. The management was quite surprised to understand this from the auditor and did not agree with revenue recognition to be shown as key audit matter in the audit report. As per the management, the auditors didn't have any modification and such a matter getting reported as key audit matter would not go down well with various stakeholders and would significantly impact the financial positions of the company in the market. The auditors were not able to convince the management in respect of this point and there was a difference of opinion.

- (a) You are requested to give your view in respect of this matter. The concern of the management is valid. For such a large sized company, such type of matter getting reported as key audit matter is not appropriate.
- (b) The assessment of the auditor is valid. Such a matter qualifies to be a key audit matter and hence should be reported accordingly by the auditor in his audit report.
- (c) Reporting revenue as key audit matter when the auditor does not have observation in that area leading to any modification in his report, would not be appropriate.
- (d) This being the first year of reporting of key audit matters, the auditor should take a soft stand and should avoid reporting such controversial matters in his report.

Answer: (C) Reporting revenue as key audit matter when the auditor does not have observation in that area leading to any modification in his report, would not be appropriate.

BDJ Ltd is engaged in the business of providing management consultancy services and have been in operation for the last 15 years. The company's financial reporting process is very good and its statutory auditors always issued clean report on the audit of the financial statements of the company. The auditors were required to be rotated due to mandatory audit rotation requirement of the Companies Act 2013.

RNJ & Associates, a firm of Chartered Accountants, was appointed as the new auditor of the company for a term of 5 years and have to start their first audit for the financial year ended 31 March 2019. The auditors had a detailed and clear discussion with the management that they will perform their audit procedures in respect of opening balances along with the audit procedures for the financial year ended 31 March 2019.

Management agreed with that and the audit was completed as per the plan.

The auditors did not have any significant observations and hence they communicated to the management that their report will be clean. Management was quite happy with this and also requested the auditors to share draft report before issuing the final report.

In the draft audit report, all the particulars were fine except 'other matters paragraph' wherein the auditors gave a reference that the financial statements for the comparative year ended 31 March 2018 was audited by another auditor. Management asked the audit team to remove this paragraph as the auditors had performed all the audit procedures on opening balances also. But the auditors did not agree with the management.

Please advise the auditor or the management whoever is incorrect with the right guidance.

- (a) The contention of the management is valid. After performing all the audit procedures, an auditor should not pass on the responsibility to another auditor by including such references in his audit report.
- (b) Any auditor has two options, either to perform audit procedures on opening balances or given such reference of another auditor in his report. An auditor can not mix up the things like this auditor has done. It is completely unprofessional.
- (c) In the given situation even if the auditor wants to give such reference, the management and the auditor should have taken approval from the previous auditor at the time of appointment of new auditor. In this case, it cannot be done.
- (d) The report of the auditor is absolutely correct and is in line with the auditing standards. An auditor is required to include such reference in his report as per the requirements of the auditing standard.

Answer: (b) Any auditor has two options, either to perform audit procedures on opening balances or given such reference of another auditor in his report. An auditor can not mix up the things like this auditor has done. It is completely unprofessional.

SKJ Private Ltd has an annual turnover of INR 200 crores and profits of INR 25 crores. The company is engaged in the business of textiles and has fairly stable operations over the years. There has not been much growth in the company in the last few years despite the attempts of the management. Currently the management is more focused towards cost cutting and has been considering all the options to achieve that objective.

The statutory auditors of the company have been auditing the financial statements for the last 3 years and have issued clean reports over these years.

During the financial year ended 31 March 2019, management got a large project from a new customer which resulted in significant increase in the turnover of the company. However, the profitability of the company did not improve much because the margins in the contract were not high.

The statutory auditors during the course of their audit of financial statements for the year ended 31 March 2019 (their fourth year of audit) did not agree with the revenue recognition criteria followed by the company. Since the matter was significant, lot of discussions/ debates happened between the auditor and the management. But it was finally agreed that the auditors would qualify their audit report.

Auditors wanted that the management should explain this matter in detail in the notes to accounts to the financial statement over which the auditors are qualifying the audit report. However, the management had a different view. Management said that if the auditor is qualifying his report then why should the management also highlight that matter in the financial statement and hence refused to include any note for the same.

Because of this conflict, audit is not getting concluded. You are requested to give your view in respect of this matter so that the matter gets concluded.

- (a) In the given situation, if the management does not agree to give a note in the financial statements then the auditor should not hold the audit report. However, in such a case, the auditor would need to give disclaimer of opinion in his report instead of qualification.
- (b) The argument of the management seems correct. Auditor cannot do both the things i.e. to qualify and then also get that highlighted in the financial statements. That note would not be beneficial for the users of the financial statements.
- (c) In case of such matters related to revenue recognition, it is always better to give detailed explanation in the notes to accounts to the financial statements. If the explanation is

satisfactory then the auditor should also consider giving emphasis of matter instead of qualification.

- (d) The requirement of the auditor is beneficial for the company because by giving an explanation of the matter, on which auditor has given a qualification, in the notes to accounts, the management would be able to explain their perspective/ point of view to the users of the financial statements. In that case, auditor while giving the qualification can give reference to the notes to accounts otherwise the entire matter would form part of the audit report. However, the auditor should not hold his report if the management does not want to give any explanation in the notes to accounts.

Answer: (d) Any auditor has two options, either to perform audit procedures on opening balances or given such reference of another auditor in his report. An auditor can not mix up the things like this auditor has done. It is completely unprofessional.

While conducting the current year audit of Finco Ltd, the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements. This misstatement was related to recognition of research and development expenditure. The provisions of Ind AS 38 Intangible Assets relating to capitalisation of development expenditure was not applied properly. On this, unmodified opinion had been previously issued. The current auditor verified that the misstatement had not been dealt with as required under Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Accordingly, the current auditor will:

- (a) Express an unmodified opinion in the auditor's report on the current period financial statements since it was related to the prior year.
- (b) Express a qualified opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
- (c) Express a qualified or an adverse opinion in the auditor's report on the current period financial statements modified with respect to the corresponding figures included therein.
- (d) Express an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.

Answer: (c) Any auditor has two options, either to perform audit procedures on opening balances or given such reference of another auditor in his report. An auditor can not mix up the things like this auditor has done. It is completely unprofessional.

1.RTP May 2018 Qn no.7(b)

C Limited has defaulted in repayment of dues to a financial institution during the financial year 2016-17 and the same remained outstanding as at March 31, 2017. However, the Company settled the total outstanding dues including interest in April, 2017 subsequent to the year end and before completion of the audit. Discuss how you would deal with this matter and draft a suitable Auditor's Report.

ANSWER

Reporting for Default in Repayment of Dues: As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, terms of repayment of term loans and other loans is required to be disclosed in the notes to accounts. It also requires specifying the period and amount of continuing default as on the balance sheet date in repayment of loans and interest, separately in each case.

Further, as per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to state in his report whether the Company has defaulted in repayment of dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

In the given case, C Ltd. has defaulted in repayments of dues to a financial institution during the financial year 2016-17 which remain outstanding as at March 31, 2017. However, the company has settled the total outstanding dues including interest in April, 2017 but, the dues were outstanding as at March 31, 2017. Therefore, it needs to be reported in the notes to accounts.

The draft report for above matter is as under:

“The company has taken a loan during the year, from a financial institution amounting to ` XXXX @ X% p.a. which is repayable by monthly installment of ` XXXX for XX months.

The company has defaulted in repayment of dues including interest to a financial institution during the financial year 2015-16 amounting to ` XXXX which remained outstanding as at March 31, 2017. The period of default is XXX days. However, the outstanding sum was settled by the company in April, 2017.”

2.RTP May 2018 Qn no.7(c)

Relevant Notes given by the management in the financial statements of India Branch Office of ABC Limited are:

- **Income tax authorities have raised demands (including interest upto the date of demand) aggregating to ` 100 crores and ` 40 crores respectively for assessment year 2013-14 based on report by auditors consequent to conduct of special audit as directed under section 142(2A) of the Income tax Act, 1961 and in addition, have also initiated penalty proceedings**

against the Company. The Company has contested these demands before the Commissioner of Income tax (Appeals) and has also filed applications for stay of penalty proceedings and the same are currently pending disposal.

Based on review of underlying documents and legal inputs, the management has assessed that there is probability of likely outflow to the extent of ` 50 crores (including interest liability till date of stay of payment of ` 15 crores) in relation to the above demands and has accounted for the same in these financial statements. With respect to further liability of ` 50 crores, the management believes that it has the necessary documents to furnish to the tax authorities and basis the expert's inputs believes that Company has good chances of success of receiving the judgments in its favour. Further, the management believes that the likelihood of penalties being imposed against the Company is not probable and accordingly, no adjustments are considered necessary in these financial statements.

As at March 31, 2017, the Company has accumulated losses of ` 150 crores against equity of ` 100 crores and also net current liabilities of ` 35 crores. The management is of the view that the current year losses are primarily attributable to income tax liabilities devolving on the Company, as discussed under paragraph XX. As per the management assessment, it is likely to generate ` ___ and ` from the operations during the financial years ending March 31, 2018 and March 31, 2019 respectively. Further, the Company's key shareholders have confirmed that they shall provide continuing financial support to the Company's day to day operations so as to enable the Company to pay off its debts, as and when they fall due. Accordingly, these financial statements have been prepared on a going concern basis.

As an auditor of ABC Limited, you are required to draft emphasis of matter para in the given situation on the basis of analysis of above notes (when there is material tax litigation that casts significant doubt on the entity being regarded as going concern)

Answer

Emphasis of Matters Para:

- We draw attention to Note XX, regarding certain income-tax demands of ` 100 crores pending in various stages of assessments/ appeals. The management based upon expert's advice believes that no demand or liability including interest and penalty on account of settlement of assessment/ appeals of the pending matters by the Income tax authorities is likely to devolve on the Company, in addition to those already provided for in these financial statements. Pending the final outcome of the aforesaid matters, no further adjustments have been made in these financial statements in this regard.
- Note XX of the financial statements that as at March 31, 2017, the Company has accumulated losses of ` 150 crores against equity of ` 100 crores and also net current liabilities of ` 35 crores. These conditions indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern, which is dependent

on establishing profitable operations and obtaining continuing financial support from its key shareholders. These mitigating factors have been more fully discussed in Note XX of the accompanying financial statements, in view of which the accompanying financial statements have been prepared under the going concern assumption, and consequently, no further adjustments have been made in these financial statements.

Our opinion is not modified in respect of the above matters.

3.MTP-Aug-18 Qn No 1(d) 5 Marks:

During the course of audit of CT Ltd. for the financial year 2017-18, it is noticed that Rs. 3.00 lakhs of employee contribution and Rs. 7.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that Rs. 5.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2018. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor

MTP Apr 18 Qn no.2(C) 5 Marks

During the course of audit of GST Ltd. for the financial year 2017 -18, it has noticed that Rs. 3.00 lakhs of employee contribution and Rs. 8.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that Rs. 4.50 lakhs only has been deposited with ESIC department during the year ended 31st March, 2018. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due, but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor.

Answer

Non-Compliance of Laws and Regulations & Reporting Requirements: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. If the auditor concludes that the non - compliance has a material effect

on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report under clause (vii)(a) of Para 3 of CARO, 2016 whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of rupees 6.50 lakhs in his report.

4.MTP-OCT-18 Qn No 1(b) 5 Marks:

XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31 -3-18 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:

Income Tax relating to Assessment Year 2014-15 Rs. 125 lacs - Appeal is pending before Hon'ble ITAT since 30-9-16.

Customs duty Rs. 85 lakhs - Demand notice received on 15-9-17 but no action has been taken to pay or appeal. Comment.

Answer:

Non-Compliance of Laws and Regulations: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report on certain matters specified in Para 3 of CARO, 2020 under section 143 of the Companies Act, 2013.

One of such matter is non-payment of dues to Government, on account of any dispute. As per clause (vii)(b) of Para 3 of CARO, 2016, in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the present case, there is Income Tax demand of Rs. 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis. Therefore, as per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", partly to the extent the company considers that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of the members by reporting.

Additionally, the demand notice has been received for Customs duty of Rs. 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting.

5.MTP-OCT-19 Qn No 2(b) 5 Marks:

Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020:-

(i) Physical verification of only 40% of items of inventory has been conducted by the company. The balance 60% will be conducted in next year due to lack of time and resources.

(ii) An amount of Rs. 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 Rs. 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.

Answer:

Physical Verification of Inventory: Clause (ii) of Para 3 of CARO, 2020 requires the auditor to report on whether physical verification of inventory has been conducted at reasonable intervals by the management. Physical verification of inventory is the responsibility of the management which should normally verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification. In the given case, the above requirement of CARO, 2020 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification

is not reasonable. He may consider the impact on financial statement and report accordingly.

(ii) As per clause (xiii) of para 3 of CARO 2020, 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 2020, as 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. Thus, the auditor is required to report accordingly.

6.MTP-Mar 2019 Qn No 6(b) 6 Marks:

Abhimanyu Finance Ltd. is a Non Banking Finance Company and was in the business of accepting public deposits and giving loans. The company was having net owned funds of Rs.1,50,00,000/ - (one crore fifty lakhs) and was not having registration certificate from RBI and applied for it on 30th March 2018. The company appointed Mr. Kabra as its statutory auditors for the year 2017-18. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?

Answer:

As per Clause (xvi) of Paragraph 3 of CARO 2020, the auditor is required to report that “whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.”

The auditor is required to examine whether the company is engaged in the business which attract the requirements of the registration. The registration is required where the financing activity is a principal business of the company. The RBI restrict companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.

Audit Procedures and Reporting:

- (i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
- (ii) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
- (iii) Whether the company has net owned funds as required for the registration as NBFC.
- (iv) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.
- (v) The auditor should report incorporating the following:-
 - (1) Whether the registration is required under section 45-IA of the RBI Act, 1934. If so, whether it has obtained the registration.
 - (2) If the registration not obtained, reasons thereof.

In the instant case Abhimanyu Finance Ltd. is a Non Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of Rs.1,50,00,000/- (one crore fifty lakhs) which is less in comparison to the prescribed limit i.e. 2 crore rupees and was also not having registration certificate from RBI (though applied for it on 30th March 2018). The auditor is required to report on the same as per Clause (xvi) of Paragraph 3 of CARO 2020.

7.RTP Nov 18 Qn no 7 , RTP May 2020 Qn no 13(b)

“When the auditor modifies the audit opinion, the auditor shall use the heading “Qualified Opinion,” “Adverse Opinion,” or “Disclaimer of Opinion,” as appropriate, for the Opinion section.” As an expert you are required to brief the special considerations required for expressing:

- (a) **Qualified Opinion;**
- (b) **Adverse Opinion and**
- (c) **Disclaimer of Opinion.**

Answer

- (a) **Special consideration required for expressing Qualified Opinion:** When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase “except for the possible effects of the matter(s) ...” for the modified opinion.

- (b) **Special consideration needed for expressing Adverse Opinion:** When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor’s opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:
 - (i) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
 - (ii) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].
- (c) **Special consideration is required for expressing Disclaimer of Opinion:** When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:
 - (i) State that the auditor does not express an opinion on the accompanying financial statements;
 - (ii) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
 - (iii) Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor’s report shall not include a Key Audit Matters section in accordance with SA 701.

8.MTP-Mar 2019 Qn No 4(a) 5 Marks:

Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020:-

- (i) The long term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far.
- (ii) 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 Rs.12 Lakhs.

Answer:

(i) As per clause (xiii) of para 3 of CARO 2020 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 2020 receipt of long term borrowing from Parent Company which is transactions with the related party.

(ii) As per clause Clause (x) of para 3 of CARO 2016 the auditor is required to report, "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 in accordance with clause (x) of para 3 of CARO 2020.

9.MTP-Apr-19 Qn No 6(c) 5 Marks:

XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-3-19 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:

- Income Tax relating to Assessment Year 2015-16 rupees 125 lacs - Appeal is pending before Hon'ble ITAT since 30-9-17.
- Customs duty rupees 85 lakhs - Demand notice received on 15-9-18 but no action has been taken to pay or appeal.

As an auditor, how would you bring this fact to the members?

Answer:

Non-Compliance of Laws and Regulations: As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statement”, it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity’s financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report on certain matters specified in Para 3 of CARO, 2016 under section 143 of the Companies Act, 2013.

One of such matter is non-payment of dues to Government, on account of any dispute. As per clause (vii)(b) of Para 3 of CARO, 2016, in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. {A mere representation to the concerned Department shall not be treated as a dispute.}

In the present case, there is Income Tax demand of Rs. 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis. Therefore, as per AS 29 “Provisions, Contingent Liabilities and Contingent Assets”, partly to the extent the company considers that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of the members by reporting.

Additionally, the demand notice has been received for Customs duty of Rs. 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting.

10.RTP May 2019 Qn no 16

Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020:-

- (a) The long term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far.
- (b) 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.
- (c) 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.
- (d) 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.

Answer

- a) 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 2020 regarding receipt of long term borrowing from Parent Company which qualifies as a transaction with the related party.

- b) As per clause (i) (c) of para 3 of CARO 2020 the auditor is required to report, "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 2020.

The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise in **case of land:-**

- total number of cases,
- whether leasehold / freehold,
- gross block and net block, (as at Balance Sheet date), and
- remarks, if any.

C) As per clause (xiii) of para 3 of CARO 2020, 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 2020, as one of related party transaction amounting 3.25 lakhs per month i.e. in lieu of marketing services has been noticed of which amount ` 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. Thus, the auditor is required to report accordingly.

D) As per clause Clause (x) of para 3 of CARO 2020 the auditor is required to report, “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 in accordance with clause (x) of para 3 of CARO 2020.

11.RTP Nov 2019 Qn no 16(a)

Under CARO, 2016, as a statutory auditor, how would you report?

- (i) RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director, which is an arrangement by which the RPS Ltd. is in process to acquire assets for consideration other than cash.**
- (ii) NSP Limited has its factory building, appearing as fixed assets in its financial statements in the name of one of its director who was overlooking the manufacturing activities.**

Answer

(i) Non-cash Transactions with Relative of Director: As per Clause (xv) of paragraph 3 of CARO, 2016, the auditor is required to report “whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with”.

Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

In the instant case, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is an arrangement by which RPS Ltd. is in process to acquire assets for consideration other than cash. In the above situation the provisions of section 192 of Companies Act, 2013 have been complied with.

However, the reporting requirements under this clause are given in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

In the given situation, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is affirmative answer to the first part of the Clause(xv) of Paragraph 3 of CARO, 2016, thus, reporting is required for the same. Draft report is given below.

According to the information and explanations given to us, the Company has entered into non-cash transactions with Mr. Rahul, son of one of the directors during the year, for the acquisition of assets, which in our opinion is covered under the provisions of Section 192 of the Companies Act, 2013.

- (ii) **Title deeds of Immovable Property in the name of Director:** As per Clause (i)(c) of Paragraph 3 of the CARO, 2016, the auditor is required to report on whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.

The auditor should verify the title deeds available and reconcile the same with the fixed assets register. The scrutiny of the title deeds of the immovable property may reveal a number of discrepancies between the details in the fixed assets register and the details available in the title deeds. This may be due to various reasons which needs to be examined.

In the given case, NSP Limited has its factory building, appearing as fixed assets in its financial statements in the name of director. Thus, the auditor shall report on the same under Clause (i)(c) of Paragraph 3 of the CARO, 2016.

The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise:

A:In case of land:-

- total number of cases,
- whether leasehold / freehold,
- gross block and net block, (as at Balance Sheet date), and
- remarks, if any.

B:In case of Buildings:-

- total number of cases,
- gross block & net block, (as at Balance Sheet date) and
- remarks, if any.

12.RTP Nov 2019 Qn no 16(b)

KPI Ltd. is a company on which International Standards on Auditing are applicable along with Standard on Auditing issued by the ICAI. The company appointed new auditors for the audit of the financial statements year ended 31 March 2019 after doing all appointment formalities. Therefore, the auditor's report referred the International Standard on Auditing in addition to the Standard on Auditing issued by the ICAI.

As an expert, you are required to advise the auditor regarding auditor's report for audits conducted in accordance with both the Standards.

Answer

Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing or Auditing

Standards of Any Other Jurisdiction: As per SA 700, "Forming an Opinion and Reporting on Financial Statements", an auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other

jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

- (a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:
 - (i) to form a different opinion, or
 - (ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; **and**
- (b) The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

13.RTP May 2020 QN no 13(c)

The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

- (i) **Circumstances beyond the control of the entity;**
- (ii) **Circumstances relating to the nature or timing of the auditor's work; or**
- (iii) **Limits imposed by the management**

Explain with the help of examples.

Answer:

The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

- (i) Circumstances beyond the control of the entity;
- (ii) Circumstances relating to the nature or timing of the auditor's work; or
- (iii) Limitations imposed by management.

An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. Limitations imposed by management may have other

implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

Examples of circumstances beyond the control of the entity include when:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

Examples of circumstances relating to the nature or timing of the auditor's work include when:

- The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

Audit Committee and Corporate Governance

Multiple Choice Questions

MTP Mar 2019 Qn no 3 (1 Mark)

High Limited is a public limited company engaged in the manufacturing of watches. The company has appointed CA. Eshaan as statutory auditor of the company for the year 2018-19. On verification of the composition of Board of Directors of the company, the auditor observed that during the reporting period in one of the board meeting the chairman was non-executive director and less than one-third of the Board comprised of Independent Directors. The auditor wants to examine the effect of changes in the composition of the Board and/or its chairman and its impact on compliance throughout the reporting period. But the management restricts the auditor from examining the same. Whether the auditor has right to examine the effect of changes in composition of board?

- (a) The auditor has no right to verify the composition of Board and examine the effect of changes in the composition since it is not related with preparation of financial statements.
- (b) The auditor should verify the composition of Board and examine its impact on compliance throughout the reporting period as a part of certifying compliance with the requirements of corporate governance.
- (c) The management's act is void, as the auditor is appointed by Board of Directors only so the auditor should necessarily verify the composition of Board and its impact on compliance.
- (d) Since High Limited is a public limited company, its Board composition has to be compulsorily verified by the auditor.

Answer:(b) The auditor should verify the composition of Board and examine its impact on compliance throughout the reporting period as a part of certifying compliance with the requirements of corporate governance.

MTP Oct 2019 QN no 7 (1 Mark)

The auditor should ensure that the board of directors of the top 100 listed entities shall comprise of –

- (a) not less than 7 directors.
- (b) not less than 4 directors.
- (c) not less than 6 directors.
- (d) not less than 2 directors

Answer: (c) not less than 6 directors

1.May 2018 5(c) – 4 Marks

M/s All-in-One Limited is a large-sized listed Indian Company with focus on design and delivery of custom made Information Technology applications for various business entities in India and abroad. The Management wants to know whether they are required to constitute Risk Management Committee as per LODR, 2015 and if so, required, what should be its composition? Advise.

Answer

Constitution of Risk Management Committee: As per regulation 21 of LODR 2015, provision relating to constitution of risk management committee is applicable to top 500 listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year. In the instant case, All-in-One Limited, is a large sized listed Indian Company with focus on design and delivery of custom made IT applications for various business entities in India and abroad. As per fact of the case it is a large sized listed Indian company, assuming that it is included in top 500 listed entities, All – in – One Limited is required to constitute risk management committee.

Composition of Risk Management Committee:

- The Board of Directors shall constitute a Risk Management Committee.
- The majority of members of Risk Management Committee shall consist of members of the Board of Directors. However in case of a listed entity having outstanding superior rights equity shares, atleast two thirds of the risk management committee shall comprise of independent directors.
- The Chairperson of the Risk Management Committee shall be a member of the Board of Directors and senior executives of the listed entity may be members of the committee.
- The Board of Directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.
- The provisions of these regulations shall be applicable for top 500 listed entities, determined on the basis of Market capitalisation, as at the end of the immediate previous financial year.

These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. A majority of this Committee will be the members of the Board of Directors. Senior executives of the company may be also be members of the Committee, but the Chairperson of the Committee shall be a member of the Board of Directors.

2.RTP May 2018 Qn no.20 (C)

Key features of the Qualified and Independent Audit Committee set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

MTP Apr 18 Qn no.5(D) 4 Marks

Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference.” State the main features of the Qualified and Independent Audit Committee set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 .

MTP-Aug-18 Qn No 5(e) 4 Marks:

Every listed company shall constitute a qualified & Independent audit committee in accordance with the terms of reference subject to a few conditions. Explain.

RTP May 2019 Qn no 20(c)

Key features of the Qualified and Independent Audit Committee set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

ANSWER

The main features of a qualified and independent audit committee to be set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are as follows:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors, however in case of a listed entity having outstanding Superior Rights equity shares the audit committee shall only comprise of independent directors.
2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise;

Explanation (i): The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3. The Chairperson of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
4. The Company secretary shall act as the secretary to the committee.

5. The Audit Committee at its discretion shall invite the finance director or the head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee; provided that occasionally, the Audit Committee may meet without the presence of any executives of the listed entity.;

3.RTP Nov 18 Qn no 8

Irregular Limited, a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India the revenue of the company is going down and there is slow down in other activities of the company. Therefore, it was expected that there would not be significant work for members of the Audit Committee. Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet once in a year only on March 31, 2018. They reviewed monthly information system of the Company and found no errors. As an auditor of Irregular Limited would you consider the decision taken by the Audit Committee is in line with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

RTP May 2020 Qn no 20(b) ,Nov 18 Qn no 5(d) 4 Marks

List few documents that require mandatory review by Audit Committee.

ANSWER

One of the following additional requirement as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent directors present.

Besides, there is a mandatory review requirement and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly information system of the company and the same is not sufficient as per LODR Regulations.

The Audit Committee shall mandatorily review the following information as per LODR Regulations:

- (i) Management discussion and analysis of financial condition and results of operations;
- (ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
- (iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
- (iv) Internal audit reports relating to internal control weaknesses; and

- (v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee;
- (vi) Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

Applying the above, the decision taken by the audit committee is not in line with the LODR Regulations

4. May 2019 Qn no 3(a) 6 Marks

You have been appointed as an auditor of M/s Real Ltd. in which total number of directors in the board is 9. As an auditor, state the points to be considered in verification of composition of Board under Regulation 17 of The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Answer

Verification regarding Composition of Board [Regulation 17]

- (i) The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one woman director and not less than 50% of the Board of Directors comprising non-executive directors. It may be noted that the Board of directors of the top 500 listed entities shall have at least one independent woman director (and the Board of directors of the top 1000 listed entities shall have at least one independent woman director by April 1, 2020).

The top 500 and 1000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

The auditor should also ensure that no listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy five years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

The directors of listed entities shall comply with the following conditions with respect to the maximum number of directorships, including any alternate directorships that can be held by them at any point of time -

- (1) A person shall not be a director in more than eight listed entities (and in not more than seven listed entities with effect from April 1, 2020).

It may be noted that a person shall not serve as an independent director in more than seven listed entities.

- (2) Notwithstanding the above, any person who is serving as a whole time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities.

For the purpose of above-mentioned provision, the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange.

The minutes of the Board of Directors' meetings should be verified to ascertain whether a director is an executive director or a non-executive director.

- (ii) The auditor should also verify that where the Chairperson of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case the listed entity does not have a regular non-executive Chairperson, at least half of the Board of Directors should comprise independent directors. Further, if the regular non-executive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors.

In determining the number of requisite independent directors and/or non-executive directors, the fraction, if any, in the number of one-half or one-third as the case may be, should be rounded off. Since the terms in this clause refer to 'not less than' and 'at least', it would be appropriate to compute the number by rounding off any fraction to the next integer. For example, in a Board headed by a non-executive Chairman and comprising of six other directors (i.e., seven directors), the independent directors should be three or more.

No listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy five years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

- (iii) The auditor should ensure that the board of directors of the top 1000 listed entities (and the top 2000 listed entities with effect from April 1, 2020) shall comprise of not less than six directors.

Explanation: The top 1000 and 2000 entities shall be determined on the basis of market capitalisation as at the end of the immediate previous financial year.

- (iv) With effect from April 1, 2020, the audit shall ensure that the Chairperson of the board of the top 500 listed entities is

(a) a non-executive director;

(b) not related to the Managing Director or the Chief Executive Officer as per the definition of the term “relative” defined under the Companies Act, 2013.

It may be noted that this provision shall not be applicable to the listed entities which do not have any identifiable promoters as per the shareholding pattern filed with stock exchanges.

It may also be noted that the top 500 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

(V) In case of listed company having outstanding SR equity shares, the auditor shall check that at least half of the board of directors comprises of independent directors.

(VI) Annual disclosure submitted by the directors to the Board of Directors may be examined for this purpose. If the Board of Directors has followed any particular procedure(s) to ascertain the independence of directors, the auditor should examine the same. Effect of changes in the composition of the Board and/or its Chairman and its impact on compliance throughout the reporting period should also be examined.

(VII) An independent non-executive director, apart from receiving remuneration, should not have had/ should not have any material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year. Also, such independent director, either by himself or with any of his relatives should not be a material supplier, service provider or customer or a lessor or lessee of the listed entity, and should not also be a substantial shareholder of the listed entity. In determining ‘not a substantial shareholder’, he (together with his relatives) should not own 2% or more of total voting power of the listed entity.

5.RTP Nov 2019 Qn no 18, MTP-Apr-19 Qn No 4(b) 5 Marks:

Comment on the following in the light of certificate of compliance of conditions of Corporate Governance to be issued for a listed company where the Board consists of 10 directors including a non-executive director as its chairman:

- (i) There were 5 audit committee meetings held during the year as follows 01/04/2018, 01/06/2018, 01/09/2018, 03/01/2019, 25/03/2019.
- (ii) There are 4 independent directors. One of them resigned on 25/05/2018. A new independent director was appointed on 01/09/2018.

- (iii) The Chairman of Audit Committee did not attend the Annual General meeting held on 14/09/2018.
- (iv) The internal audit reports were obtained by Audit Committee on quarterly basis. Quarter 1 internal audit report commented on certain serious irregularities as regards electronic online auction of scrap. The agenda of Audit Committee did not deliberate or take note of the issue.
- (v) There is no woman director.

Compliance of conditions of Corporate Governance in case of Listed Company:

As per Listing Obligation and Disclosure Requirements Regulations 2015, depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for example:

- (i) The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings. The number of days between the meetings held on 1.9.2018 and 3.01.2019 is more than 120 days. Hence it is a non-compliance and would require qualification in certificate of corporate governance
- (ii) Since the Chairman is the non-executive director, there should be 1/3rd of directors (rounded to next integer) to be independent. In this case, 4 directors need to be independent. Any vacancy during shortfall of independent directorship should be filled within next 3 months or before the start of next meeting, whichever is later. In the instant case, since the independent director was appointed after lapse of 3 months (i.e. on 1.9.2018) and after next first meeting 1/6/2018, there is default which would require qualification in certificate on corporate governance.
- (iii) Chairman shall be present at Annual General Meeting to answer shareholder queries. In the given scenario, Chairman of Audit Committee did not attend the Annual General Meeting held on 14/09/2018 which is not in order/compliance.
- (iv) The Audit Committee shall mandatorily review the Internal audit reports relating to internal control weaknesses as per Part C (B) of Schedule II and the auditor should ascertain from the minutes book of the Audit Committee and other sources like agenda papers, etc. whether the Audit Committee has reviewed the above-mentioned information. In the given situation, the agenda of Audit Committee did not deliberate or take note of serious irregularity mention in Internal Audit Report which is again not in compliance of conditions of Corporate Governance and warrant audit qualification in certificate on corporate governance.

- (v) The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one-woman director. Therefore, there should be at least one- woman director. In the given situation, there is no woman director which is again not in compliance.

6.MTP-OCT-18 Qn No 5(d) 4 Marks:

Some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance. Give four examples of such situations.

Answer:

Adverse or Qualified Statement: Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for e.g.,

- (i) The number of non-executive directors is less than 50% of the strength of Board of directors.
- (ii) A qualified and independent audit committee is not set up.
- (iii) The Chairman of the audit committee is not an independent director.
- (iv) The Audit Committee does not meet four times a year.
- (v) The necessary powers in terms of Part C of Schedule II have not been vested by the Board in the Audit Committee.
- (vi) The time gap between two Board meetings is more than one hundred and twenty days.
- (vii) A director is a member of more than ten committees or acts as Chairman of more than five committees across all companies in which he is a director.
- (viii) The information of quarterly results is neither put on the listed entity's website nor sent in a form so as to enable the stock exchange on which the entity's securities are listed to enable such stock exchange to put it on its own website.
- (ix) The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer agents.

7.Nov 2019 Qn no 5(b) 5 Marks

D Ltd., a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India, the revenue of the company is going down and there is slowdown in other activities of the company. Therefore, it is expected that there would not be significant work for members of the Audit Committee.

Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet only once at the year end. They reviewed monthly information system of the Company and found no errors As an auditor of D Limited, would you consider the decision taken by the Audit Committee to hold the meeting once in a year, in complying with Listing Obligation and Disclosure Requirements (LODR)? Also state the quorum requirements for such meetings.

Answer

One of the following additional requirement as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is : The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent directors present.

The Audit Committee shall mandatorily review the following information as per LODR Regulations:

- (v) Management discussion and analysis of financial condition and results of operations;
- (vi) Statement of **significant related party transactions** (as defined by the Audit Committee), submitted by management;
- (vii) **Management letters** / letters of internal control weaknesses issued by the statutory auditors;
- (viii) **Internal audit reports** relating to internal control weaknesses;
- (ix) The **appointment, removal and terms of remuneration of the Chief internal auditor** shall be subject to review by the Audit Committee; and
- (x) **Statement of deviations:** (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

In the instant case, due to recessionary conditions, slowdown in activities of the company and not expecting the significant work for the members of the audit committee, D Ltd. decided unanimously to meet only once at the year end. They also reviewed monthly information system of the company and found no errors.

In view of above, **decision taken by the audit committee** to hold the meeting only once at the year end is **not correct** as the Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings.

Besides, there is a **mandatory review requirement** and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly information system of the company and **the same is not sufficient as per LODR Regulations.**

Study Material

8.State the main features of the Qualified and Independent Audit Committee set up SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

The main features of a qualified and independent audit committee to be set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are as follows:

- (i) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors, **however, in case of a listed entity having outstanding SR (Superior Rights) equity shares, the audit committee shall only comprise of independent directors;**
- (ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise;
Explanation (i): The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.
Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.
- (iii) The Chairperson of the Audit Committee shall be an independent director;
- (iv) The Chairperson of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
- (v) The Audit Committee at its discretion shall invite the finance director or the head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee; provided that occasionally, the Audit Committee may meet without the presence of any executives of the listed entity; The Company Secretary shall act as the secretary to the committee

9. Write short notes on the following:

- (1) Content of Management Discussion and Analysis.
- (2) Corporate Governance

Answer

Content of Management Discussion and Analysis: As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position-

- (a) Industry structure and developments.
- (b) Opportunities and Threats.
- (c) Segment-wise or product-wise performance.
- (d) Outlook.
- (e) Risks and concerns.
- (f) Internal control systems and their adequacy.
- (g) Discussion on financial performance with respect to operational performance.
- (h) Material developments in Human Resources/Industrial Relations front, including number of people employed.
 - a. Details of significant changes (i.e. change of 25% or more as compared to the immediately previous financial year) in key financial ratios, along with detailed explanations therefor, including:
 - i. Debtors Turnover
 - ii. Inventory Turnover
 - iii. Interest Coverage Ratio
 - iv. Current Ratio
 - v. Debt Equity Ratio
 - vi. Operating Profit Margin (%)
 - vii. Net Profit Margin (%)

or sector-specific equivalent ratios, as applicable.

- b. Details of any change in Return on Net Worth as compared to the immediately previous financial year along with a detailed explanation thereof.

- (b) **Corporate Governance:** Corporate governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible

for governance of their companies. A number of reports and codes of corporate governance have been published internationally.

SEBI on September 2, 2015, issued the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”), with the objective of streamlining and consolidating the provisions of various listing agreements in operation for different segments of the capital markets, such as equity shares, preference shares, debt instruments, units of mutual funds, Indian depository receipts, securitised debt instruments and any other securities that the SEBI may specify.

The LODR Regulations are divided into two parts - the substantive provisions are incorporated in the main body while the procedural requirements are incorporated in the form of schedules. The LODR Regulations also capture the corporate governance principles found in Clause 49 of SEBI’s Model Listing Agreement. It may be noted that the LODR Regulations deal with only post-listing requirements and exclude all pre-listing requirements.

10. Dishonest Limited, a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India the revenue of the company is going down and there is slow down in other activities of the company. Therefore, it was expected that there would not be significant work for members of the Audit Committee. Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet once in a year only on March 31, 2018. They reviewed monthly information system of the Company and found no errors. As an auditor of Dishonest Limited would you consider the decision taken by the Audit Committee is in line with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

One of the following additional requirement as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee, whichever is greater, but there should be a minimum of two independent directors present.

Besides, there is a mandatory review requirement and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly information system of the company and the same is not sufficient as per LODR Regulations.

The Audit Committee shall mandatorily review the following information as per LODR Regulations:

- (vi) Management discussion and analysis of financial condition and results of operations;
- (vii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;

- (viii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
- (ix) Internal audit reports relating to internal control weaknesses;
- (x) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee; and
- (xi) Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

Applying the above, the decision taken by the audit committee is not in line with the LODR Regulations

11. XYZ Limited has conducted 4 meetings in 2019-20. i.e. June 15, 2019, October 18, 2019, February 10, 2020 and June 10, 2020. Does it comply with provisions of conducting meeting?

ANSWER:

As per Listing Obligation and Disclosure Requirements Regulations 2015, depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance. The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings.

In the given case, XYZ Limited has conducted 4 meetings in 2019-20. i.e. June 15, 2019, October 18, 2019, February 10, 2020 and June 10, 2020. It does not comply with provisions because time gap between June 15 and October 18 is more than 120 days i.e. 125 days.

Statutory auditor of ABC Limited has resigned on July 10, 2020. Whether he shall be liable for issuing limited review report for quarter ended June 30, 2020.

All listed entities/material subsidiaries while appointing/re-appointing an auditor shall ensure compliance with If the auditor resigns within 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for such quarter. In the given situation, statutory auditor of ABC Limited has resigned on July 10, 2020. he would be liable for issuing limited review report for quarter ended June 30, 2020 because time gap between July 13, 2020 and June 30, 2020 is less than 45 days.

12. PQR, auditor of XYZ Limited has signed limited review report of 2nd and 3rd quarter. Whether auditor is liable to issue limited review report of 4th quarter before resignation?

ANSWER:

All listed entities/material subsidiaries while appointing/re-appointing an auditor shall ensure compliance in case the auditor has signed the limited review/ audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year. In the instant case, PQR, auditor of XYZ Limited has signed limited review report of 2nd and 3rd quarter. Auditor is not liable to issue limited review report of 4th quarter because he has not signed limited review report of first 3 quarters

13. The Board of Directors of PQR Ltd. have laid down the code of conduct for all Board members and senior management. The auditor is provided with the annual compliance affirmations received from the Board members and explained that since there has been no change in the composition of the senior management, the previous year's affirmations may be considered valid. Is the contention of the Company valid?

ANSWER:

. Under Regulation 26(3) of LODR, all Board members and senior management personnel have to affirm compliance with the code on an annual basis. The decision to consider the previous year's affirmations from the senior management personnel as valid is not in line with the LODR Regulations.

RST Ltd. has established a vigil mechanism to enable its directors and employees to report genuine concerns and seek protection against victimization. The details of the mechanism are available on the company intranet which is accessible by the directors and employees. Are the measures taken by the Company in line with the LODR Regulations?

ANSWER:

Under Regulation 22 of the LODR, the vigil mechanism can be used by directors, employees and any other person. To that effect, Regulation 46 of the LODR requires the details of establishment of such mechanism to be disclosed by the Company on its website and in the Board Report. By only providing the details in the intranet, the Company has failed to meet the LODR Regulations.

14. Genuine Ltd. has established the Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 ('POSH Act'). The details (names, email addresses and contact numbers) of the Committee members are available on the company intranet which is accessible by all employees. However, no disclosure regarding number of complaints pertaining to sexual harassment of women at workplace is being made. Are the measures taken by the Company adequate?

ANSWER:

As per Schedule V Disclosures in relation to the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, amongst other matters, following should be disclosed in the section on Corporate Governance of the Annual Report:

- number of complaints filed during the financial year
- number of complaints disposed of during the financial year
- number of complaints pending as on end of the financial year .

The POSH Act offers protection to all women, be it employees or contract staff or any other women who are associated with the Company in any other capacity (including service providers, vendors, professionals, etc.) By only providing the details in the intranet, the Company has failed to meet the requirements under the POSH Act. In view of above, Genuine Ltd. is required to make necessary disclosures in accordance with Schedule V of SEBI (LODR) Regulation 2015.

Multiple Choice Question

1.The Audit Committee should consist of the following:

- a) minimum of 3 directors with independent directors forming a majority.
- b) minimum of 4 directors with only one independent director.
- c) minimum 2 directors which are independent.
- d) minimum 5 directors with 1 independent woman director

Answer: (a) minimum of 3 directors with independent directors forming a majority.

2.ABC Ltd is one of the top 1000 listed entities on the basis of market capitalisation. The Board of Directors of ABC Ltd does not comprise of any women director. The Statutory Auditor who is certifying Corporate Governance as per SEBI regulations, has to ascertain that –

- a) the Board of directors will have at least 2 independent woman director.
- b) the Board of directors will have at least 1 independent woman director.
- c) the Board of directors will have at least 5 independent woman director.
- d) None of the above

Answer: (b) the Board of directors will have at least 1 independent woman director.

3.The auditor should ensure that the board of directors of the top 100 listed entities shall comprise of –

- e) not less than 7 directors.
- f) not less than 4 directors.
- g) not less than 6 directors.
- h) not less than 2 directors

Answer: (c) not less than 6 directors

4.Annual Remuneration payable to a single non-executive director of ABC Ltd exceeds 25% of the total annual remuneration payable to all non-executive directors.

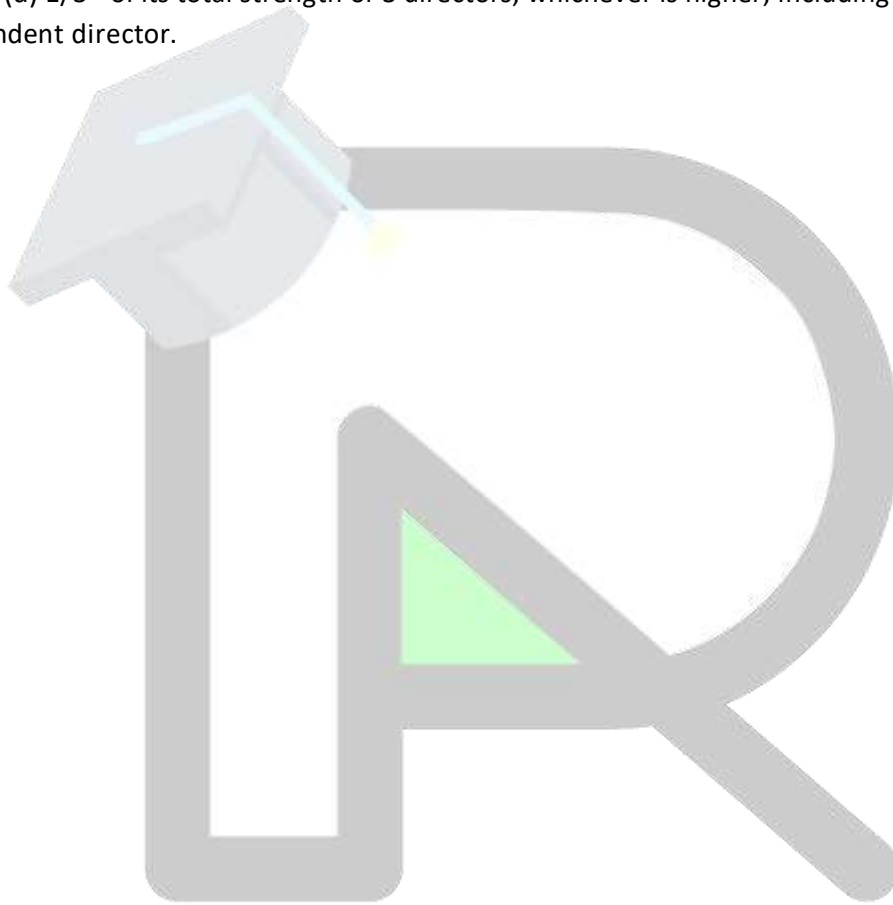
- a) Approval of shareholders by special resolution shall be obtained every year.
- b) Approval of shareholders in general meeting shall be obtained every year.
- c) None of the above
- d) Approval of Board of Directors.

Answer: (c) None of the above

5. The Board of Directors of XYZ Ltd, one of the top 2000 listed entities meets 4 times a year. What should be the quorum of the Board of Directors from 1st April 2020-

- a) $1/3^{\text{rd}}$ of its total strength or 3 directors, whichever is higher, including at least 1 independent director.
- b) $1/3^{\text{rd}}$ of its total strength or 4 directors, whichever is higher, including at least 1 independent director.
- c) $1/3^{\text{rd}}$ of its total strength or 3 directors, whichever is higher, including at least 2 independent director.
- d) $1/3^{\text{rd}}$ of its total strength or 3 directors, whichever is higher, including at least 1 non- executive director.

Answer: (a) $1/3^{\text{rd}}$ of its total strength or 3 directors, whichever is higher, including at least 1 independent director.



CHAPTER – 8 Audit of Consolidated Financial Statements

Multiple Choice Questions

1. IRC Ltd is in the business of construction and infrastructure. The company is listed in India having an annual turnover of INR 2500 crores. The company has various projects offices/ operations in India and outside India. The functional currency of the company and its project offices is INR. The company has five joint ventures and various jointly controlled operations. The company has been audited by Luthra & Associates, a firm of Chartered Accountants, since beginning. During the year ended 31 March 2018, new auditors were appointed as the statutory auditors of the company for the audit of the financial statements for the year ended 31 March 2018. New statutory auditors have raised various points related to the consolidation procedures followed by the company. Management did not agree to the observations of the auditors as they have been following this since many years now and there was no observation of previous auditors in respect of the same. Auditors have highlighted a point that joint ventures have been consolidated by the company in its standalone financial statements. However, management has an argument that those are in the nature of its operations and hence to reflect the true and fair view it would be appropriate to consolidate the same in the standalone financial statements.

Please advise as auditors how would you deal with this matter.

- Since the matter is related to consolidation which is more relevant for consolidated financial statements, hence no reporting in respect of this matter would be required in the auditors report for the year ended 31 March 2018.
- Auditor should look at the materiality and conservatism principle. Company has included extra information in the financials which can be considered by the auditors and basis that clean audit report should be given.
- Management should restate the financials to adjust the error related to consolidation of joint ventures in standalone financial statements. Otherwise auditor may modify his opinion on current year's financial statements considering the materiality.
- As per the requirements of accounting standard, joint venture if consolidated in standalone financial statements should not be consolidated again in the consolidated financial statements. Basis that this point should be dropped by the auditor.

Answer: Option C

2.MTP Mar 2019 Qn no 13

Brown Ltd is a holding company with two subsidiaries Black Ltd and White Ltd. You have been given the task of covering the valuation of non-current tangible assets in the consolidated financial statements. You note that Black Ltd and Brown Ltd. adopt straight line method of depreciation for its assets whereas White Ltd, follows written down method for calculating the depreciation. Which of the following adjustment

would be considered as correct in respect of the consolidated financial statements preparation?

- (a) White Ltd is required to depreciate the assets adopting straight line method of depreciation which is the method adopted by the holding company.
- (b) Brown Ltd is required to make suitable adjustments as to the depreciation charged by White Ltd, at the time of consolidation.
- (c) Brown Ltd and Black Ltd are required to depreciate the assets adopting written down value as to facilitate the harmonization of accounting policies.
- (d) No adjustment is required as there can be different methods of calculation of depreciation for its assets for the group companies.

Answer: (d) No adjustment is required as there can be different methods of calculation of depreciation for its assets for the group companies.

Descriptive Questions

May 2018 -2(a) – 5Marks

1. As an Auditor give your comments for the following disclosures made by a Company which adopted Ind AS for compilation of Financial Statements:

- (i) In the Balance Sheet, the sub-head inventories contained an item goods in transit in which a consolidated amount aggregating the cost of raw materials in transit and loose tools billed on company but delivery not made to company had been specified.
- (ii) Provision for doubtful debts of trade debtors was grouped in, "Provisions" under current liabilities.
- (iii) In Statement of Profit and Loss, prior period income was shown under "Other Income".
- (iv) Sale proceeds of scrap incidental to manufacture were included in "Other Income".
- (v) Payment towards a one time voluntary retirement scheme introduced during the year

Answer

- (i) **Goods in Transits:** As per Division II of Schedule III of the Companies Act, 2013, cost of raw material in transit shall be disclosed as sub-head of raw material and loose tools billed on the company would be shown as separate sub-head of Loose tools under heading of Inventories i.e. part of Current Asset. Thus, disclosure of consolidated amount aggregating the cost of raw material in transit and loose tools is not correct.
- (ii) **Provision for Doubtful Debts of Trade Debtors was grouped in "Provisions" under current liabilities:** The term 'doubtful debts' is an

- (iii) adjustment to the carrying amounts of assets, hence no provision is created separately for it as per Ind-AS 37 “Provisions, Contingent Liabilities and Contingent Assets”. Thus, provision should be shown net in trade receivable.
- (iv) **In Statement of Profit and Loss, Prior Period Income was shown under Other Income:** As per Ind-AS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”, Prior Period Income should not be shown in statement of profit and loss. The entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Sale Proceeds of Scrap incidental to manufacture were included in “Other

Income”: As per Ind-AS 2 “Inventories”, sale proceeds of scrap incidental to manufacture should be deducted from the cost of the main product. Thus, disclosure of sale proceeds of scrap as other income is not correct.

- (v) **Payment towards a one time VRS during the year included in Employee Benefit Expenses:** As per Ind-AS 19 “Employee Benefits”, if the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognized, the entity shall apply the requirements for short-term employee benefits, in case it is not expected to be settled before twelve months the entity shall apply the requirements for long term employee benefits. In the instant case, it should be shown as short term employee benefits in place of Employee Benefit Expenses. Thus, treatment of such payment as employee benefit expenses is not correct.

MAY 2018 3(a) 5 Marks

2. H Co. Ltd., is a holding company with two subsidiaries R Co. Ltd., and S Co. Ltd. The H Co. Ltd., adopts straight line method of depreciation for its assets whereas S Co. Ltd., follows written down value or diminishing value method. Though R Co. Ltd., follows straight line method of depreciation, it does not give effect to component accounting of depreciation in respect of high value assets. While consolidating the financials of the R Co. Ltd., and S Co. Ltd., with those of H Co. Ltd., determine the possible issues that you have to ensure for compliance in the light of above facts.

ANSWER:

When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework is Different than that of the Parent: A component may alternatively prepare financial statements on the basis of

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

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

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

In the given case, assets of R Co. Ltd. (subsidiary company) is depreciated using straight line method, assets of S Co. Ltd. (subsidiary company) are depreciated using written down value method and assets of parent company (H Co. Ltd.) are depreciated using straight line method, is in order. However, each part of an item of Property Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately under Component Method of Depreciation as per AS 10 on Property, Plant and Equipment. Thus, R Co. Ltd., though adopting straight line method but does not giving effect to component accounting of depreciation in respect of high value assets , is not in compliance with Ind AS 16/ Accounting Standard 10 Property Plan and Equipment.

3.RTP May 2018 Qn no. 10, MTP Apr 18 Qn no.3(C) 5 Marks

You are appointed as an auditor of Nawab Limited, a listed company which is a main supplier to the UK building and construction market. With a turnover of ` 2.9 billion, the company operates through 11 business units and has nearly 1,80 branches across the countries .

As an auditor, how will you draft the report in case:

(a) When the Parent's Auditor is also the Auditor of all its Components?

- (b) **When the Parent's Auditor is not the Auditor of all its Components?**
- (c) **When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent?**
- (d) **When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?**
- (e) **Where the financial statements of one or more components is not audited?**

Answer

(a) When the Parent's Auditor is also the Auditor of all its Components:

While drafting the audit report, the auditor should report whether principles and procedures for preparation and presentation of consolidated financial statements as laid down in the relevant accounting standards have been followed. In case of any departure or deviation, the auditor should make adequate disclosure in the audit report so that users of the consolidated financial statements are aware of such deviation. Auditor should issue an audit report expressing opinion whether the consolidated financial statements give a true and fair view of the state of affairs of the Group as on balance sheet date and as to whether consolidated profit and loss statement gives true and fair view of the results of consolidated profit or losses of the Group for the period under audit. Where the consolidated financial statements also include a cash flow statement, the auditor should also give his opinion on the true and fair view of the cash flows presented by the consolidated cash flow statements.

- (b) **When the Parent's Auditor is not the Auditor of all its Components:** In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of SA 600 "Using the Work of Another Auditor".

As prescribed in SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor. Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidation adjustments. Reference in the report of the auditor on the consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its subsidiaries.

When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent: The parent may have components located in multiple geographies outside India applying an

accounting framework (GAAP) that is different than that of the parent in preparing its financial

statements. Foreign components prepare financial statements under different financial reporting frameworks, which may be a well-known framework (such as US GAAP or IFRS) or the local GAAP of the jurisdiction of the component. Local component auditors may be unable to report on financial statements prepared using the parent's GAAP because of their unfamiliarity with such GAAP.

When a component's financial statements are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's consolidated financial statements, the parent's management perform a conversion of the components' audited financial statements from the framework used by the component to the framework under which the consolidated financial statements are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.

A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies". When applying the approach of using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements. This ensures that the information prepared under the requirements of the group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements.

- (c) **When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent:** Normally, audits of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India ("Indian GAAS"). In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the consolidated financial statements, the components' financial statements should also be audited under a framework that corresponds to Indian GAAS.

- (d) **Components Not Audited:** Generally, the financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi-location group audit. Such audits and audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components' auditor.

Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

4.MTP Mar 2018 Qn no.3(d) 5 Marks

Parent Ltd. acquired 51% shares of Child Ltd. during the year ending 31-3-2016. During the financial year 2016-17 the 20% shares of Child Ltd. were sold by Parent Ltd. Parent Ltd. while preparing the financial statements for the year ending 31-3-2016 and 31-3-2017 did not consider the financial statements of Child Ltd. for consolidation. Comment.

RTP Nov 18 Qn no 10, MTP-OCT-18 Qn No 3(d) 5 Marks:

Moon Ltd. acquired 51% shares of Star Ltd. during the year ending 31 -3-2017. During the financial year 2017-18 the 20% shares of Star Ltd. were sold by Moon Ltd. Moon Ltd. while preparing the financial statements for the year ending 31-3-2017 and 31-3-2018 did not consider the financial statements of Star Ltd. for consolidation. As a statutory auditor how would you deal with it?

Answer

Accounting Standard 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are acquired & held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".

In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary is temporary, the auditor should verify that the intention of the parent, to dispose the subsidiary, in the near future, existed at the time of acquisition of the subsidiary. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements.

As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.

However, as per section 129(3) of the Companies Act, 2013 where a company having subsidiary, which is not required to prepare consolidated financial statements under the applicable Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

Conclusion: In the given case, Parent Ltd. has acquired 51% shares of Child Ltd. during the year ending 31.03.2016 and sold 20% shares during the year 2016-17. Parent Ltd. did not consolidate the financial statements of Child Ltd. for the year ending 31.03.2016 and 31.03.2017.

The intention of Parent Ltd. is quite clear that the control in Child Ltd. is temporary as the former company disposed off the acquired shares in the next year of its purchase. Therefore, Parent Ltd. is not required to prepare consolidated financial statement as per AS 21 however, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013, Parent Ltd. is required to made disclosures in the financial statements as per the provisions provided in Schedule III to the Companies Act' 2013.

However, if the Parent Ltd. is required to prepare its financial statements under Ind AS, it shall have to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" is not available under Ind AS 110. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

5.MTP-Aug-18 Qn No 3(d) 5 Marks:

You are appointed as an auditor of Najib Limited, a listed company which is a main supplier to the USA building and construction market. With a turnover of Rs. 1.9 billion, the company operates through 11 business units and has nearly 1,70 branches across the countries.

As an auditor, how will you draft the report in case (I) When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent?(II) When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?

Answer:

(I) When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent: The parent may have components located in multiple geographies outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its financial statements. Foreign components prepare financial statements under different financial reporting frameworks, which may be a well - known framework (such as US GAAP or IFRS) or the local GAAP of the jurisdiction of the component. Local component auditors may be unable to report on financial statements prepared using the parent's GAAP because of their unfamiliarity with such GAAP.

When a component's financial statements are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's consolidated financial statements, the parent's management perform a conversion of the components 'audited financial statements from the framework used by the component to the framework under which the consolidated financial statements are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.

A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies".

When applying the approach of using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements. This ensures that the information prepared under the requirements of

the group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements.

(II) When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent: Normally, audits of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India ("Indian GAAS"). In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the consolidated financial statements, the components' financial statements should also be audited under a framework that corresponds to Indian GAAS.

6.Nov 18 Qn no 3(d) 5 Marks

H Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your views.

Answer

Consolidated Financial Statements: According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

However, an investment entity need not present consolidated financial statements if it is required, in accordance with Ind AS 110 'Consolidated Financial Statements', to measure all of its subsidiaries at fair value

through profit or loss. A parent shall determine whether it is an investment entity. (An investment entity is an entity that (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.)

In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated then list should be disclosed in notes to accounts with reason.

7.RTP Nov 2019 Qn no 25(a)

Write a short note on the Auditor's objectives in an audit of consolidated financial statements

Answer

The auditor's objectives in an audit of consolidated financial statements are:

- to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of applicable financial reporting framework;
- to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements;
- to enquire into the matters as specified in section 143(1) of the Companies Act, 2013; and.
- to report on the matters given in the clauses (a) to (i) of section 143(3) of the Companies Act, 2013, for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014, to comment on the matters specified in sub-rule (a), (b) and (c)¹ to the extent applicable;
- The auditor should also validate the requirement of preparation of CFS for the company as per applicable financial reporting framework.

Study Material

1.R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?

Answer

Consolidation of Financial Statement: AS 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when:

- (i) Control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future or
- (ii) Subsidiary operates under severe long- term restrictions which significantly impair its ability to transfer funds to the parent.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares held as 'stock-in-trade' are acquired and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".

As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

However, as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

In the given case, R Ltd's intention is to dispose off the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is temporary, Therefore, R Ltd. is not required to prepare consolidated financial statement as per AS 21, however, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013 read with Companies (Accounts) Rules, 2014, R Ltd. is required to make disclosures in the financial statements as per the provisions provided in Schedule III to the Companies Act, 2013

However, if R Ltd. is required to prepare its financial statements under Ind AS, it shall have to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110.

2.A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd., what factors would be considered by you as the statutory auditors of A Ltd for the audit of its consolidated financial statements prepared under Ind AS?

Answer

10% Voting Power and Control over the composition of Board of Directors: In this case, A Ltd. holds only 10 percent of the voting power but has control over the composition of the Board of Directors of B Ltd.

In such a case, A Ltd shall be considered as a parent of B Ltd and, therefore, it would consolidate B Ltd in its consolidated financial statements as a subsidiary.

The auditor should verify A Ltd's management's assessment of having control in B Ltd despite having only 10% voting power as per the requirements of Ind AS 110. Auditor would need to verify as to how A Ltd controls the composition of the Board of Directors or corresponding governing body of B Ltd.

There can be various means by which such kind of control can be established. In this regard, the auditor may verify the minutes of Board meetings, shareholder agreement entered into by the parent, agreements with B Ltd to which the parent might have provided any technology or know how, enforcement of statute, etc.

Further, the auditor should verify that the adjustments warranted by Ind AS 110 have been made wherever required and have been properly authorised by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments. The auditor should make plan, among other things, for the understanding of accounting policies of the A Ltd and B Ltd and determining and programming the nature, timing, and extent of the audit procedures to be performed etc.

Further, the duties of an auditor with regard to reporting of transactions with any other related parties are given in SA 550 on Related Parties. As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity are considered as Related Party. In forming an opinion on the financial statements, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance

with Ind AS 110 and Schedule III and whether the effects of the related party relationships and transactions prevent the financial statements from achieving true and fair presentation (for fair presentation frameworks) or cause the financial statements to be misleading (for compliance frameworks).

3. Whether preparation of consolidated financial statements is mandatory? If yes, please elaborate on the requirements under the statute.

ANSWER:

According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Further, section 129(4) of the said Act, provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to its the consolidated financial statements.

The consolidated financial statements shall also be approved by the Board of Directors before they are signed on behalf of the Board, along with its standalone financial statements and shall also be laid before the annual general meeting of the company along with the laying of its standalone financial statement.

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary(ies) in Form AOC-1.

According to the Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act [refer Appendix given at the end of Chapter 5 for Schedule III].

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification. Thus, the companies having subsidiaries, which have previously never prepared the consolidated financial statements, must prepare their consolidated financial statements in adherence with this mandatory requirement. This will provide the holding companies' stakeholders more transparency about the companies' businesses.

An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

4. Please elaborate on the situations wherein the requirement related to preparation of consolidated financial statements may not apply.

ANSWER:

The requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:

- (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
- (ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
- (iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

5. While doing the audit of Consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?

ANSWER:

Current period consolidation adjustments primarily relate to elimination of intra-group transactions and account balances including:

- (a) intra-group interest paid and received, or management fees, etc.;
- (b) unrealised intra-group profits on assets acquired/ transferred from/ to other subsidiaries;
- (c) record deferred taxes on unrealised intercompany profits elimination in accordance with Ind AS 12;
- (d) intra-group indebtedness;
- (e) adjustments related to harmonising the different accounting policies being followed by the parent and its components;
- (f) adjustments to the financial statements (of the parent and the components being consolidated) for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the consolidated financial statements of the group.
- (g) adjustments for the effects of significant transactions or other events that occur between the date of the components balance sheet and not already recognised in its financial statements and the date of the auditor's report on the group's consolidated financial statements when the financial statements of the component to be used for consolidation are not drawn upto the same balance sheet date as that of the parent;
- (h) In case of a foreign component, adjustments to convert a component's audited financial statements prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared;
- (i) determination of movement in equity attributable to the minorities interest/non-controlling interest since the date of acquisition of the subsidiary. It should also be noted that under Ind AS, non-controlling interest can also result in negative balance. Unlike earlier AS, as per paragraph 28 of Ind AS 27, if the net worth of subsidiary is negative, non-controlling interest could have deficit balance;

(j) adjustments of deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intragroup transactions and undistributed profits of the component in case of consolidated financial statements prepared under Ind AS.

6. Write a short note on:

(a) Responsibility of holding company for preparation of Consolidated Financial Statements.

ANSWER:

The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent. This includes:

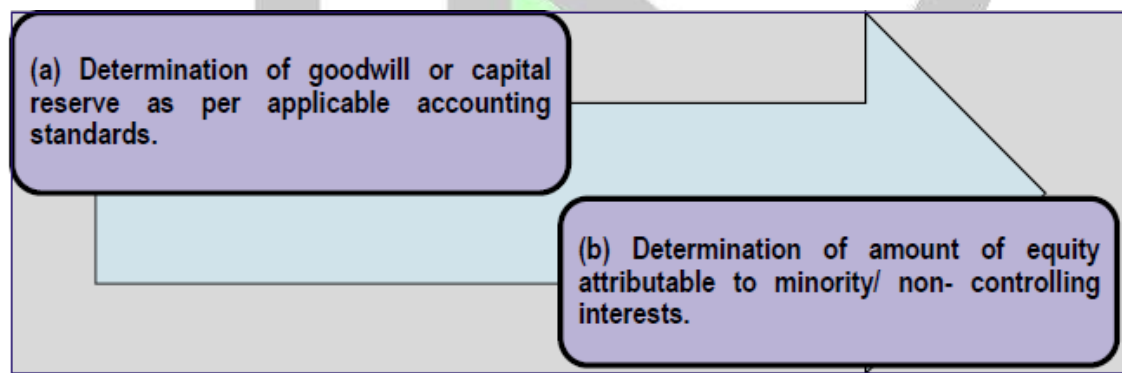
- (a) identifying components, and including the financial information of the components to be included in the consolidated financial statements;
- (b) where appropriate, identifying reportable segments for segmental reporting;
- (c) identifying related parties and related party transactions for reporting;
- (d) obtaining accurate and complete financial information from components;
- (e) making appropriate consolidation adjustments;
- (f) harmonization of accounting policies and accounting framework; and
- (g) GAAP conversion, where applicable.

Apart from the above, the parent ordinarily issues instructions to the management of the component specifying the parent's requirements relating to financial information of the components to be included in the consolidated financial statements. The instructions ordinarily cover the accounting policies to be applied, statutory and other disclosure requirements applicable to the parent, including the identification of and reporting on reportable segments, and related parties and related party transactions, and a reporting timetable.

(b) Permanent Consolidated Adjustments.

ANSWER:

Permanent consolidation adjustments are those adjustments that are made only on the first occasion or subsequent occasions in which there is a change in the shareholding of a particular entity which is consolidated. Permanent consolidation adjustments are:



The auditor should verify that the above calculations have been made appropriately.

- The auditor should pay particular attention to the determination of pre-acquisition reserves of the components. Date(s) of investment in components assumes importance in this regard.
- The auditor should also examine whether the pre-acquisition reserves have been allocated appropriately between the parent and the minority interests/ non-controlling interests of the subsidiary.
- The auditor should also verify the changes that might have taken place in these permanent consolidation adjustments on account of subsequent acquisition of shares in the components, disposal of the components in the subsequent years.

It may happen that while working out the permanent consolidation adjustments, in the case of one subsidiary, goodwill arises and in the case of another subsidiary, capital reserve arises. The parent may choose to net off these amounts to disclose a single amount in the consolidated balance sheet where permitted by the applicable financial reporting framework. In such cases, the auditor should verify that the gross amounts of goodwill and capital reserves arising on acquisition of various subsidiaries have been disclosed in the notes to the consolidated financial statements to reflect the excess/shortage over the parents' portion of the subsidiary's equity.

8.M Ltd. acquired 51 % shares of S Ltd. on 01-04-2019 and sold 25% of these shares during the financial year 2019-20. M Ltd. did not prepare Consolidated Financial Statements for the financial year 2019-20 on the plea that the control was only temporary. Do you agree with the view of M Ltd.? Decide, assuming, that M Ltd. is required to prepare its financial statements under Ind AS.

ANSWER:

Consolidation of Financial Statement: As per Ind AS 110, there is no such exemption for 'temporary control', or "for operating under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.

Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee". In the given case, M Ltd acquired 51% shares of S Ltd on 01.04.2019 and sold 25% shares during the year ended 2019-20. M Ltd did not consolidate the financial statements of S Ltd for the year ended 31.03.2020 on the plea that control was only temporary. The intention of M Ltd. is quite clear that the control in S Ltd. is temporary as the former company disposed off the acquired shares in the same year of its purchase.

However, even though the intention of M Ltd. is for temporary holding of shares in S Ltd. as per Ind AS, M Ltd is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for "temporary control" is not available under Ind AS 110. However, "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee". Here, due to sale of investment in S Ltd. up to 25%, M Ltd. loses control of S Ltd.

Accordingly, M Ltd., is required to prepare consolidated statement till the date of disposal of the 25% shares to comply with the same.

Multiple Choice Question

1.BCO Private Limited is operating in India for the last 15 years. It has three group companies

– one subsidiary in India and the other two in Ireland and France. All these subsidiaries were acquired one by one and investments were made in these companies gradually i.e. initially control was not obtained and after investment for some period, control was obtained. The statutory auditors have evaluated that all the group companies are significant for the purpose of audit of consolidated financial statements.

During the year ended 31 March 2019, the audited financial statements of all the components are available except for French company whose audit got delayed and

would not get completed before the release date of CFS of parent company.

For the purpose of consolidation, the parent company has provided the audited financial statements of other components. Please suggest what can be the possible situation in respect of financial statements of French company for the purpose of consolidation for the purpose of audit of CFS.

- (a) Since the audit of French company is in progress, its financial statements subject to audit can be considered by auditor of parent company and audited signed financials can be given to auditors even after release of audited CFS as this is matter of documentation only.
- (b) The management should give management accounts to the auditors of CFS and auditor can mention the same point in other matters paragraph in his audit report which is an acceptable approach.
- (c) Auditor should get the financial statements of French company excluded from CFS.
- (d) If the auditor does not receive audited financial statements of French company, he should modify his audit report.

Answer: (d) If the auditor does not receive audited financial statements of French company, he should modify his audit report.

2.KB Ltd is engaged in the business of construction. It has multiple subsidiaries and associates in India. The company acquired PPP GmbH in Germany on 1 February 2019. The company also obtained control in PPP GmbH on the same date. Its investment in PPP GmbH was of a huge amount. The company has been preparing its CFS over the last few years and this has also become a matter of concern for the company for the year ended 31 March 2019. The management is of the view that consolidation of PPP GmbH would not be required in CFS for the year ended 31 March 2019 because this is the first year of acquisition. However, the auditors have not been agreeing for the same. The timeline of submission of audited financial statements is due in few months time.

In the meantime, the management moved on the consolidation of PPP GmbH taking audited financial statements of PPP GmbH which are available in the GAAP of its local country and GAAP conversion adjustments from its local GAAP to Indian GAAP have been made by the parent company. GAAP conversion adjustments are significant at CFS level. In the meantime, the management has also been consulting whether the consolidation would be required or not also considering the fact that comparative figures in case of PPP GmbH would not be available.

Further the auditors have also raised observations regarding the GAAP conversion adjustments over which management has a disagreement. As per the management

the auditors are not required to comment on GAAP adjustments because audited financial statements of PPP GmbH have been given to the auditors. Please help to resolve these matters.

- a) Consolidation of PPP GmbH should be done but GAAP conversion adjustments are not required to be audited.
- b) Consolidation of PPP GmbH should not be done and accordingly, GAAP conversion adjustments would not arise.
- c) Consolidation of PPP GmbH should be done and GAAP conversion adjustments are also required to be audited.
- d) Consolidation of PPP GmbH is a choice of management as the accounting standard does not mandate this. However, in case it is done then the GAAP conversion adjustments would be required to be audited.

Answer: (C) If the auditor does not receive audited financial statements of French company, he should modify his audit report.

3. VDN Ltd is a medium-sized company engaged in the business of retail. It has two subsidiaries and one joint venture. Both the subsidiaries are larger in size as compared to the parent company. The accounting policies of the parent company, its subsidiaries and joint venture were same. However, during the year ended 31 March 2019, one of its subsidiary, SMA Pvt Ltd changed the method of depreciation of Property, plant and equipment (PPE) to written down value method which is different from the method followed by the parent company i.e. Straight line method. Further this subsidiary also changed the method of valuation from FIFO to Weighted average method which has become different from parent as the parent follows FIFO method.

These changes were made by the subsidiary because it reflected the better picture of its standalone financial statements. Now for the purpose of CFS, the auditors have asked the management of parent company to ensure that accounting policies of the group companies should align with that of parent in line with the requirements of accounting standard. But the management of parent and subsidiary company believe that out of three group companies other than parent, only one group company requires this change for the purpose of consolidation and the same should be ignored by the auditors. Please suggest.

- a) The view of management is correct.
- b) For CFS, method of depreciation of SMA Pvt Ltd may continue to be different, however, method of valuation of inventory should be aligned with that of the parent.

- c) For CFS, method of valuation of inventory of SMA Pvt Ltd may continue to be different, however, method of depreciation should be aligned with that of the parent.
- d) The auditor should get these changes made in the standalone financial statements of SMA Pvt Ltd.

Answer: (b) For CFS, method of depreciation of SMA Pvt Ltd may continue to be different, however, method of valuation of inventory should be aligned with that of the parent

4.AJ Private Ltd is engaged in the business of retail having annual turnover of Rs. 1,800 crores. The company has a plan to get listed on Bombay Stock Exchange next year. The company has 3 associates, 4 subsidiaries, and 1 joint venture. The company prepares its consolidated financial statements on a quarterly basis for the purpose for internal purposes. The quarterly financials are reviewed by the statutory auditors of the company.

The group companies of the parent company have increased in terms of their size looking at the total assets and revenue of the group.

For the purpose of audit of consolidated financial statements for the year ended 31 March 2019, management has request the statutory auditors that it would be able to provide management certified accounts of the joint venture as its audit would not get completed on time and even without joint venture, the auditors would be able to cover 75% of the total assets of the group at consolidated level. However, the statutory auditors are insisting that they need to cover at least 80% of the total assets of the group at consolidated level as per the requirements of the Auditing Standards and for that financials of the joint venture should also be audited. Please advise.

- a) Auditors should accept the management certified accounts of joint venture.
- b) Auditors cannot accept management certified accounts of joint venture and should report the matter to the Registrar of Companies.
- c) Auditors cannot accept management certified accounts of joint venture and should report the matter to the Securities and Exchange Board of India, considering the plan to get listed next year.
- d) Auditors should accept management certified accounts of joint venture provided the revenue of the joint venture is less than 10% of the total revenue of the group.

Answer: (a) Auditors should accept the management certified accounts of joint venture

5. Advik Ltd is an unlisted public company. The company acquired few companies in the last 3-4 years which have been assessed as its subsidiaries/ associates/ joint ventures (hereinafter jointly called as 'components'). The company prepares its condensed consolidated financial statements every quarter to review the performance of the group. In the past years, the company used to get the financials of its components reviewed/ audited on a quarterly basis. AJ & Co LLP is the statutory auditor of parent company and KSH & Associates is the statutory auditor of all the components. Quarterly condensed consolidated financial statements of the group are reviewed by the statutory auditors as per the terms of the engagement letter.

AJ & Co LLP has communicated to Advik Ltd that in line with the requirements of the Companies Act 2013, it would also be required to undertake audit/ limited review of all the components which would be consolidated with those of Advik Ltd and for which KSH & Associates are the statutory auditors currently.

Management is not agreeing with the same as they don't want to change KSH & Associates as auditors of the components and the requirement mentioned by AJ & Co LLP would lead to duplication of work of auditors as well as the management. Please advise.

- a) In an audit/review of consolidated financial statements (whether condensed or complete), the principal auditor is required to perform various procedures in accordance with SA 600, Using the work of another auditor and hence the requirement of auditor is valid.
- b) In an audit/review of consolidated financial statements (whether condensed or complete), the principal auditor is required to perform various procedures in accordance with the requirements of the Companies Accounts and Audit Rules 2014 and hence the requirement of auditor is valid
- c) In an audit/review of consolidated financial statements (whether condensed or complete), the principal auditor is not required to re-perform audit/ limited review of the components and hence the requirement of auditor is not correct.
- d) Management and the auditor need to decide this mutually as this is based on the contractual arrangement between them

Answer: (c) In an audit/review of consolidated financial statements (whether condensed or complete), the principal auditor is not required to re-perform audit/ limited review of the components and hence the requirement of auditor is not correct.

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Chapter 9 Audit of Banking Companies

Multiple Choice Questions

1.RTP May 2019 Qn no 10

The Advances Bank Ltd. has sanctioned overdraft limit of Rs. 44 crore to ASG Ltd. on the working capital of the company as on 31st March 2015. As per bank norms the drawing power in the overdraft account need to be reviewed on quarterly basis as per the audited stock statement of the company. As a central statutory auditor for the year 2016-17, while verifying the advances for the year ending 31st March 2017, you noticed that the bank has not obtained the stock statement of ASG Ltd. for the two quarters ending 31st December 2016 and 31st March 2017 and no provision of NPA has been made for this account in the financial statements for the year 2016-17. What will be your decision as a central statutory auditor?

- a. Classify the borrower's account as NPA as the borrower's financial position cannot be determined due to non-submission of stock statement.
- b. Instruct the bank to obtain the audited stock statement for both the quarters and review the credit limit accordingly.
- c. As per bank norms the drawing power need to be determined on the basis of stock statement and it was more than three months old as on 31st March 2017, so the outstanding in the account will be deemed as irregular.
- d. You should give a qualificatory note in the audit report as per SA700.

Answer: Option C

2.MTP Apr 2019 QN no

Your firm has been appointed statutory auditor by a Nationalised Bank for the year 2017-18. Your senior advised you to check all the standard assets shown in the balance sheet as on 31st March 2018. While verification you observed that one of the accounts was regularised on 28th March 2018, for which the interest and instalment amount was overdue from the quarter ending 30th September 2017. The account was regularised after the repayment of overdue interest and instalment amounts was done on 26th March 2018. Only the last day of the financial year was reckoned as the date of account becoming NPA by the Bank. As a statutory auditor will you agree with the Bank's policy?

- (a) As the interest charged in the account was overdue for more than 90 days from the end of quarter, it should be classified as NPA and should be considered as sub-standard asset for the balance sheet as on 31st March 2018.

- (b) As the overdue interest and instalment amount was paid before the balance sheet date there is no reason to classify the account as NPA.
- (c) The auditor should not agree with the Bank's policy to regularise the account before balance sheet date as overdue interest indicates more than normal risk attached to the business.
- (d) Bank can regularise the account before balance sheet date but should ensure that the amount has been paid through genuine resources and not by sanction of additional facilities, and the account remains in order subsequently.

Answer: (d) Bank can regularise the account before balance sheet date but should ensure that the amount has been paid through genuine resources and not by sanction of additional facilities, and the account remains in order subsequently.

3.MTP Oct 2019 QN no 6 (1 Mark)

PFS Bank was engaged in the business of providing Portfolio Management Services to its customers, for which it took prior approval from RBI. Your firm has been appointed as the statutory auditors of the Bank's financial statements for the year 2018-19. Your senior has instructed you to verify the transactions of Portfolio Management Services (PMS). While verifying the transactions you noticed that the bank has not prepared separate record for PMS transactions from the Bank's own investments. As a statutory auditor what will be your decision for verification of PMS transactions?

- (a) It is not necessary to maintain separate records for PMS clients from Bank's own investments, so the auditor can verify the PMS transactions as part of investment verification for Bank's financial statements and submit the audit report accordingly.
- (b) As per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions till the Bank segregates the transactions from its own investments.
- (c) The auditor can give a qualified opinion in his audit report on the financial statements of the Bank and report the matter in special purpose certificate.
- (d) Auditor should verify that PMS funds are not utilised for lending, inter-bank deposits or deposits to corporate bodies and bills re-discounting only. So, whether the PMS transactions are recorded separately or not will not matter for the auditor.

Answer: (b) As per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions till the Bank segregates the transactions from its own investments.

4.MTP Oct 2019 QN no 10 (2 Marks)

The Chanakya Bank Ltd. was having 150 branches all over India by the year ending 31st March, 2019. Ten branches of the bank were already covered for concurrent audit and the Bank's Audit Committee decided to include the below mentioned branches for concurrent audit from the year 2019-20.

1. Allahabad branch which started foreign exchange business from February 2019.
2. Rae Bareilly branch whose aggregate deposits were more than 35% of the aggregate deposits of the bank.

Whether the decision of audit committee to include both the branches mentioned in above paragraph for concurrent audit is as per RBI Guidelines?

- (a) The decision of audit committee is valid as according to RBI Guidelines, both the branches fulfil the criteria for compulsory concurrent audit.
- (b) Allahabad branch falls under the compulsory audit criteria as per RBI Guidelines, however Rae Bareilly branch whose aggregate deposits are less than 50% of the aggregate deposits of the Bank is not required to be compulsorily covered for concurrent audit.
- (c) Allahabad and Rae Bareilly branch are compulsorily not required to be covered under concurrent audit as per RBI Guidelines.
- (d) Allahabad branch has started foreign exchange business in February 2019 and as per RBI Guidelines only the branches dealing in Foreign exchange business from more than three years are covered under concurrent audit. Therefore, Allahabad branch is not covered under compulsory concurrent audit criteria as per RBI Guidelines but the Rae Bareilly branch is covered under compulsory concurrent audit criteria.

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

Descriptive Questions

1.May 2018 5(d) -4 Marks

In the course of audit of Skip Bank Ltd., you found that the Bank had sold certain of its non performing assets. Draft the points of audit check that are very relevant to this area of checking.

Answer

Sale of Non-Performing Assets: In case of Sale of NPA by Bank, the auditor should examine :

- the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers.

- that only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- the assets have been sold/ purchased “without recourse’ only.
- subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- the NPA has been sold at cash basis only.
- the bank has not purchased an NPA which it had originally sold.
- that on the sale of the NPA, the same has been removed from the books of the account.
- that the short fall in the net book value has been charged to the profit and loss account.
- that where the sale is for a value higher than the NBV, no profit is recognised and the excess provision has not been reversed but retained to meet the shortfall/ loss because sale of other non-performing financial assets.

2.RTP May 2018 –Qn no.11

Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

As an expert in bank audit, you are required to briefly discuss the area of focus and suggested audit procedures regarding evaluation of internal controls over advances, substantive audit procedures and recoverability of advances.

Answer

Audit Procedures -In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

Area of Focus	Suggested Audit Procedures
Evaluation of Internal Controls over Advances	<ul style="list-style-type: none"> • Examine loan documentation; • Examine the validity of the recorded amounts; • Examine the existence, enforceability and valuation of the security; • Ensure compliance with the terms of sanction and end use of funds. • Ensure compliance with Loan Policy of Bank as well as RBI norms including appropriate classification and provisioning • Review the operation of the accounts;
Substantive Audit Procedures	<ul style="list-style-type: none"> ☐ Check that the advances represent amount due to the bank ☐ Verify that the advances are disclosed, classified and

	<p>described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.</p> <ul style="list-style-type: none"> ☐ Check that appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices. ☐ Examine all large advances while other advances may be examined on a sample basis ☐ Verify completeness and accuracy of interest being charged ☐ Ensure that there are no unrecorded advances ☐ Check that the stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation ☐ Check whether the amounts included in the balance sheet are outstanding as on the date of balance sheet. ☐ Verify completeness and accuracy of interest being charged.
<p>Recoverability of Advances</p>	<ul style="list-style-type: none"> • Review periodic statements submitted by the borrowers indicating the extent of compliance with terms and conditions. • Review latest financial statements of borrowers. • Review reports on inspection of security. • Review Auditors' reports in the case of borrowers enjoying aggregate credit limits of Rupees 10 lakh or above for working capital from the banking system.

3.MTP Mar 2018 Qn no.6(d) 4 Marks, RTP Nov 2018 Qn no 11(b)

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. The bank is a consortium member of Cash Credit Facilities of ` 50 crores to X Ltd Bank's own share is ` 10 crores only. During the last two quarters against a debit of ` 1.75 crores towards interest the credits in X Ltd's account are to the tune of ` 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing. Advise your views on the issue which were brought to your notice by your Audit Manager.

Answer

The bank is a consortium member of cash credit facilities of ` 50 crores to X Ltd. Bank's own share is ` 10 crores only. During the last two quarters against a debit of ` 1.75 crores towards interest, the credits in X Ltd's account are to the tune of ` 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions

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

4.MTP Apr 18 Qn no.6(d) 4 Marks,RTP May 2020

In course of audit of Fair Samaritan Bank as at 31st March, 18 you observed that in a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Advise. Would your answer be different if the advance is guaranteed by a State Government?

RTP Nov 2019 Qn no 19(a),MTP Apr 2019 Qn no 3(c) 5 Marks

In course of audit of True Princi Bank as at 31st March, 2019, you observed that in a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Comment. Would your answer be different if the advance is guaranteed by a State Government?

Answer

Government Guaranteed Advance: If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

5.MTP-Aug-18 Qn No 6(d) 4 Marks:

M/s. S Ltd. is a MSME unit. The company does multiple banking. The company is availing cash credit limit from U Bank of Rs. 25 crores. The limit availed remained less than Rs. 5.00 crores during all the days of F.Y. 2017-18. The company has not done any credit in cash credit account during the year as it is operating current account in newly opened another bank branch adjoining to company premises. The company is having sufficient security of stocks and debtors and DP of Rs.25.00 crores remains all over the year. The company is availing term loans from other bank branches. Now the Bank Manager is insisting to route the sale proceeds through U Bank, otherwise cash credit limit and term loan accounts with other banks will be treated as Non-Performing Accounts. Now company seeks your opinion.

Answer:

Classification of Account as NPA in case of Multiple Banking: If the account remains overdue for more than 90 days, the account becomes Non-Performing Assets. The account will also be called as overdue, if there are not sufficient credits in the cash credit account which even could not serve the interest charged. In this case, there are no credits in accounts, it means interest has not been served in the account. Thus, accounts become overdue after 90 days for non-credit of amounts which could even serve the interest amount. Thus, cash credits will become as NPA if no credits/sale proceeds are deposited in that account.

However, in multiple banking system, each bank is independent for classification of account as NPA. If SBI declares the account as NPA due to non-serving of interest amount, other bank will be free and will not classify the term loan accounts as NPA, if they are regular.

6.RTP Nov 18 Qn no 11

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager:

- (a) **The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year.**

It is not a prudent practice to treat dividend on shares of corporate bodies and units of mutual funds as income unless these are actually received. Accordingly, income from dividend on shares of corporate bodies and units of mutual funds should be booked on cash basis. In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis,

provided interest is serviced regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government. Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This is also in accordance with AS 9 as well. In the instant case, therefore, the recognition of income by the bank on accrual basis is not in order.

7.Nov 18 Qn no 6(d) 4 Marks

You are the Concurrent Auditor of a Branch of Nationalized Bank which deals in foreign exchange transactions. Give focus areas of your checking in this respect.

Answer

Focus Areas in case of Foreign Exchange Transactions:

- Check foreign bills negotiated under letters of credit.
- Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.
- Check whether inward/outward remittance have been properly accounted for.
- Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorised and necessary charges have been recovered.
- Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.
- Ensure that the overbought/oversold position maintained in different currencies is reasonable considering the foreign exchange operations.
- Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations.
- Ensure verification/reconciliation of Nostro and Vostro account transactions/balances.

8.RTP May 2019 Qn no 18

ABC Chartered Accountants have been appointed as concurrent auditors for the branches of Effective Bank Ltd. for the year 2017-18. You are part of the audit team for Agra branch of the bank and have been instructed by your senior to verify the advances of the audit period. You are required to guide your assistant about the areas to be taken care while doing verification during the concurrent audit.

Answer

Verification of Advances as a Concurrent Auditor:

- (i) Ensure that loans and advances have been sanctioned properly in accordance with delegated authority.
- (ii) Ensure that securities and documents have been received and properly charged/ registered.
- (iii) Ensure that post disbursement supervision and follow-up is proper, such as receipt of stock statements, instalments, renewal of limits, etc.
- (iv) Verify whether there is any mis-utilisation of the loans and whether there are instances indicative of diversion of funds.
- (v) Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions.
- (vi) Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates.
- (vii) Ensure proper follow-up of overdue bills of exchange.
- (viii) Verify whether the classification of advances has been done as per RBI guidelines.
- (ix) Verify whether the submission of claims to DICGC and ECGC is in time.
- (x) Verify that instances of exceeding delegated powers have been promptly reported to controlling/Head Office by the branch and have been got confirmed or ratified at the required level.

9.RTP May 2019 Qn no 1(b)

Write a short note on reversal of income under bank audit

Answer

Reversal of Income: If any advance, including bills purchased and discounted, becomes Non-Performing Assets as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).

10.May 2019 Qn no 3(b) 4 Marks

Banks, because of certain characteristics, are distinguished from other commercial enterprises and hence it needs special audit consideration.

As an auditor of a bank, specify the various peculiarities which may necessitate special audit consideration to be taken care by you.

Answer

Special audit considerations arise in the audit of banks because of:

- (i) the particular nature of risks associated with the transactions undertaken;
- (ii) the scale of banking operations and the resultant significant exposures which can arise within short period of time;
- (iii) the extensive dependence on IT to process transactions;
- (iv) the effect of the statutory and regulatory requirements;
- (i) the continuing development of new products and services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices;

Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk.

The auditor should consider the effect of the above factors in designing his audit approach. It is imperative for Branch Auditor and Statutory Central auditor (SCAs) to have detailed knowledge of the products offered and risks associated with them, and appropriately address them in their audit plan to the extent they give rise to the risk of material misstatements in the financial statements.

In today's environment, the banks use different applications to carry out different transactions which may include data flow from one application to other application; the auditor while designing his plans should also understand interface controls between the various applications.

11.RTP Nov 2019 Qn no 19(b)

While auditing FAIR Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks.

Answer

Contingent Liabilities for Banks: The Third Schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet-

(A) Contingent liabilities

- (i) Claims against the bank not acknowledged as debts.
- (ii) Liability for partly paid investments.
- (iii) Liability on account of outstanding forward exchange contracts.

- (iv) Guarantees given on behalf of constituents-
 - (1) In India.
 - (2) Outside India.
 - (v) Acceptances, endorsements and other obligations.
 - (vi) Other items for which the bank is contingently liable.
- (B) Bills for collection.**

12.Nov 2019 Qn no 4(b) 5 Marks

You have been appointed as an auditor of LCO Bank, a nationalized bank. LCO Bank also deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over storage and issue of credit cards. How will you evaluate the Internal Control System in the area of Credit Card operations of a Bank?

Answer

Evaluation of the Internal Control System in the area of Credit Card Operations of a bank:

- (i) There should be **effective screening** of applications with reasonably good credit assessments.
- (ii) There should be strict control over **storage and issue of cards.**
 - There should be a system whereby a merchant confirms the status of **unutilised limit of a credit-card** holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder. There should be a system of **prompt reporting** by the merchants of all settlements accepted by them through credit cards.
 - **Reimbursement to merchants** should be made only after verification of the validity of merchant's acceptance of cards.
 - All the **reimbursement (gross of commission)** should be immediately charged to the customer's account.
 - There should be a system to ensure that **statements are sent regularly and promptly** to the customer.
 - There should be a system to **monitor and follow-up customers' payments.**
 - **Items overdue** beyond a reasonable period should be identified and attended to carefully. Credit should be stopped by informing the merchants through **periodic bulletins**, as early as possible, to avoid increased losses.

- There should be a system of **periodic review of credit card holders' accounts**. On this basis, the **limits of customers may be revised**, if necessary. The review should also include **determination of doubtful amounts and the provisioning in respect thereof**.

13.RTP May 2020 Qn no 14(a) (2)

The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.

Answers:

The Audit Programme to Verify Advances against Life Insurance Policies is as under-

- (i) The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer.
- (ii) The auditor should also examine whether premium has been paid on the policies and whether they are in force.
- (iii) Certificate regarding surrender value obtained from the insurer should be examined.
- (iv) The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value

Study Material

14.Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager:

- (a) **The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year.**
- (b) **The bank is a consortium member of Cash Credit Facilities of ` 50 crores to X Ltd. Bank's own share is ` 10 crores only. During the last two quarters against a debit of ` 1.75 crores towards interest the credits in X Ltd's account are to the tune of ` 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing.**

Answer

(a) It is not a prudent practice to treat dividend on shares of corporate bodies and units of mutual funds as income unless these are actually received. Accordingly, income from dividend on shares of corporate bodies and units of mutual funds should be booked on cash basis. In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced

regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government. Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This is also in accordance with AS 9 as well. In the instant case, therefore, the recognition of income by the bank on accrual basis is not in order.

- (b) The bank is a consortium member of cash credit facilities of ` 50 crores to X Ltd. Bank's own share is ` 10 crores only. During the last two quarters against a debit of 1.75 crores towards interest, the credits in X Ltd's account are to the tune of 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.

15. In course of audit of Good Samaritan Bank as at 31st March, 19 you observed the following:

- a) **In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government?**
- b) **The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.**

Answer

(a) Government Guaranteed Advance: If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

(b)The Audit Programme to Verify Advances against Life Insurance Policies is as under-

The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer

- (i) The auditor should also examine whether premium has been paid on the policies and whether they are in force.
- (ii) Certificate regarding surrender value obtained from the insurer should be examined.
- (iii) The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

16.As statutory central auditors of a Nationalized bank, what special points are to be borne in mind in the audit of compliance with "Statutory Liquidity Ratio" (SLR) requirements?

ANSWER:

SLR is the requirement that every scheduled commercial bank in India is required to maintain in the form of certain liquid assets such as gold, cash and government approved securities before providing credit to the customers. The Reserve Bank of India requires statutory central auditors of banks to verify the compliance with SLR requirements of 12 odd dates in different months of a fiscal year not being Fridays. The objective of maintaining SLR is to have an amount in the form of liquid assets which can be used to handle a sudden increase in demand for the amount from the depositors. The resultant report is to be sent to the top management of the bank and to the Reserve Bank.

Area of Focus	Suggested Audit Procedures
Compliance with CRR and SLR requirements	<ul style="list-style-type: none"> • Obtain an understanding of the relevant circulars/ instructions of the RBI, particularly regarding composition of items of DTL. • Request the branch auditors to send their weekly trial balance as on Friday and these are consolidated at the head office. Based on this consolidation, the DTL position is determined for every reporting Friday. The statutory central auditor should request the branch auditors to verify the correctness of the trial balances relevant to the dates selected by him/her. The branch auditors should also be • specifically requested to examine the cash balance at the branch on the selected dates. • Examine, on a test basis, the consolidations regarding DTL position prepared by the bank with reference to the related returns received from branches. The auditor should examine whether the

valuation of securities done by the bank is in accordance with the guidelines prescribed by the RBI.

- While examining the computation of DTL, specifically examine that the following items have been excluded from liabilities-
 - o Part amounts of recoveries from the borrowers in respect of debts considered bad and doubtful of recovery.
 - o Amounts received in Indian currency against import bills and held in sundry deposits pending receipts of final rates.
 - o Un-adjusted deposits/balances lying in link branches for agency business like dividend warrants, interest warrants, refund of application money, etc., in respect of shares/debentures to the extent of payment made by other branches but not adjusted by the link branches.
 - o Margins held and kept in sundry deposits for funded facilities.
- Similarly, specifically examine that the following items have been included in liabilities-
 - o Net credit balance in branch adjustment accounts including these relating to foreign branches.
 - o Interest on deposit as at the end of the first half year reversed in the beginning of the next half-year.
 - o Borrowings from abroad by banks in India needs to be considered as 'liabilities to other' and thus, needs to be considered at gross level unlike 'liabilities towards banking system in India', which are permitted to be netted off against 'assets towards banking system in India'. Thus, the adverse balances in Nostro Mirror Account needs to be considered as 'Liabilities to other'.
 - o The reconciliation of Nostro accounts (with Nostro Mirror Accounts) needs to be scrutinized carefully to analyze and ascertain if any inwards remittances are received on behalf of the customers / constituents of the bank and have remained unaccounted and / or any other debit (inward) entries have remained unaccounted and are pertaining to any liabilities for the bank.
- Examine whether the consolidations prepared by the bank include the relevant information in respect of all the branches.
- It may be noted that, even though interest accrues daily, it is recorded in the books only at periodic intervals. Thus, examine whether such interest accrued but not accounted for in books is included in the computation of DTL.
- The auditor at the central level should apply

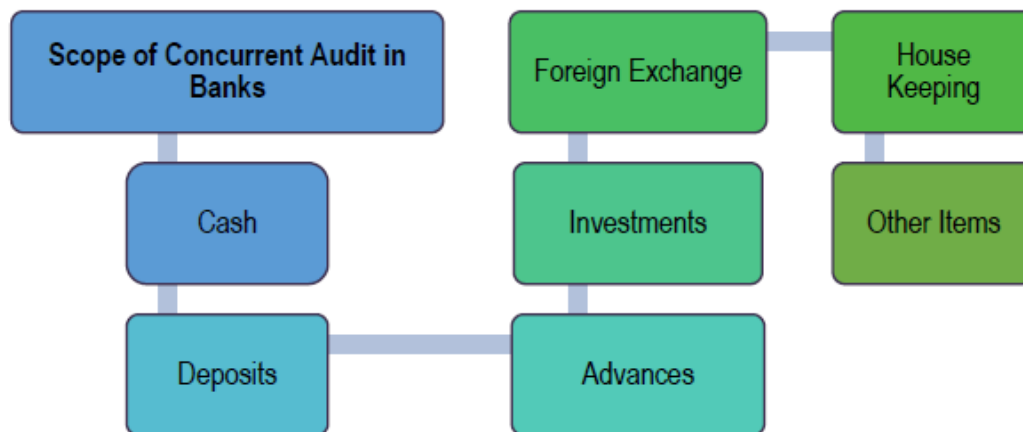
the audit procedures listed above to the overall consolidation prepared for the bank as a whole. Where such procedure is followed, the central auditor should adequately describe the same in the report.

- While reporting on compliance with SLR requirements, the auditor should specify the number of unaudited branches and state that he/she has relied on the returns received from the unaudited branches in forming an opinion. Recently, there has been introduction of Automated Data Flow (ADF) for CRR & SLR reporting and the auditors should develop necessary audit procedures around this.

17. Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India guidelines.

The detailed scope of the concurrent audit should be clearly and uniformly determined for the Bank as a whole by the Bank’s Inspector and Audit Department in consultation with the Bank’s Audit Committee of the Board of Directors (ACB). In determining the scope, importance should be given to checking high-risk transactions having large financial implications as opposed to transactions involving lesser amounts. The detailed scope of the concurrent audit may be determined and approved by the ACB.

Further, the guidelines issued by the RBI cover all the key areas of activities of the branch which is under concurrent audit. Most banks have prepared an Audit Manual for this purpose. Broadly stated, the following areas are covered by these guidelines:



18. You have been appointed as Concurrent Auditor of a nationalized bank branch. The main business at the branch is dealing in foreign exchange. Suggest the main areas of coverage with regard to foreign exchange transactions of the said branch under concurrent audit.

ANSWER:

Foreign Exchange

- Check foreign bills negotiated under letters of credit.
- Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.
- Check whether inward/outward remittance have been properly accounted for.
- Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorised and necessary charges have been recovered.
- Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.
- Ensure that the overbought/oversold position maintained in different currencies is reasonable, considering the foreign exchange operations.

19.ABC Bank had sanctioned credit limits of Rs.100 lakh to M/s Volkart Ltd on 1st September 2018. The renewal of limits was due on 1st September 2019. While doing the statutory branch audit for the year ended 31st March 2020, you find that the renewal has not been done even though 180 days are over. The bank says that the renewal process has been initiated on time and most of the document are received. The account is operated regularly and is in order; balance is maintained within drawing power. It also shows a letter from Volkart stating that due to a sudden death of their auditor, a new auditor had to be appointed. Procedure for appointment took some time and the new auditor was doing the audit all over again. The limit was not renewed till 31/3/2020. However, the audited financials are received on 10th April 2020 and the renewal letter was issued immediately. Your assistant is insisting that the account must be classified as NPA since the limit was not renewed as on 31/3/2020. What is your opinion?

ANSWER:

As per Guidelines of Reserve Bank of India the account should be classified as NPA if renewal is not done in 180 days. However, in the present case, operations in the account are excellent. The bank has shown a letter from that company that due to certain reasons the audited financial statements are delayed. Further, the limit has been renewed before signing the audit report. Thus, even if the sanction was issued after the balance sheet date, it relates to the position as on the balance sheet date. Therefore, it is an adjusting event under AS 4, Contingencies and Events Occurring After the Balance Sheet Date. It is also a matter of substance over form.

The auditor would consider classifying the account as a standard asset.

20. You are auditing a small bank branch with staff strength of the manager, cashier and three other staff S1, S2 and S3. Among allocation of work for other areas, S1 who is a peon also opens all the mail and forwards it to the concerned person. He does not have a signature book so as to check the signatures on important communications. S2 has possession of all bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.

ANSWER:

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

In the instant case, S1 who is a peon opens all the mail and forwards it to the concerned person. Further, he does not have a signature book so as to check the signatures on important communications is not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.

All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery. In the given case, S2 has possession of all bank forms (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis.

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

The auditor should report the same in his report accordingly.

Multiple Choice Question

You are the internal auditor of FCD Bank Limited for the year 2018-19 and the bank maintains all the data on computer. You are instructed by your senior to verify the loan against fixed deposits of the Navi Mumbai branch. As per the scope of audit, you need to ensure that proper lien has been marked on all the fixed deposits against which loan has been issued. Which of the following procedure you will follow for the same:

- (a) Ensure that all the fixed deposit receipts are attached along with the approved loan documents.
- (b) Ensure that all the fixed deposit receipts, against which the loan has been sanctioned, are discharged in favour of bank and check that the lien is marked in the computer software.
- (c) Discuss the process followed for lien marking with the branch manager.
- (d) Ensure that all the fixed deposit receipts, against which the loan has been sanctioned, are discharged in favour of bank, check that the lien is marked in

the computer software and the fixed deposit should be kept separately with the branch manager.

Answer: (b) Ensure that all the fixed deposit receipts, against which the loan has been sanctioned, are discharged in favour of bank and check that the lien is marked in the computer software

PFS Bank was engaged in the business of providing Portfolio Management Services to its customers, for which it took prior approval from RBI. Your firm has been appointed as the statutory auditors of the Bank's financial statements for the year 2018-19. Your senior has instructed you to verify the transactions of Portfolio Management Services (PMS). While verifying the transactions you noticed that the bank has not prepared separate record for PMS transactions from the Bank's own investments. As a statutory auditor what will be your decision for verification of PMS transactions?

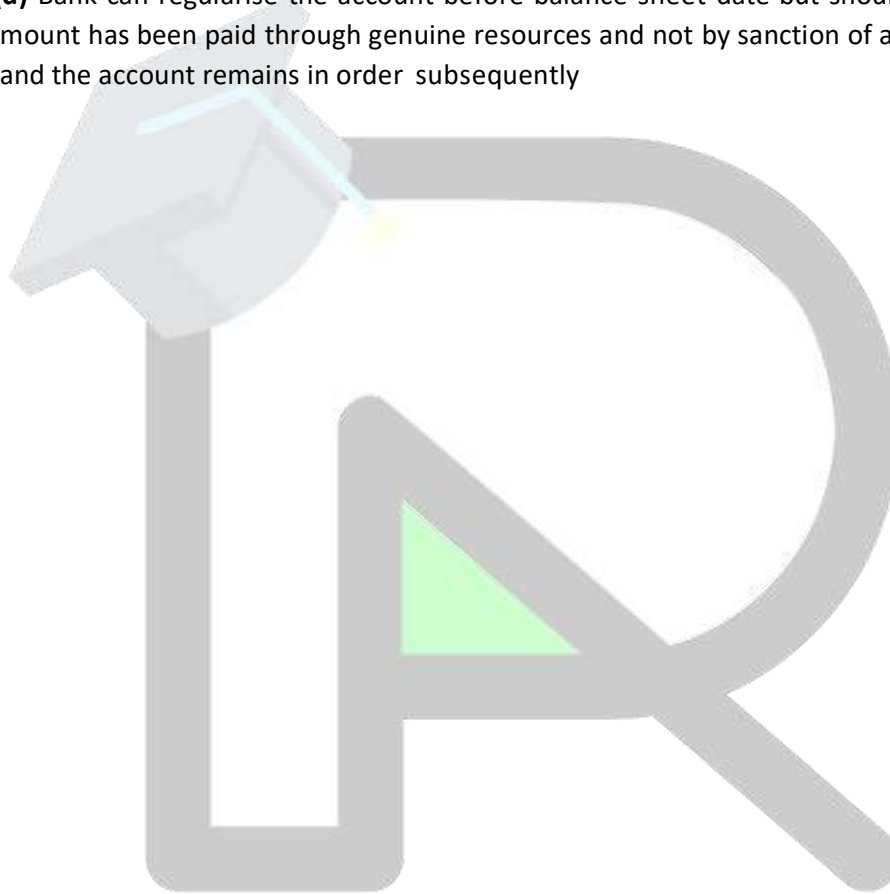
- a) It is not necessary to maintain separate records for PMS clients from Bank's own investments, so the auditor can verify the PMS transactions as part of investment verification for Bank's financial statements and submit the audit report accordingly.
- b) As per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions till the Bank segregates the transactions from its own investments.
- c) The auditor can give a qualified opinion in his audit report on the financial statements of the Bank and report the matter in special purpose certificate.
- d) Auditor should verify that PMS funds are not utilised for lending, inter-bank deposits or deposits to corporate bodies and bills re-discounting only. So, whether the PMS transactions are recorded separately or not will not matter for the auditor.

Answer: (b) As per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions till the Bank segregates the transactions from its own investments

Your firm has been appointed statutory auditor by a Nationalised Bank for the year 2018-19. Your senior advised you to check all the standard assets shown in the balance sheet as on 31st March 2019. While verification you observed that one of the accounts was regularised on 28th March 2019, for which the interest and instalment amount was overdue from the quarter ending 30th September 2018. The account was regularised after the repayment of overdue interest and instalment amounts was done on 26th March 2019. Only the last day of the financial year was reckoned as the date of account becoming NPA by the Bank. As a statutory auditor will you agree with the Bank's policy?

- a) As the interest charged in the account was overdue for more than 90 days from the end of quarter, it should be classified as NPA and should be considered as sub-standard asset for the balance sheet as on 31st March 2019.
- b) As the overdue interest and instalment amount was paid before the balance sheet date there is no reason to classify the account as NPA.
- c) The auditor should not agree with the Bank's policy to regularise the account before balance sheet date as overdue interest indicates more than normal risk attached to the business.
- d) Bank can regularise the account before balance sheet date but should ensure that the amount has been paid through genuine resources and not by sanction of additional facilities, and the account remains in order subsequently

Answer: (d) Bank can regularise the account before balance sheet date but should ensure that the amount has been paid through genuine resources and not by sanction of additional facilities, and the account remains in order subsequently



CHAPTER -10 Audit of Insurance Companies

Multiple Choice Questions

RTP Nov 2019 Qn no 9

NIC Ltd. is a large company engaged in the business of insurance for the last 9 years. The company has expanded its business considerably over the years and have set up various divisions across India.

The accounting and the operational systems of the company are centralized wherein the accounts of all the divisions, trial balances and their balance sheets are prepared by the Head Office. AJ & Co, a firm of Chartered Accountants, are the statutory auditors of this company and audit all the divisions and the head office. The auditors have completed the audit of the financial statements of the company for the year ended 31 March 2019 and the company's financial statements are approved.

Before the annual general meeting of the company, the company received a notice from the Insurance Regulatory and Development Authority of India (IRDAI) which has asked the company to respond within 7 days as to why this company breached the requirement of IRDAI guidelines by having a single auditor for all the divisions and head office.

The management of the company has been doing this over the years and were never aware of this requirement. To respond to this, the management has consulted many legal experts and also the auditors. They would also like to understand your views as to how to respond to IRDAI in this critical situation. Please advise carefully.

- (a) There has been breach of IRDAI guidelines and accordingly the management should respond.
- (b) The management can request IRDAI to consider relaxation in respect of this provision for the company for the current year as relaxation for the same is permissible.
- (c) The management should respond to IRDAI that this provision is applicable to a company only after 15 years of its existence and hence there is no breach of IRDAI guidelines.
- (d) The management should respond to IRDAI that this provision should have been ensured by the auditors only. Hence, they should not be held liable for this breach of provision of the IRDAI guidelines.

Answer: Option a

MTP Mar 2019 Qn no 6

Bajaj Allianz General Insurance Ltd. agreed to insure a large commercial client. Due to the size of this client's operations, there is the potential that it could suffer a substantial loss. It would be financially difficult for Bajaj Allianz to pay the entire claim itself. To spread this risk, Bajaj Allianz contacted Bharti AXA General Insurance to request that it cover a portion of the risk. Bharti AXA General Insurance agreed, but only on the condition that it receive a portion of the premium the client has paid to Bajaj Allianz General Insurance Ltd. The term that best describes this scenario is

- a. retention.
- b. reinsurance.
- c. loadings.
- d. casualty insurance.

Answer: (b) reinsurance.

1.May -2018 4 (c) 4 Marks

You are the Auditor of Good Luck General Insurance Company. You want to ensure that there exists good system that Effectively serves the requirements of true and fair accounting of claim-related expenses and liabilities. Suggest how this can be ensured.

ANSWER

Claims Provisions -The auditor should obtain from the divisions/branches, the information for each class of business, categorizing the claims value-wise before commencing verification of the claims provisions, so that appropriate statistical sampling techniques may be applied, to ensure that representative volume of claims is verified for each class of business. The auditor should determine the total number of documents to be checked giving due importance to claim provisions of higher value.

The outstanding liability at the year-end is determined at the divisions/branches where the liability originates for outstanding claims. Thereafter, based on the total consolidated figure for all the divisions/branches, the Head Office considers a further provision in respect of outstanding claims. The auditor should satisfy himself that the estimated liability provided for by the management is adequate with reference to the relevant claim files/dockets, keeping in view the following:

(i) that provision has been made for all unsettled claims as at the year-end on the basis of claims lodged/communicated by the parties against the company. The date of loss (and not the date of communication thereof) is important for recording/recognizing the claim as attributable to a particular year.

(ii) Insurance companies normally have an 'initial provision' or 'default provision' based on a pre-determined formula or on a primary assessment of the damage by a surveyor. The auditor would need to review the pre-determined formula to ensure that initial reserving made is adequate.

In certain circumstances, the claims are incurred by the insurance company but are not reported at the balance sheet date by the insured. Such claims are known as claims incurred but not reported (IBNR). The auditor should check the records for subsequent periods to ascertain that adequate provision has been created for such claims also.

(iii) that provision has been made for only such claims for which the company is legally liable, considering particularly, (a) that the risk was covered by the policy, if in force, and the claims arose during the currency of the policy; and (b) that claim did not arise during the period the company was not supposed to cover the risk, e.g., where the premium was not paid or where cheques covering premium have been dishonoured (refer section 64VB of the Insurance Act, 1938) or where a total loss under a policy has already been met/settled.

(iv) that the provision made is normally not in excess of the amount insured except in some categories of claims where matters may be sub-judice in legal proceedings which will determine the quantum of claim, the amount of provision should also include survey fee and other direct expenses.

(v) that in determining the amount of provision, events after the balance sheet date have been considered, e.g., (a) claims settled for a materially higher/lower amount in the post-audit period; (b) claims paid by other insurance companies during the year under audit and communicated to company after the balance sheet date where other companies are the leaders in co-insurance arrangements; and (c) further reports by surveyors or assessors & (d), re-insurance cover available is considered.

(vi) that the claims status reports recommended to be prepared by the Divisional Manager on large claims outstanding at the year-end have been reviewed with the contents of relevant files or dockets for determining excess/short provisions. The said report should be complete as to material facts to enable the auditor to take a fair view of the provision made.

(vii) that in determining the amount of provision, the 'average clause' has been applied in case of under-insurance by parties.

(viii) that the provision made is net of payments made 'on account' to the parties wherever such payments have been booked to claims.

(ix) that in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability.

(x) that wherever an unduly long time has elapsed after the filing of the claim and there has been no further communication and no litigation or arbitration dispute is involved, the reasons for carrying the provision have been ascertained.

(xi) that wherever legal advice has been sought or the claim is under litigation, the provision is made according to the legal advisor's view and differences, if any, are explained.

(xii) that in the case of amounts purely in the nature of deposits with courts or other authorities, adequate provision is made and deposits are stated separately as assets and provisions are not made net of such deposits.

(xiii) that no contingent liability is carried in respect of any claim intimated in respect of policies issued.

(xiv) that the claims are provided for net of estimated salvage, wherever applicable.

(xv) that intimation of loss is received within a reasonable time and reasons for undue delay in intimation are looked into.

(xvi) that provisions have been retained as at the yearend in respect of guarantees given by company to various Courts for claims under litigation.

(xvii) that due provision has been made in respect of claims lodged at any office of the company other than the one from where the policy was taken, e.g., a vehicle insured at Mumbai having met with an accident at Chennai necessitating claim intimation at one of the offices of the company at Chennai.

In cases of material differences in the liability estimated by the management and that which ought to be provided in the opinion of the auditor, the same must be brought out in the auditor's report after obtaining further information or explanation from the management. For determining the adequacy of the provisions in respect of any category of business, the auditor may resort to the method of testing the actual payments, wherever made, with the provisions made earlier for that category of business. Whether such liability has been estimated in the past on a fair and realistic basis can, thus, be examined by looking into current year's payments against provisions of the earlier year.

Claims Paid - The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows:

- (i) that in case of co-insurance arrangements, claims paid have been booked only in respect of company's share and the balance has been debited to other insurance companies;
- (ii) that in case of claims paid on the basis of advices from other insurance companies (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company. Such claims which have been communicated after the year-end for losses which occurred prior to the year-end must be accounted for in the year of audit;
- (iii) that the claims payments have been duly sanctioned by the authority concerned and the payments of the amounts are duly acknowledged by the claimants;
- (iv) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure;
- (v) that the amounts of the nature of pure advances/deposits with Courts, etc., in matters under litigation/arbitration have not been treated as claims paid but are held as assets till final disposal of such claims. In such cases, full provision should be made for outstanding claims;
- (vi) that payment made against claims partially settled have been duly vouched. In such cases, the sanctioning authority should be the same as the one which has powers in respect of the total claimed amount;
- (vii) that in case of final settlement of claims, the claimant has given an unqualified discharge note, not involving the company in any further liability in respect of the claim; and
- (viii) that the figures of claims, wherever communicated for the year by the Division to the Head Office for purposes of reinsurance claims, have been reconciled with the trial balance-figure.
- (ix) that payments have been made within 30 days of the receipt of the last document received. In case, there are delays, interest on such delays have to be paid as per IRDAI regulations.

- (x) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure.

2.RTP May 2018 Qn No.12

(a) Mr. Bhavya is appointed as an auditor of General Insurance Company limited. State the verification procedure to be followed by Mr. Bhavya in case of outstanding premium and agent's balances.

Answer

(a) General Insurance Company – Verification of Outstanding Premium and Agents' Balances: The following are the audit procedures to be followed for verification of outstanding premium and agents' balances:

- (i) Scrutinise and review control account debit balances and their nature should be enquired into.
- (ii) Examine inoperative balances and treatment given for old balances with reference to company rules.
- (iii) Enquire into the reasons for retaining the old balances.
- (iv) Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.
- (v) Check age-wise, sector-wise analysis of outstanding premium.
- (vi) Verify whether outstanding premiums have since been collected.
- (vii) Check the availability of adequate bank guarantee or premium deposit for outstanding premium.

3.MTP-OCT-18 Qn No 4(c) 5 Marks:

High Life Insurance is into life insurance business and has established presence in this field since last 25 years. Your firm, SR & Co. are appointed auditors of the High Life Insurance company. While conducting its audit, you come across several important actuarial processes being followed in accordance with general regulatory guidelines. You also understand & realise that the actuarial department is calculating and modelling hub of the company. In the above context explain the role of auditors.

RTP May 2018 Qn no 12

Briefly discuss the importance and role of auditor with respect to actuarial process for Life Insurance business

(b) Importance of Actuarial Process and Role of Auditor in case of Life Insurance Business :

Importance of Actuarial Process: Actuaries in Life Insurance business have gained tremendous importance. The role of Actuary in life insurance has shifted from supervising compliance to certify whether products and financial reports are in accordance with the general regulatory guidelines.

The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk. The actuarial department is calculating and modelling hub of the Company. Within the department fundamentals of Insurance business is determined from pricing to policy valuations techniques.

Role of Auditor: Auditors in the Audit report are required to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India in concurrence with the IRDA

Actuarial department broadly concentrates following key areas of Insurance business:

- Product Development/ Pricing and Experience analysis.
- Model Development.
- Statutory Valuations and reserving.
- Business Planning.
- Solvency management.
- Management reporting on various business valuations and profitability models of the Life Insurance business.

Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.

4.MTP Mar 2018 Qn 4(C) 4 Marks

As on 31st March 2017 while auditing Safe Insurance Ltd, you observed that a policy has been issued on 25th March 2017 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The company maintained that it is a usual practice in respect of big customers and the money was collected later on. As an auditor discuss the steps to be taken while verifying the Premium of Life Insurance Company

RTP Nov 18 QN no 12

Auditors should evaluate various sub-processes, employed by the Insurance Companies in accounting of premiums like collection of premium from the policy holders, booking of premium, banking, accounting and reconciliation of the same. In view of above, you are required to briefly discuss some illustrative points, auditors are required to follow during the Audit of Accounting of Premiums in case of Life Insurance Companies.

Answer

Collection of Premium:

- Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.
- Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.

Calculation of Premium:

- Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly.
- Check that system employed as such is equipped to calculate all types of premium modes correctly.

Recognition of Income:

- Check that premium is recognised only on the basis of 'Issued Policies' and not on underwriting dates.
- Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies.
- Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.

Accounting of 'Advance Premium':

- Check, whether system has capability to identify regular and advance premium.
- Check whether there is a process of applying advance premium to a contract when premium is due.

Reporting of Premium figures to IRDA/ Management:

- Check the methodology for generation of MIS from the system and there is no manual intervention.
- Check the procedure for Maker/ Checker before finalising the MIS.
- Check whether there is a reconciliation process between premium Income as per financials and as reported.

Other Areas:

- Check whether there are appropriate SOPs developed by the Companies and are strictly followed by all the departments/ branches of the Company.
- Ensure duly approved Delegation of Authority parameters matrix already in place for authorisation limits.
- Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel.
- Check that the Company conducts premium reconciliation on daily basis.
- Check the robustness of interface between administration and accounting system.

5.MTP Apr 18 Qn no 4 (C) 4 Marks

Girnar is appointed as an auditor of National Insurance Company limited. State the verification procedure to be followed by Mr. Girnar in case of Re-insurance outward.

Answer

Verification of Re-insurance Outward: The following steps may be taken by the auditor in the verification of re-insurance outward:

- (i) The auditor should verify that re-insurance underwriting returns received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims.
- (ii) The auditor should check whether the pattern of re-insurance underwriting for outward cessions fits within the parameters and guidelines applicable to the relevant year.
- (iii) The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk.
- (iv) The auditor should verify whether the cessions have been made as per the agreements entered into with various companies.
- (v) It should also be seen whether the outward remittances to foreign re-insurers have been done as per the foreign exchange regulations.
- (vi) It should also be seen whether the commission on cession has been calculated as per the terms of the agreement with the re-insurers.
- (vii) The auditor should verify the computation of profit commission for various automatic treaty arrangements in the light of the periodical accounts rendered and in relation to outstanding loss pertaining to the treaty.
- (viii) The auditor should examine whether the cash loss recoveries have been claimed and accounted on a regular basis.
- (ix) The auditor should also verify whether the Claims Paid item appears in Outstanding Claims list by error. This can be verified at least in respect of major claims.
- (x) He should see whether provisioning for outstanding losses recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified.
- (xi) Accounting aspects of the re-insurance cession premium, commission receivable, paid claims recovered, and outstanding losses recoverable on cessions have to be checked.
- (xii) The auditor should check percentage pattern of gross to net premium, claims paid and outstanding claims to ensure comparative justification.
- (xiii) The auditor should also check that the re-insurers balance on cessions and whether the sub ledger balances tallies with the general ledger

balances.

- (xiv) The auditor should review the individual accounts to find out whether any balance requires provisioning / write off or write back.
- (xv) He should verify whether the balances with re-insurers are supported by necessary confirmation obtained from them.
- (xvi) He should verify whether opening outstanding claims not paid during the year find place in the closing outstanding claims vis-a-vis the reinsurance inwards outstanding losses recoverable on cessions appears in both opening and closing list. If not, the reason for the same should be analysed.
- (xvii) Any major event after the Balance Sheet date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re - insurance balances will need to be brought out suitably.

6.MTP-Aug-18 Qn No 4(C) 4 Marks:

While auditing Secure Insurance Ltd., you observed that the major proportion of expense of the company is the remuneration/commission paid to its insurance agents. As the auditor of the company, what audit procedure would you adopt for verification of such expense?

Nov 18 Qn no 4(c) 4 Marks

You have been appointed to carry out the audit of Sky Insurance Company Ltd. for the year 2017-18. In the course of your audit, you observed that the commission paid to agents constituted a major expense in operating expenses of the Company. Enumerate the audit concerns that address to the assertions required for the Auditor to ensure the continued existence of internal control as well as fairness of the amounts in accounting of commission paid to agents.

Commission: The commission is the consideration payable for getting the insurance business. The term 'commission' is used for the payment of consideration to get Direct business. Commission received on amount of premium paid to a re-insurer is termed 'Commission on reinsurance accepted' and is reduced from the amount of commission expenditure. The internal control with regard to commission is aimed at ensuring that commission is paid in accordance with the rules and regulations of the company and in accordance with the agreement with the agent, commission is paid to the agent who brought the business and the legal compliances, for example, tax deduction at sources, GST on reverse charge mechanism and provisions of the Insurance Act, 1938 have been complied with.

Role of Auditor: The auditor should, inter alia, do the following for verification of commission:

- Ensure that commission is not paid in excess of the limits specified by

IRDAI

- Ensure that commission is paid as per rates with the agent and rates filed with IRDAI
- Ensure that commission is paid to the agent/broker who has solicited the business
- Ensure that the agent is not blacklisted by IRDAI and is not terminated for fraud etc.
- Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.
- Check whether the vouchers are authorized by the officers-in-charge as per rules in force and income tax is deducted at source, as applicable.
- Test check correctness of amounts of commission allowed.
- Scrutinize agents' ledger and the balances, examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.
- Check whether commission outgo for the period under audit been duly accounted.

7.RTP May 2019 Qn no 20

As at 31st March 2018 while auditing Safe Insurance Ltd, you observed that a policy has been issued on 25th March 2018 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The company maintained that it is a usual practice in respect of big customers and the money was collected on 5th April, 2018. You further noticed that there was a fire accident in the premises of the insured on 31st March 2018 and a claim was lodged for the same. The insurance company also made a provision for claim. Please advise.

Answer

Provision for Claim: No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

8.May 2019 Qn no 6(b) 4 Marks

You have been appointed as an auditor of ABC Insurance Co. Ltd. and found that M/s PQR Ltd. got their Plant & Machinery insured on 01-10-2018 but the amount of premium has been paid by them on 15-10-2018. In the meanwhile, on 10-10-2018 a fire has broken out in the factory and the company filed a claim for damages of plant & machinery with the Insurance company. Advise the insurance company in this regard.

Answer

No Risk Assumption without Premium: No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co- insurance premium.

Therefore, in the instant case, PQR Ltd. signed the insurance documents on 01.10.2018 but did not paid the premium. In case of non-payment of insurance premium if any accidental incident occurs insurance company will have no liability to pay claim. In the given case, fire is occurred on 10th October, 2018 in factory and premium has been paid on 15 October 2018, the ABC Insurance Company Ltd. will not be liable for claim for damages of plant and machinery.

9.RTP Nov 2019 Qn no 25(c)

Auditor's considerations while reviewing of Investment Department of Life Insurance Company.

Answer

Role of Auditor: The Auditor during his review of Investment Department of Life Insurance Company should mainly consider the following:

- Review the Investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office.
- Review of insurer's Standard Operating Procedures which are prescribed by the
- IRDA Regulations and are required to cover the entire gamut of investment related processes and policies.
- Review of insurer's Investment policy.
- Review of functioning and scope and minutes of Investment Committee.
- Compliance of all Investment regulations, various other

circulars specified by IRDA and other regulations specified in the Insurance Act, 1938.

- Review of insurer's Disaster Recovery, Backup and Contingency Plan.
- Review of access Controls, authorization process for Orders and Deal execution, etc.
- Review of insurer's Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer's system should be able to determine the amount of Investible surplus.
- Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments.
- Review of fund wise reconciliation with Investment Accounts, Bank, and Custodian records.
- Ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life (Participating & Non-Participating), Pension & Group (Participating & Non-Participating) and Unit Linked Fund.
- Review the arrangements and reconciliations of holdings with the insurer's custodian.
- Review and check insurer's Investment Accounting and valuation policy and the controls around this process.
- Insurer's risk management policies and processes to manage investment risk such as Market risk, Liquidity risk, Settlement risks, etc.
- Determine the extent of activities outsourced and the controls over such activities.
- Controls over NAV computation and declaration.
- Controls over various system interfaces such as Seamless integration of data, between front office and back office, in the Investments accounting system.
- Flow of data from PMS to the Investment Accounting system.

- ❑ Controls around personal dealings, insider trading and front running.

10.RTP May 2020 Qn no 14(b)

Amrapali & Co., Chartered Accountants are the Auditors of Natural Care General Insurance Company Limited. As on March 31, 2019 the Management made a provision for claims outstanding. Enumerate the steps to be taken by the Auditor while verifying the "Claims Provision".

Answer:

Verification of "Claims Provision" in the Case of a General Insurance Company: The outstanding liability at the year-end is determined at the divisions/branches where the liability originates for outstanding claims. Thereafter, based on the total consolidated figure for all the divisions/branches, the Head Office considers a further provision in respect of outstanding claims. The auditor should satisfy himself that the estimated liability provided for by the management is adequate with reference to the relevant claim files/dockets, keeping in view the following:

- (i) that provision has been made for all unsettled claims as at the year-end on the basis of claims lodged/communicated by the parties against the company. The date of loss (and not the date of communication thereof) is important for recording/ recognizing the claim as attributable to a particular year.
- (ii) that provision has been made for only such claims for which the company is legally liable, considering particularly, (a) that the risk was covered by the policy, if in force, and the claims arose during the currency of the policy; and (b) that claim did not arise during the period the company was not supposed to cover the risk.
- (iii) that the provision made is normally not in excess of the amount insured except in some categories of claims where matters may be sub-judice in legal proceedings which will determine the quantum of claim, the amount of provision should also include survey fee and other direct expenses.
- (iv) that in determining the amount of provision, events after the balance sheet date have been considered.
- (v) that the claims status reports recommended to be prepared by the Divisional Manager on large claims outstanding at the year-end have been reviewed with the contents of relevant files or dockets for determining excess/short provisions.
- (vi) that in determining the amount of provision, the 'average clause' has been applied in case of under-insurance by parties.
- (vii) that the provision made is net of payments made 'on account' to the parties wherever such payments have been booked to claims.
- (viii) that in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability.
- (ix) that wherever an unduly long time has elapsed after the filing of the claim and there has been no further communication and no litigation or

arbitration dispute is involved, the reasons for carrying the provision have been ascertained.

- (x) that wherever legal advice has been sought or the claim is under litigation, the provisions is made according to the legal advisor's view and differences, if any, are explained.
- (xi) that in the case of amounts purely in the nature of deposits with courts or other authorities, adequate provision is made and deposits are stated separately as assets and provisions are not made net of such deposits.
- (xii) that no contingent liability is carried in respect of any claim intimated in respect of policies issued.
- (xiii) that the claims are provided for net of estimated salvage, wherever applicable.
- (xiv) that intimation of loss is received within a reasonable time and reasons for undue delay in intimation are looked into.
- (xv) that provisions have been retained as at the year-end in respect of guarantees given by company to various Courts for claims under litigation.
- (xvi) that due provision has been made in respect of claims lodged at any office of the company other than the one from where the policy was taken, e.g., a vehicle insured at Mumbai having met with an accident at Chennai necessitating claim intimation at one of the offices of the company at Chennai.

In cases of material differences in the liability estimated by the management and that which ought to be provided in the opinion of the auditor, the same must be brought out in the auditor's report after obtaining further information or explanation from the management.

Study Material

11.As at 31st March 2020 while auditing Safe Insurance Ltd, you observed that a policy has been issued on 25th March 2020 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The company maintained that it is a usual practice in respect of big customers and the money was collected on 5th April, 2019. You further noticed that there was a fire accident in the premises of the insured on 31st March 2019 and a claim was lodged for the same. The insurance company also made a provision for claim. Please respond

Answer

Provision for Claim: No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed

manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business,

premium received from reinsurance business and the share of co-insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

12. What are the steps to be taken while verifying the Premium of (a) General Insurance Company; and (b) Life Insurance Company?

(i) Before commencing verification of premium income, the auditor should look into the internal controls and compliance thereof as laid down for collection and recording of the premiums.

(ii) The auditor should broadly review the systems used by the company to collect money, underwrite and issue the policy. Insurance companies use varied and complex IT systems for risk assessment, policy issuance, premium receipting and accounting. Hence, it is essential for the auditor to understand the overall system architecture and specifically the data flow from one system to the other.

(iii) The auditor should ascertain that all the cover notes (for motor business) relating to the risks assumed have been serially numbered for each class of business. The auditor should also verify that there is an adequate internal check on the issue of stationery comprising of cover notes, policy documents, stamps, etc. The auditor may apply sampling techniques for verification of larger volume of transactions.

(iv) The auditor should ensure that premium in respect of risks incepting during the relevant accounting year has been accounted as premium income of that year on the basis of premium revenue recognition. The auditor, as part of his audit procedures, should make an assessment of the reasonability of the risk pattern established by the management. The auditor should also see whether the premium received during the year but pertaining to risk commencing in the following year has been accounted for under the head 'Premium Received in Advance' and has been disclosed separately. Normally, such instances relate to the issue of cover notes and certificates at the end of the accounting year relating to risks commencing in the next accounting period. Generally, there is a column in the Premium Register called "Commencement of Risk", indicating the date and time from which the risk under the policy issued has commenced. The auditor should verify that policy documents have not been issued, in case:

- (a) premium had not been collected at all;
- (b) premium had been collected but the relevant cheques have been dishonoured; (refer Cheque Dishonoured Book);
- (c) premium had not immediately been collected due to furnishing of a bank guarantee or cash deposit but either the deposit or guarantee had fallen short or has expired or the premium had been collected beyond the stipulated time limit (i.e., there is a shortfall in bank guarantee account or cash deposit account of the insured);
- (d) premium had not been collected due to risk cover being increased or where stipulated limits have been exhausted in respect of open declaration policies (i.e., where premium has accrued but has not been received); and
- (e) instalments of premium have not been collected in time in respect of certain categories of policies, e.g., marine-cum-erection policies where facility has been granted for premium being paid in instalments (such facility is normally available

(vi) The auditor should verify the collections lodged by agents after the balance sheet date to

see whether any collection pertains to risk commencing for the year under audit. The auditor should also check that the premium has been recorded originally at the gross figure, i.e., without providing for unexpired risks and reinsurances.

(vii) In case of co-insurance business, where the company is not the leader, because of the non-availability of the relevant information in many cases the premium is not booked even though the risk has commenced during the relevant accounting year. The auditor should see that the company's

share of the premium has been accounted for on the basis of the available information on nature of risk and the provisional premium charged by the leading insurer. The auditor should examine the communications issued to the company by the leading insurers advising them of the company's share of premium income. Such communications should be seen even in respect of the post-audit period. Where the company is the leader, the auditor should obtain a reasonable assurance that only the company's own share of premium has been shown as income and accounts of the other companies have been credited with their share of the premium collected.

(viii) The auditor should check whether Premium Registers have been maintained chronologically, for each underwriting department, giving full particulars including service tax charged as per acceptance advice on a day-to-day basis. The auditor should verify whether the figures of premium mentioned in the register tally with those in General Ledger.

(xi) Where policies have been issued with a provision to collect premium periodically (i.e., under instalment clause, special declaration policy or periodical declaration under open policies in marine insurance), the auditor should check whether premium are collected as and when they become due.

(x) The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit. Also examine whether instalments of premium falling due in the subsequent year have not been recognised in the accounts as outstanding premium.

(xi) The auditor should verify the year end transactions to check that amounts received during the year in respect of risks commencing/ instalments falling due on or after the first day of next financial year are not credited to premium account but credited to Premium Received in Advance Account.

(xii) The auditor should verify the collections remitted by agents immediately after the cut-off date to verify the risk assumed during the year under audit on those collections.

(xiii) The auditor should also check that in case of cancellation of policies/cover notes issued, no risk has been assumed between the date of issue and subsequent cancellation thereof.

(xiv) Where premium originally received has been refunded, the auditor should verify whether the agency commission paid on such premium has been recovered.

(xv) The auditor should verify whether GST has been charged from the insured, at the rates in force, on the total premium for all classes of business other than those exempted under service tax laws. Check whether GST so collected is disclosed under

'Current Liabilities' to the extent not deposited in Government's Account.

(xvi) In the case of co-insurance business, the auditor should verify whether GST at the rates in force, based on the place of business and place of delivery on the whole premium has been charged or collected from the insured by the company in case it is the leader.

Check that GST/service tax so collected on premium charged from the insured by the company have been regularly deposited in the Government's Account.

(xvii) The auditor should also check that money collected by the agents from the policyholders have been received by the company as quickly as possible.

(xviii) The auditor should also check whether the bank guarantees against which policies are issued are valid and there is a tracking mechanism of the amounts of policies issued against the guarantees.

12. Enumerate the steps to be taken by an auditor for the verification of Re-insurance outward by a General Insurance Company.

The following steps may be taken by the auditor in the verification of re-insurance outward:

(i) The auditor should verify that re-insurance underwriting returns received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims.

(ii) The auditor should check whether the pattern of re-insurance underwriting for outward cessions fits within the parameters and guidelines applicable to the relevant year.

(iii) The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk.

(iv) The auditor should verify whether the cessions have been made as per the agreements entered into with various companies.

(v) It should also be seen whether the outward remittances to foreign re-insurers have been done as per the foreign exchange regulations.

(vi) It should also be seen whether the commission on cession has been calculated as per the terms of the agreement with the re-insurers.

(vii) The auditor should verify the computation of profit commission for various automatic treaty arrangements in the light of the periodical accounts rendered and in relation to outstanding loss pertaining to the treaty.

(viii) The auditor should examine whether the cash loss recoveries have been claimed and accounted on a regular basis.

(ix) The auditor should also verify whether the Claims Paid item appears in Outstanding Claims list by error. This can be verified at least in respect of major claims.

(x) He should see whether provisioning for outstanding losses recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified.

(xi) Accounting aspects of the re-insurance cession premium, commission receivable, paid claims recovered, and outstanding losses recoverable on cessions have to be checked.

(xii) The auditor should check percentage pattern of gross to net premium, claims paid and outstanding claims to ensure comparative justification.

(xiii) The auditor should also check that the re-insurers balance on cessions and whether the sub ledger balances tallies with the general ledger balances.

(xiv) The auditor should review the individual accounts to find out whether any balance requires provisioning / write off or write back.

- (xv) He should verify whether the balances with re-insurers are supported by necessary confirmation obtained from them.
- (xvi) He should verify whether opening outstanding claims not paid during the year find place in the closing outstanding claims vis-a-vis the reinsurance inwards outstanding losses recoverable on cessions appears in both opening and closing list. If not, the reason for the same should be analysed.
- (xvii) Any major event after the Balance Sheet date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re-insurance balances will need to be brought out suitably.

13.State the procedure for verification of Agents' Balances in the course of audit of a General Insurance Company.

ANSWER:

Outstanding Premium and Agents' Balances: The following are the audit procedures to be followed for verification of outstanding premium and agents' balances:

- (i) Inquire reasons for long outstanding credit balances in outstanding premium accounts and examine the reasons for policies not being issued or the outstanding premium not adjusted against amounts due.
- (ii) Scrutinise and review control account debit balances and their nature should be enquired into.
- (iii) Examine inoperative balances and treatment given for old balances with reference to company rules.
- (iv) Enquire into the reasons for retaining the old balances.
- (v) Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.
- (vi) Check age-wise, sector-wise analysis of outstanding premium.
- (vii) Verify whether outstanding premiums have since been collected.
- (viii) Check the availability of adequate bank guarantee or premium deposit for outstanding premium.

14.ABC & Co., Chartered Accountants are the Auditors of Just Care Life Insurance Company Limited. Enumerate the steps to be taken by the auditor while verifying the "Investment".

ANSWER:

The Auditor during his review of Investment Department should mainly consider the following:

- Review the Investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office;
- Review of insurer's Standard Operating Procedures which are prescribed by the IRDA Regulations and are required to cover the entire gamut of investment related processes and policies;
- Review of insurer's Investment policy;
- Review of functioning and scope and minutes of Investment Committee;
- Compliance of all Investment regulations, various other circulars specified by IRDAI and other regulations specified in the Insurance Act, 1938;
- Review of insurer's Disaster Recovery, Backup and Contingency Plan ;
- Review of access Controls, authorization process for Orders and Deal execution, etc.;

---Review of insurer's Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer's system should be able to determine the amount of Investible surplus;

---Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments;

---Review of fund wise reconciliation with Investment Accounts, Bank, and Custodian records ;

---Ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life (Participating & Non-Participating), Pension & Group (Participating & Non-Participating) and Unit Linked Fund;

---Review the arrangements and reconciliations of holdings with the insurer's custodian;

---Review and check insurer's Investment Accounting and valuation policy and the controls around this process; insurer's risk management policies and processes to manage investment risk such as M2Qarket risk, Liquidity risk, Settlement risks, etc.;

---Determine the extent of activities outsourced and the controls over such activities;

---Controls over NAV computation and declaration;

---Controls over various system interfaces such as Seamless integration of data, between front office and back office, in the Investments accounting system;

---Flow of data from PMS to the Investment Accounting system;

Controls around personal dealings, insider trading and front running.

15. Briefly explain the term policy lapse and revival in case of Life Insurance Company and role of auditor in verifying the same.

ANSWER:

Policy Lapse and Revival: "Lapse" is the discontinuance of the policy owing to non-payment of premium dues. The term "lapse" is not defined in the insurance legislation, except stating that "a policy which has acquired a surrender value shall be kept alive to the extent of the paid-up sum assured" - vide section 113(2) of the Insurance Act, 1938.

In order to keep a life insurance policy "in force" the policy holder is required to pay premiums when due (either monthly/ quarterly/annual/bi-annual). If payment is missed, the insurer allows a period of 15/30 days from the premium due date for making the payment. This period is termed as "grace period". If the policy holder does not make the payment within the grace period, the policy gets "lapsed". Thus, a payment within the grace period is deemed to be a payment on the due date.

Lapsation affects all the stakeholders – the policy holder, agents and the insurer. A lapsed policy ceases to provide insurance protection to the insured. It forfeits the benefits under the policy and cost of new policy is higher. Agents do not get renewal premium commission if the policy is lapsed.

The terms and conditions of the policy stipulate, that where the premium is not paid within the grace period, the policy lapses but may be revived during the life time of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy and that it would be better to take out a fresh policy.

The insurer should have taken persistent measures for monitoring receipt of renewal premium within the due dates. In case of most of insurers, policy lapsation is tracked over the PMS, wherein premium due dates are monitored by the system once initial data of the policy is entered in the system.

Role of Auditor: The primary objective of the audit is to check and confirm that due dates are recorded and monitored properly and policies are marked as “lapsed” on non-receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy.

16. You have been appointed to carry out the audit of Sky Insurance Company Ltd. for the year 2019-20. In the course of your audit, you observed that the commission paid to agents constituted a major expense in operating expenses of the Company. Enumerate the audit concerns that address the assertions required for the Auditor to ensure the continued existence of internal control as well as fairness of the amounts in accounting of commission paid to agents.

ANSWER:

Role of Auditor: The auditor should, inter alia, do the following for verification of commission: Ensure that commission/brokerage is not paid in excess of the limits specified by IRDAI
Ensure that commission/brokerage is paid as per rates with the agent and rates filed with IRDAI
Ensure that commission/brokerage is paid to the agent/broker who has solicited the business
Ensure that the agent/broker is not blacklisted by IRDAI and is not terminated for fraud etc.
Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.
Check whether the vouchers are authorised by the officers-in-charge as per rules in force and income tax is deducted at source, as applicable.
Test check correctness of amounts of commission allowed.
Scrutinise agents’ ledger and the balances, examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.
Check whether commission outgo for the period under audit been duly accounted.

17. Your audit assistant seeks your help in checking the claim liability of Bharat Insurance Co. Ltd. and wants to know the registers and records which they should obtain and review in this regard.

ANSWER:

Claims: A demand for payment of policy benefit because of the occurrence of an insured event is known as ‘claim’. Claims in general insurance business are primarily in the nature of indemnity i.e. re-imbursing the loss incurred to the policy holder. Cost of claims to the company includes all the expenses incurred in settlement of claims. Internal controls are established over claims to ensure that only bonafide claims are paid and that claims paid do not exceed the value of loss incurred and/r do not exceed the sum insured. Cost of claims are properly recorded and disclosed in the financial statements.

The components of the cost of claims to an insurer comprise the claims under policies and claim settlement costs. Claims under policies comprise the claims paid for losses incurred, and those estimated or anticipated claims pending settlements under the policies. Settlement cost of claims includes surveyor fee, legal expenses, etc. A liability for outstanding claims should be brought to account on the following:

The liability includes future payments in relation to unpaid reported claims and claims incurred but not reported including inadequate reserves which would result in future cash or asset outgo for settling liabilities against those claims. Change in estimated liability represents the difference between the estimated liabilities for outstanding claims in respect of claims under policies, whether due or intimated at the beginning and at the end of the financial period. The accounting estimate also includes claims cost adjusted for salvage value if there is sufficient degree of certainty of its realisation.

Registers and Records -The following register and records are generally prepared in respect of claims:
(i) Claims Intimation Register;
(ii) Claims Paid Register;
(iii) Claims Disbursement Bank Book;
(iv) Claims Dockets, normally containing the following records: Claim intimation, claim form, particulars of policy, survey report, Photograph showing damage, repairer’s bills, letter of subrogation, police report (in case of theft), fire service report, claim settlement note, claim satisfaction note, salvage report, salvage disposal note, claims discharge voucher, etc.;
(v) Report of quality assurance team; and
(vi) Salvage register.

18.As an auditor of Life Insurance Company, how will you verify the ‘Commission Payable’ to its Agents?

ANSWER:

Commission payable to Agent: Insurance business is generally solicited by the Insurance agents. The remuneration of agent is paid by way of commission which is calculated by applying percentage to premium collected by him. Agency commission contributes towards significant portion of expenses incurred by the Insurance Commission.

Commission is payable towards generation of new business and towards settlement of renewal premium Role of Auditor: The Auditor during his review of Commission paid to Agents should mainly consider the following:

Review the system established by the Insurer with respect to calculation of commission to eligible agents accurately and processing the same in timely manner.

Review the commission payment system is in sync with the premium collection system.

Check whether commission paid is within the limit prescribed under Insurance Act.

Check whether commission is clawed-back on the cancelled policies.

Check the completeness of commission processing system.

19.What is the ‘Actuarial Process’ in Life Insurance Business and what is the role of Auditor with respect to the same?

ANSWER:

Actuarial Process: Actuaries in Life Insurance business have gained tremendous importance. The role of Actuary in life insurance has shifted from supervising compliance to certify whether products and financial reports are in accordance with the general regulatory guidelines.

The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk. The actuarial department is calculating and modelling hub of the Company. Within the department fundamentals of Insurance business is determined from pricing to policy valuations techniques.

Role of Auditor: Auditors in the Audit report are required to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India in concurrence with the IRDA.

Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities. Actuarial department broadly concentrates following key areas of Insurance business:

- Product Development/ Pricing and Experience analysis.
- Model Development.
- Statutory Valuations and reserving.
- Business Planning.
- Solvency management.
- Management reporting on various business valuations and profitability models of the Life Insurance business.

Multiple Choice Question

KIC Ltd is a company engaged in the business of general insurance and has been in existence for over 15 years. The company has a subsidiary company, PIC Ltd, which is also engaged in the business of insurance other than general insurance.

The previous statutory auditors of PIC Ltd have completed their tenure as an auditor and accordingly have resigned and the management of PIC Ltd is looking for new statutory auditors.

KB & Associates, a firm of Chartered Accountants, have vast experience of audit of insurance companies and would like to get appointed as auditor of PIC Ltd. KB & Associates is a large firm and have also employed experts – engineers, valuers, lawyers for various client services. The firm is evaluating as to what should be the criteria for get appointed as auditors of PIC Ltd because in the past they have audited only the holding companies and considering a subsidiary company for the first time

In this context, please help the firm by answering which of the following options would be correct?

- The firm should be appointed by the Board of Directors of PIC Ltd and should ensure that they don't take up audit of more than 2 insurance companies.
- The firm should be appointed by the Comptroller and Auditor General of India and should ensure that they don't take up audit of more than 3 insurance companies.
- The firm cannot take audit of PIC Ltd because they have employed experts which is not permitted by the IRDAI Guidelines.
- The firm can take up audit of PIC Ltd by ensuring that they are eligible to be appointed as per the criteria laid down in the Companies Act 2013 for audit of subsidiary companies and they would need to submit a certificate in this respect to the ICAI.

Answer: (b) The firm should be appointed by the Comptroller and Auditor General of India

and should ensure that they don't take up audit of more than 3 insurance companies.

NIC Pvt Ltd is a large private company engaged in the business of insurance for the last 9 years. The company has expanded its business considerably over the years and have set up various divisions across India.

The accounting and the operational systems of the company are centralized wherein the accounts of all the divisions, trial balances and their balance sheets are prepared by the Head Office. AJ & Co, a firm of Chartered Accountants, are the statutory auditors of this company and audit all the divisions and the head office. The auditors have completed the audit of the financial statements of the company for the year ended 31 March 2019 and the company's financial statements are approved.

Before the annual general meeting of the company, the company received a notice from the Insurance Regulatory and Development Authority of India (IRDAI) which has asked the company to respond within 7 days as to why this company breached the requirement of IRDAI guidelines by having a single auditor for all the divisions and head office.

The management of the company has been doing this over the years and were never aware of this requirement. To respond to this, the management has consulted many legal experts and also the auditors. They would also like to understand your views as to how to respond to IRDAI in this critical situation. Please advise carefully.

- a) There has been no breach of IRDAI guidelines and accordingly the management should respond.
- b) The management should request IRDAI to consider relaxation in respect of this provision for the company for the current year as the audit is completed and it would be practically very difficult to complete the entire process within the required timelines.
- c) The management should respond to IRDAI that this provision is applicable to a company only after 15 years of its existence and hence there is no breach of IRDAI guidelines.
- d) The management should respond to IRDAI that this provision should have been ensured by the auditors and hence they should be held liable for this breach of provision of the IRDAI guidelines.

Answer: (a) There has been no breach of IRDAI guidelines and accordingly the management should respond

BIC Ltd is an insurance company looking to expand their operations in the Northern India. The company's operations have been considerable in the Southern India and its head office is also based at Chennai.

The company had strong processes and controls from its starting days and have appointed consultants over the years to ensure their operative effectiveness at various points of time. Shivam Ltd exercises significant influence over BIC Ltd and the financial statements of Shivam Ltd are prepared as per Ind AS (Indian Accounting Standards) and audited by Shubham & Associates. Advik & Associates are the statutory auditors of BIC Ltd. For the financial year ended 31 March 2019, BIC Ltd also requested Advik & Associates to certify the Investment Risk Management Systems and Processes of BIC Ltd as per discussions with Shivam Ltd.

Advik & Associates completed this task and also submitted the required certificate which

the management has submitted to the required authorities.

After submission, BIC Ltd received notice from the Insurance Regulatory and Development Authority of India (IRDAI) that the company has not complied the provisions in respect of submission of certificate.

The company discussed this matter with Shivam Ltd and would also like to have your views on this.

- a) BIC Ltd, being an associate of a company and because of the fact that Ind AS is applicable on Shivam Ltd, should have appointed another firm of Chartered Accountants along with Advik & Associates for this certification work.
- b) BIC Ltd should have got this certification work done from their internal auditors as per the required provisions of IRDAI.
- c) BIC Ltd should not have got this certification work done from their statutory auditors.
- d) The certification work should have been done by Shubham & Associates.

Answer: (c) BIC Ltd should not have got this certification work done from their statutory auditors

An Indian insurance company in the name of Trust Life Limited was carrying on life insurance business with paid-up capital of ` 250 crores. The Company appointed Mr. Vineet, as its statutory auditor for the year 2018-19. The auditor verified the investments of the company in terms of title, acquisition or disposal, safeguard etc. In the financial statements of the company the investments were classified in terms of portfolio maintained with central, state or any other notified investment. The auditor mentioned in the report that the company has complied with the guidelines of the IRDAI. The shareholders raised an objection that the audit report is incomplete as the financial statements don't give the classification of investments as percentage of total investments in Housing Projects or Infrastructural Projects as per IRDA (Investment) Regulations. Is it necessary for the auditor to verify and give the details in audit report for investments made in Housing or Infrastructural Projects?

- a) As per IRDA (Investment) Regulations if the auditor has classified the investments made by the company on the basis of investments with central, state or any other notified investment, there is no need to verify in terms of Housing or Infrastructural Projects.
- b) The auditor has to verify only the valuation of investments and appropriateness of the method of accounting policy followed.
- c) The auditor is required to give classification of investments on the basis of investments in Housing Projects or Infrastructural Projects as, according to IRDAI guidelines the insurance company carrying on life insurance business shall invest a minimum of 5% of investment Assets in Housing Project.
- d) The auditor is required to ensure compliance with the guidelines of IRDAI and accounting policy followed for valuation of investments.

As the auditor mentioned in the report that the company has complied with the guidelines of the IRDAI it is complete and no other disclosure is required from the auditor.

Answer: (d) The auditor is required to ensure compliance with the guidelines of IRDAI and accounting policy followed for valuation of investments. As the auditor mentioned in the report that the company has complied with the guidelines of the IRDAI it is complete and no other disclosure is required from the auditor.

KJLIC Ltd is a life insurance company. The company is based at Nagpur and has offices across Western India.

KJ & Associates are the statutory auditors of this company. At the time of audit of this company, areas like cash and bank, receipts and payment and fixed assets where the internal controls of the management are similar to the ones adopted by other companies are dealt by the auditors as per the publications on the Internal Control Questionnaire, published by the Institute of Chartered Accountants of India (ICAI). Since various operational cycles are inter-linked, the internal controls operating within the systems of such cycles are reviewed simultaneously by the auditors. The company avails services of an actuary for computing various liabilities and provisions which are certified by the actuary.

During the audit of the financial statements for the financial year ended 31 March 2019, the auditors of the company would like to have a discussion with the actuary who has given actuarial certificate on the basis of which certain liabilities have been recorded in the financial statements, however, the actuary and the management of the company are not comfortable with this and they have asked the auditor to complete their work on the basis of certificate. Further the management also provides management representation letter in respect of all of these points.

Please suggest if you were the auditors of this company, how would you have handled this matter?

- a) The management is correct and as an auditor getting certificate would be a good audit evidence.
- b) The management is not correct and the auditor may have discussions with the actuary.
- c) The auditor is not correct because the IRDAI Guidelines require the actuary to maintain confidentiality and by having such discussion it would be a non-compliance. Auditors should be aware of such legal requirements.
- d) The auditor is not correct because such requirements require approval of the Insurance Regulatory and Development Authority of India (IRDA) and that would unnecessarily delay the completion of audit.

Answer: (b) The management is not correct and the auditor may have discussions with the actuary.

CHAPTER 11 Audit of Non Banking Financial Companies

MULTIPLE CHOICE QUESTIONS

MTP Mar 2019 QN no 9 (1 Mark)

Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation (DICGC) is :

- (a) Not available to depositors of NBFCs
- (b) Available to depositors of NBFCs
- (c) Available to depositors of Banks
- (d) Not available to depositors of both NBFCs and banks

Answer: (a) Not available to depositors of NBFCs

MTP Oct 2019 QN no 5 (1 Mark)

CER Ltd is a non-banking financial company and has been operating for the last 10 years. The company is duly registered as per the requirements of the Reserve Bank of India. The company's assets base has been very strong over the years due to its efficient management function. The company is also planning to get listed for which required work is going on.

For the financial year ended 31 March 2019, the company has closed its books of accounts and prepared the financial statements for the purpose of statutory audit in a timely manner. The auditors of the company have started their fieldwork. It has been observed by the auditors that the company's various term loans which have been given to various parties have become overdue in terms of instalment including interest for a period of 5 months. As per the auditors these term loans should be considered by the company for making provision at the rate of 20% of total outstanding amount, however, the management has considered a provision at the rate of 0.30%. Please advise the auditors and the management regarding this matter considering that "Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016" are applicable to this NBFC.

- (a) Provision should be made at 10%.
- (b) Provision should be made 0.30%
- (c) Provision should be made at 20%.
- (d) Provision should be made at 0.40%

Answer: a) Provision should be made at 10%.

RTP Nov 2019 Qn no 4

Yuvraj Ltd. is a non-banking financial company other than Nidhi company and is covered under "Master Direction - Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016". The NBFC has been in existence for the last 11 years and its operations are considerable in size having a net worth of ` 299 crores. The NBFC has new statutory auditors for the financial year ended 31

March 2019. The audit report (including CARO) of the NBFC was clean for the financial year ended 31 March 2018. The company had a planning discussion with the auditors of the company for the financial year ended 31 March 2019 who raised a point regarding the applicability of new set of accounting standards, Indian Accounting Standards (Ind AS), on the NBFC for the financial year ended 31 March 2019 and have asked the management to ensure that its financial statements should be according to that. This comes as a big surprise to the management who had assessed that Ind AS would not be applicable to this NBFC because of the fact that CARO is applicable on this NBFC. There is a big disconnect on this matter between the auditor and the management. Please help by resolving this matter.

- (A) Both the management and statutory auditors are not correct because Ind AS is not applicable to any NBFC covered under “Master Direction - Non-Banking Financial Companies Auditor’s Report (Reserve Bank) Directions, 2016”.
- (B) Management is correct because Ind AS is only applicable to NBFC which are also a Nidhi company. In this case, CARO being applicable Ind AS cannot apply to this NBFC.
- (C) If the management does not agree with the view of statutory auditors then they should give adverse opinion in their report and also report this to RBI.
- (D) Ind AS would not be applicable for financial year ended 31 March 2019 and hence the view of statutory auditors is not correct.

Answer: Option D Ind AS would not be applicable for financial year ended 31 March 2019 and hence the view of statutory auditors is not correct.

MTP Oct 2019 QN no 8 (1 Mark)

50:50 test determination is popularly used in

- (a) Banking Company
- (b) Insurance Company
- (c) NBFC Company
- (d) Stock Trading Company

Answer: Option (c) NBFC Company

Descriptive Questions

RTP May 2018 Qn no.13

1. In the case of companies carrying on the business of a non-banking financial institution, the auditor needs to report under CARO, 2016 whether the registration has been obtained under section 45-IA of the Reserve Bank of India Act, 1934, if required.

You are required to state in brief the audit procedure to be followed while reporting under above mentioned circumstances.

ANSWER

Reporting under CARO, 2016 for Registration under RBI Act, 1934: As per Clause (xvi) of paragraph 3 of the CARO, 2016, the auditor is required to report whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934. If so, whether the registration has been obtained.

Audit Procedures and Reporting-

- (i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
- (ii) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
- (iii) Whether the company has net owned funds as required for the registration as NBFC.
- (iv) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.
- (v) The auditor should report incorporating the following
 - Whether the registration is required under section 45- IA of the RBI act,1934
 - If so whether it has obtained the registration
 - If the registration is not obtained, the reasons thereof.

RTP May 2019 Qn no 20(d)

2. Write short note on the Classification of Frauds by NBFC

Answer

Classification of Frauds by NBFC: In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

- (i) Misappropriation and criminal breach of trust.
- (ii) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- (iii) Unauthorised credit facilities extended for reward or for illegal gratification.
- (iv) Negligence and cash shortages.
- (v) Cheating and forgery.
- (vi) Irregularities in foreign exchange transactions.

(vii) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

- (i) cases of cash shortages more than Rs.10,000/- and
- (ii) cases of cash shortages more than Rs.5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the prescribed format and procedures.

3.MTP-OCT-19 Qn No 4(a) 6 Marks:

Aviral & Co LLP are the auditors of NBFC (Investment and Credit Company). In this context, please explain what verification procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC).

RTP Nov 2019 Qn no 20

Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC).

Answer

Some points that may be covered in the audit of NBFC - Investment and Credit Company (NBFC-ICC):

- i. Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- ii. Verify whether the NBFC has not advanced any loans against the security of its own shares.
- iii. Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the

same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.

- iv. Test check bills/contract notes received from brokers with reference to the prices vis- à-vis the stock market quotations on the respective dates.
- v. Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.
- vi. Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
- vii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- viii. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- ix. An auditor will have to ascertain whether the requirements of AS 13 “Accounting for Investments” or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- x. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- xi. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).
- xii. Verify charges received or paid in respect of securities lend/borrowed.
- xiii. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
- xiv. An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of

security, interest, terms of repayment, etc.

- xv. An auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which an advance could be considered realisable.
- xvi. Obtain balance confirmations from the concerned parties.
- xvii. As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscouted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.
- xviii. Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.
- xix. An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.
- xx. Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

(Note: The above checklist is not exhaustive. It is only illustrative. There could be various other audit procedures which may be performed for audit of an NBFC.)

4.Nov 2019 Qn no 4(a) 5 Marks.RTP May 2020 Qn no 20(C)

Mr. G. has been appointed as an auditor of LMP Ltd., a NBFC company registered with RBI. Mr. G is concerned about whether the format of financial statements prepared by LMP Ltd. is as per notification issued by the Ministry of Corporate Affairs (MCA) dated October 11, 2018. The notification prescribed the format in Division III under Schedule III of the Companies Act, 2013 applicable to NBFCs complying with Ind-AS. Mr. G wants to know the differences in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Help Mr. G.

Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind-AS- NBFCs) of Schedule III –The Ministry of Corporate Affairs (MCA) vide notification dated October 11, 2018 introduced Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs

complying with Ind- AS has been prescribed.

The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

- NBFCs have been allowed to present the items of the balance sheet in **order of their liquidity** which is not allowed to companies required to follow Division II, Additionally, NBFCs are required to classify items of the balance sheet into **financial and non-financial** whereas other companies are required to classify the items into **current and non-current**.
- An NBFC is required to separately disclose by way of a **note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income** . Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds **1 per cent of the revenue from operations or . 10 lakhs, whichever is higher**.
- NBFCs are required to separately disclose under **'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member**.
- NBFCs are also required to disclose items comprising **'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of as part of the notes**.

Study Material

1. Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the requirements related to registration and regulation of NBFCs which an auditor needs to keep in his mind while planning the audit of NBFC which would help this firm.

Answer

An auditor should know following points regarding registration and regulation of NBFCs: Under Section 45-IA of the RBI Act, 1934, no NBFC shall commence or carry on the business of a non-banking financial institution without

- obtaining a certificate of registration issued by the RBI; and
- having a net owned fund (NOF) of ` 25 lakhs (₹ Two crore since April 1999) not exceeding two hundred lakhs rupees, as the RBI may, by notification in the Official Gazette, specify.

(The RBI (Amendment) Act (1997) provided an entry point norm of ` 25 lakh as the minimum NOF which was revised upwards to ` 2 crore for new NBFCs seeking grant of certificate of registration (CoR) on or after 21 April 1999).

[Upper limit in relation to NOF requirement for commencing NBFC business has been increased from ` 2 crores to ` 100 crores as per Finance (No.2) Bill 2019].

A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45-IA of the RBI Act, 1934 can apply to the RBI in prescribed form along with necessary documents for registration. The RBI issues CoR after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.

However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock Broking Companies registered with SEBI, Insurance Company holding a valid CoR issued by IRDA, Nidhi Companies as notified under Section 406 of the Companies Act, 2013, Chit Companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank.

The RBI has issued directions to NBFCs on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.

Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders.

2. Define NBFC. Also give a brief description about types of NBFCs covering any five NBFCs

ANSWER:

Definition of NBFC:

45 I(f) of Reserve Bank of India (Amendment) Act, 1997 defines a non-banking financial company as:

- (i) A financial institution which is a company;
- (ii) A non-banking institution which is a company a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) Such other non-banking institution or class of such institutions, as the as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;”

Types of NBFCs- Compliance and Regulatory Perspective:

In terms of the Section 45-I(f) read with Section 45-I (c) of the RBI Act, 1934, as amended in 1997, non-banking financial company (NBFC) is a company registered under the Act, engaged in the business of loans and advances, acquisition of shares/stocks/bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing,

hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

3. Satyam Pvt Ltd is a company engaged in trading activities, it also has made investments in shares of other Companies and advanced loans to group companies amounting to more than 50% of its total assets. However, trading income constitutes majority of its total income. Whether the Company is an NBFC?

ANSWER:

In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by Reserve Bank of India.

In the given case, though Satyam Pvt Ltd is fulfilling the criteria on the asset side, but however is not fulfilling the criteria on the income side, the company cannot be classified as a deemed NBFC.

4. You are appointed as the auditor of a NBFC registered with the RBI and which is accepting and holding public deposits. You are considering your reporting requirement in addition to your report made under Section 143 of the Companies Act, 2013 on the accounts of this NBFC as per the prescribed Directions. Please explain what points are required to be known in respect of separate report to be given by you to the Board of Directors of this NBFC.

ANSWER:

Material to be included in the Auditor's report to the Board of Directors:
The auditor's report on the accounts of a non-banking financial company shall include a statement on the following matters, namely –

(A) In the case of all non-banking financial companies: I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-

banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the RBI's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI. II. In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year. III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016. Note: Every non-banking financial company shall submit a Certificate from its Statutory Auditor that it is engaged in the business of non-banking financial institution requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act and is eligible to hold it. A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, within one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year. The format of Statutory Auditor's Certificate (SAC) to be submitted by NBFCs has been issued vide DNBS. PPD.02/66.15.001/2016-17 Master Direction- Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016.

(B) In the case of a non-banking financial companies accepting/holding public deposits

Apart from the matters enumerated in (A) above, the auditor shall include a statement on the following matters, namely-

(i) Whether the public deposits accepted by the company together with other borrowings indicated below viz.

(a) from public by issue of unsecured non-convertible debentures/bonds;

- (b) from its shareholders (if it is a public limited company); and
- (c) which are not excluded from the definition of 'public deposit' in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, are within the limits admissible to the company as per the provisions of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;
- (ii) Whether the public deposits held by the company in excess of the quantum of such deposits permissible to it under the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are regularised in the manner provided in the said Directions;
- (iii) Whether the non-banking financial company is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency as per the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;
- (iv) Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein;
- (v) In respect of non-banking financial companies referred to in clause (iii) above,
- (a) whether the credit rating, for each of the fixed deposits schemes that has been assigned by one of the Credit Rating Agencies listed in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 is in force; and
- (b) whether the aggregate amount of deposits outstanding as at any point during the year has exceeded the limit specified by the such Credit Rating Agency;
- (vi) Whether the company has violated any restriction on acceptance of public deposit as provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(vii) Whether the company has defaulted in paying to its depositors the interest and /or principal amount of the deposits after such interest and/or principal became due;

(viii) Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/investments as specified in the Directions issued by the Bank in terms of the Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016;

(ix) Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-IB of the RBI Act and whether the details of the designated bank in which the approved securities are held is communicated to the office concerned of the RBI in terms of NBS 3; Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;

(x) Whether the company has furnished to the RBI within the stipulated period the return on deposits as specified in the NBS 1 to – Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;

(xi) Whether the company has furnished to the RBI within the stipulated period the quarterly return on prudential norms as specified in the Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;

(xii) Whether, in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/offices or in the case of appointment of agent, the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

(C) In the case of a non-banking financial company not accepting public deposits Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matters, namely: - (i) Whether the Board of Directors has passed a resolution for non-acceptance of any public deposits; (ii) Whether the company has accepted any public deposits during the relevant period/year; (iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of

Non- Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016; (iv) In respect of Systemically Important Non-deposit taking NBFCs as defined in Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016: (a) Whether the capital adequacy ratio as disclosed in the return submitted to the RBI in form NBS - 7, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the RBI; (b) Whether the company has furnished to the RBI the annual statement of capital funds, risk assets/exposures and risk asset ratio (NBS-7) within the stipulated period. (v) whether the non-banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI) as defined in the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

(D) In the case of a company engaged in the business of non-banking financial institution not required to hold CoR subject to certain conditions

Apart from the matters enumerated in (A)(I) above where a company has obtained a specific advice from the RBI that it is not required to hold CoR from the RBI, the auditor shall include a statement that the company is complying with the conditions stipulated as advised by the RBI.

(4) Reasons to be stated for unfavourable or qualified statements: Where, in the auditor's report, the statement regarding any of the items referred to in paragraph 3 above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred to in paragraph 3 above, his report shall indicate such fact together with reasons therefor.

5. Kamna & Co LLP, a firm of Chartered Accountants, was appointed as auditor of an NBFC. The audit work has been completed. The audit team which was involved in the fieldwork came across various observations during the course of audit of this NBFC and have also limited understanding about the exceptions which are required to be reported in the audit report. They would like to understand in detail regarding the obligations on the part of an auditor in respect of exceptions in his report so that they can conclude their work. Please explain.

ANSWER:

Obligation of auditor to submit an exception report to the RBI

(I) Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is unfavorable or qualified, or in the opinion of the auditor the company has not complied with: (a) the provisions of Chapter III B of RBI Act (Act 2 of 1934); or (b) Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or (c) Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016. It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016. (II) The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

6. Karma Pvt Ltd is a Non-Deposit Taking Non-Systemically Important NBFC registered with Reserve Bank of India. The Statutory Auditor of the company is required to give a report to the Board of Directors. What shall be the content of the Auditor's Report to the Board.

ANSWER:

The statutory auditor of Karma Pvt Ltd, being a Non-Deposit Taking Non-Systemically Important NBFC is required to submit separate report to the Board of Directors on the matters as specified as below:

I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the RBI's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI.

II. In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.

III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

Apart from the aspects enumerated above, the auditor shall include a statement on the following matters, namely: -

- (i) Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;
- (ii) Whether the company has accepted any public deposits during the relevant period/year;
- (iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016;

Where, in the auditor's report, the statement regarding any of the items referred to matters specified above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred above, his report shall indicate such fact together with reasons thereof.

7. Krishna Pvt Ltd is primarily into the business of selling computer parts. However, the company is fulfilling the Principal Business Criteria as at the balance sheet date i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50% of Gross Income. What shall be the obligation of the Statutory Auditor in such a scenario?

ANSWER:

In the given case, Krishna Pvt Ltd is fulfilling the Principal Business Criteria i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50 % of Gross Income. The company which fulfils both these criteria shall qualify as an NBFC and hence is required to obtain Certificate of Registration (CoR) with Reserve Bank of India. In such a scenario, the statutory auditor has an obligation to submit exception report to the RBI on the following matters :

- (I) Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 of the Non-Banking Financial Companies Auditor's Report

(Reserve Bank) Directions, 2016, is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:

- (a) the provisions of Chapter III B of RBI Act (Act 2 of 1934); or
- (b) Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
- (c) Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

(II) The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

Multiple Choice Question

RCE Ltd was set up under the Companies Act 2013 and got itself registered as non-banking financial company with the Reserve Bank of India, fulfilling the required criteria. During the financial year ended 31 March 2019, the company's operations have started. The company's total assets were rupees 298 crores out of which trade receivables, loans receivable in cash, cash and bank balances comprised of rupees 199 crores. During the financial year ended 31 March 2019, the company's operations generated total income of rupees 99.50 crores. The management also did an assessment and observed that income from its financial assets was not much during the year and amounted to only rupees 60 crores. The management is looking at various alternatives to improve its operations, if required, to generate better income in the coming years. Further, the company during the year also accepted and gave demand deposits which have been very efficient for the company. Management has a plan to significantly increase these deposits in the next 2 years as that would help in the overall functioning of the company.

In the context of the above, please answer which of the following options would be correct.

- (a) The company does not meet the criteria of financial assets and hence would not be considered as NBFC. Further, it cannot accept and give demand deposits and the same thing should be reported by the statutory auditors of the company.
- (b) The company does not meet the criteria of income and hence would not be considered as NBFC. Further, it cannot accept and give

demand deposits and the same thing should be reported by the statutory auditors of the company.

- (c) The company meets the criteria of financial assets and income. An NBFC can only accept demand deposits but cannot give demand deposits. Hence in this case, the statutory auditors should report regarding the same.
- (d) The company meets the criteria of financial assets and income. An NBFC can only give demand deposits but it cannot accept demand deposits. Hence in this case, the statutory auditors should report regarding this matter.

Answer: (d) The company meets the criteria of financial assets and income. An NBFC can only give demand deposits but it cannot accept demand deposits. Hence in this case, the statutory auditors should report regarding this matter.

CER Ltd is a non-banking financial company and has been operating for the last 10 years. The company is duly registered as per the requirements of the Reserve Bank of India. The company's assets base has been very strong over the years due to its efficient management function. The company is also planning to get listed for which required work is going on.

For the financial year ended 31 March 2019, the company has closed its books of accounts and prepared the financial statements for the purpose of statutory audit in a timely manner. The auditors of the company have started their fieldwork. It has been observed by the auditors that the company's various term loans which have been given to various parties have become overdue in terms of instalment including interest for a period of 5 months. As per the auditors these terms loans should be considered by the company for making provision at the rate of 20% of total outstanding amount, however, the management has considered a provision at the rate of 0.30%. Please advise the auditors and the management regarding this

matter considering that "Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016" are applicable to this NBFC.

- a) Provision should be made at 10%.
- b) Provision should be made 0.30%
- c) Provision should be made at 20%.
- d) Provision should be made at 0.40%

Answer: (a) Provision should be made at 10%.

CRE Ltd is a non-banking financial company and registered with the Reserve Bank of India as per the requirements of Section 45-IA of the Reserve Bank of India Act, 1934. The company was established with a net owned fund of Rs. 2 crores. The company's management had a great focus on the internal controls and processes. To make them robust, in the initial years of set up of the company, the management involved consultants who helped the management in setting up those processes and controls. The company's operations have grown considerably over the years and their assets base is huge.

The management has in-house function which reviews these processes regularly and any improvements required are actioned upon in no time.

With this kind of set up, the management was assured of the functioning of the NBFC as per right principles, however, despite this during the year ended 31 March 2019, the management came across instance of fraudulent encashment through forged instruments and fictitious accounts involving an amount of Rs. 5 lakhs. Though the amount was not significant but still the management discussed the same with the statutory auditors for their knowledge.

The statutory auditors after discussion told the management that the management needs to report this matter to RBI with which the management is not comfortable considering the amount involved in this matter and the size of the company.

- a) Management need not report this matter considering the nature of fraud.
- b) Management need not report this matter considering the amount involved.
- c) Management should report this matter to RBI.
- d) Management should not report this to RBI, however, it will be their responsibility to report this matter to SEBI.

Answer: (C) Management should report this matter to RBI

NBB Ltd is a non-banking financial company on which provisions of "Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016" are applicable. The company has been accepting as well as holding the public deposits. During the financial year ended 31 March 2017, the company obtained specified credit rating for its fixed deposits from CRISIL. However, during the financial year ended 31 March 2018, the company obtained minimum investment grade for its fixed deposits from ICRA Ltd. During the financial year ended 31 March 2019, no such grade/ rating was obtained. The reports of the statutory auditors for the past years have always been clean.

The statutory auditors of NBB Ltd have completed their audit for the financial year ended 31 March 2019 as well and finalizing their audit report. The auditors discussed with the management that for the financial year ended 31 March 2019, they would have to include matter regarding acceptance of public deposits by the company without obtained required specified credit rating during the year ended 31 March 2019. The auditors further explained that even during the year ended 31 March 2018, instead of specified credit rating, the management obtained minimum investment grade which was ignored by them but it cannot continue for 2 years. The management is of the view that this requirement was fulfilled as the same was obtained in the previous year and for one year if that is not taken then it should be fine. Please advise how to deal with this matter.

- a) It would have been fine if the rating was obtained in the financial year ended 31 March 2018 instead of minimum investment grade. Hence the auditor should report this matter.
- b) It does not make any difference whether rating or grade was obtained. Moreover the same should have been obtained in the current year also and hence the auditor should report this matter.
- c) It does not make any difference whether rating or grade was obtained. And hence management is correct that only upto last year it was obtained and hence no reporting is required by the the auditor on this matter.
- d) If the rating was not obtained in the previous year, it requires that NBFC obtains rating in the current year twice i.e. every half year. Accordingly, it should be reported by the auditor.

Answer: (b) It does not make any difference whether rating or grade was obtained. Moreover the same should have been obtained in the current year also and hence the auditor should report this matter.

Kshitij Ltd is a non-banking financial company other than Nidhi company and is covered under “Master Direction - Non-Banking Financial Companies Auditor’s Report (Reserve Bank) Directions, 2016”. The NBFC has been in existence for the last 11 years and its operations are considerable in size having a net worth of ` 299 crores.

The NBFC has new statutory auditors for the financial year ended 31 March 2019. The audit report (including CARO) of the NBFC was clean for the financial year ended 31 March 2018. The company had a planning discussion with the auditors of the company for the financial year ended 31 March 2019 who raised a point

regarding the applicability of new set of accounting standards, Indian Accounting Standards (Ind AS), on the NBFC for the financial year ended 31 March 2019 and have asked the management to ensure that its financial statements should be according to that. This comes as a big surprise to the management who had assessed that Ind AS would not be applicable to this NBFC because of the fact that CARO is applicable on this NBFC. There is a big disconnect on this matter between the auditor and the management. Please help by resolving this matter.

- a) Both the management and statutory auditors are not correct because Ind AS is not applicable to any NBFC covered under “Master Direction - Non-Banking Financial Companies Auditor’s Report (Reserve Bank) Directions, 2016”.
- b) Management is correct because Ind AS is only applicable to NBFC which are also a Nidhi company. In this case, CARO being applicable, Ind AS cannot apply to this NBFC.
- c) If the management does not agree with the view of statutory auditors then they should give adverse opinion in their report and also report this to RBI.
- d) Ind AS would not be applicable for financial year ended 31 March 2019 and hence the view of statutory auditors is not correct

Answer: (d) Ind AS would not be applicable for financial year ended 31 March 2019 and hence the view of statutory auditors is not correct

CHAPTER -12 Audit under Fiscal Laws

Multiple Choice Questions

MTP Mar 2019 Qn no 4 (1 Mark)

Following are the registered persons under GST Act, 2017. Which one of the registered person is required to get his accounts audited and also furnish a copy of audited annual accounts and a reconciliation statement, duly certified in FORM GSTR –9C?

- a) Mr. A is an advocate whose turnover for the financial year ended 31 March

- 2018 was Rs.1.25 crores.
- b) Mr. B is a labour contractor managing construction services and his turnover for 31 March 2018 was Rs.3.95 crores.
 - c) Dr. C is a pediatric surgeon who has newly set up his practice in Pune. He paid an amount of Rs.10.5 lakhs as taxes in the current year.
 - d) Mr. D who is an architect has paid taxes of Rs.22.5 lakhs in the current year.

Answer: (b) Mr. B is a labour contractor managing construction services and his turnover for 31 March 2018 was Rs.3.95 crores.

MTP Mar 2019 Qn no 5 (1 Mark)

As an auditor appointed under section 44AB of the Income Tax Act, 1961, under which clause of Form 3CD, you will report for amounts deemed to be profits and gains under section 32AC, 33AB or 33ABA or 33AC

- (a) clause 24
- (b) clause 40
- (c) clauses 31
- (d) clause 23

Answer:(a) clause 24

MTP Apr 2019 QN no 3 (1 Mark)

MNC Ltd., India is subsidiary of MNC Inc, US. LLP & Associates has been appointed by MNC Ltd. for audit of statutory financial statements. MNP & Associates has been appointed as the auditors of the Reporting package of MNC Ltd. prepared for the year ended 31 March which is required for consolidation purposes. MNP & Associates are also the tax auditors of MNC Ltd. What should be format for reporting of MNP & Associates on Form 3CD of MNC Ltd.?

- (a) MNC Ltd. should report as per the internal formats of the firm.
- (b) MNC Ltd. should report as per the formats issued as per ICDS (Income Computation and Disclosure Standards).
- (c) MNC Ltd. should report as per Form 3CB.
- (d) MNC Ltd. should report as per Form 3 CA.

Answer: Option (d) MNC Ltd. should report as per Form 3 CA

RTP May 2019 Qn no 1

AJ & Co LLP is a firm of Chartered Accountants. The firm has 10 Partners. The firm has a good portfolio of clients for statutory audits but the same clients had some other firms as their tax auditors. In the current year (FY 2018-19), many existing clients for whom AJ & Co LLP happens to be the statutory auditor have requested the firm to carry out their tax audits as well. The firm is expecting the no of tax audits to increase significantly this year. One of the partners of the firm has also

raised a point that the firm can accept tax audits up to a maximum limit. However, other partners are of the strong view that limits on audits is applicable in case of statutory audits and not for tax audits. This needs to be decided as soon as possible so that the appointment formalities can also be completed.

You are requested to advise the firm in this matter.

- a) There is no limit on no of tax audits in case of LLP.
- b) All the partners of the firm can collectively sign 450 tax audit reports.
- c) All the partners of the firm can collectively sign 600 tax audit reports.
- d) All the partners of the firm can collectively sign 450 tax audit reports. However, one partner can individually sign maximum 60 tax audit reports.

Answer : Option C

RTP Nov 2019 QN no 8

AOP Pvt. Ltd. is currently engaged in closing its books of accounts for the financial year ended 31 March 2019. The company has always been a compliance-savvy and has also engaged consultants for the same. The business of the company has been stable over the years and profitability has been good over the last 3 years.

The company got registered for GST on time. Since registration the company has been filing statement of returns in GSTR 3B. However, Annual Return in GSTR 9 has not been filed by the company.

Proper Officer issued a notice for failure to file Annual Return within 15 days. Even then, no Annual Return was filed by the company within the time permitted. Please advise.

- (a) In such a case, the company becomes a 'non-filer'.
- (b) In such a case, the company would remain fully compliant.
- (c) The Proper Officer would be required to discuss this matter with the GST auditors of the company.
- (d) GST auditor may resign in this situation.

Answer: Option a In such a case, the company becomes a 'non-filer'.

MTP Oct 2019 QN no 4 1 Mark

Rajeev Ltd is a listed company having business of production of motion pictures. For the year ended 31 March 2018, the company wanted to appoint GST auditor. For the purpose, somebody who is familiar with the business of the company/industry was to be preferred for appointment i.e. who would have worked with the company in the past to avoid efforts/ duplication in terms of providing the information to get the GST audit completed. The company had following options for the same. Please advise.

- (a) Internal auditors can be appointed for this work.
- (b) Both statutory and internal auditors can be jointly appointed for this work.

- (c) Internal auditors along with the tax consultants of the company can be appointed for this work.
- (d) Statutory auditors can be appointed for this work.

Answer: (d) Statutory auditors can be appointed for this work.

1.May 2018 – 2 (b) 5 Marks

ABC Ltd., is consistently following Accounting Standards as required under section 133 of the Companies Act, 2013. During your tax audit under section 44AB of the Income Tax Act, 1961, the Board of Directors informed you that profits of the Company is properly arrived at and the Accounting Standards applicable to it have been followed consistently and as such, there need not be any adjustments to be made as per Income Computation and Disclosure Standards notified under section 145 of Income Tax Act, 1961. Based on the requirements of Law in this regard, examine the validity of the stand of Management in this regard.

ANSWER

Income Computation and Disclosure Standards (ICDS): Section 145 of the Income Tax Act, 1961 deals with the Method of Accounting: Under section 145(1), income chargeable under the heads “Profits and gains of business or profession” or “Income from other sources” shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

Further, **Section 145(2)** empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessee or in respect of any class of income.

Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be **followed by all assesses** (other than an individual or a HUF who is not required to get his accounts of one previous year audited in accordance with the provisions of section 44AB), following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head “Profit and gains of business or profession” or “Income from other sources”. from the A.Y. 2017-18.

In the instant case, ABC Ltd. is consistently following Accounting Standards in compliance with section 133 of the Companies Act, 2013 but not complying with the provisions of Income Computation and Disclosure Standards notified under section 145 of the Income Tax Act, 1961. Contention of the management that they are following Accounting Standards and need not to make any adjustments as per ICDS, is not correct. Thus, ABC Ltd. is required to adjust the profits in compliance with ICDS.

2.MTP-Mar-19 Qn No 5(c) 6 Marks:, RTP May 2018 Qn no 14(a)

Concession Ltd. is engaged in the business of manufacturing of threads. The

company recorded the turnover of ` 1.13 crore during the financial year 2017-18 before adjusting the following:

Discount allowed in the Sales Invoice	`8,20,000
Cash discount (other than allowed in Cash memo/ sales invoice)	`9,20,000
Trade discount	`2,90,000
Commission on Sales	`6,00,000
Sales Return (F.Y. 2016-17)	`1,60,000
Sale of Investment	`6,60,000

You are required to ascertain the effective turnover to be considered for the prescribed limit of tax audit under the relevant Act and guide the company whether the provisions relating to tax audit applies.

Answer

The provisions relating to tax audit under section 44AB of the Income Tax Act, 1961 applies to every person carrying on business, if his total sales, turnover or gross receipts in business exceed the prescribed limit of ` 1 crore and to a person carrying on a profession, if his gross receipts from profession exceed the prescribed limit of ` 50 lakhs in any previous year. However, the term "sales", "turnover" or "gross receipts" are not defined in the Act, and therefore the meaning of the aforesaid terms has to be considered for the applicability of the section.

Some of the points for merit consideration in this regard as discussed in the Guidance Note issued by the Institute are given below-

- Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted from the turnover.
- Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. Therefore, should not be deducted from the turnover.
- Turnover discount is normally allowed to a customer if the sales made to him exceed a particular quantity. As per trade practice, it is in the nature of trade discount and should be deducted from the figure.
- Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount. If it is in the nature of commission on sales, the same cannot be deducted from the figure of turnover.
- Price of goods returned should be deducted from the turnover even if the returns are from the sales made in the earlier year/s.
- Sale proceeds of any shares, securities, debentures, etc., held as investment will not form part of turnover. However, if the shares, securities, debentures etc., are held as stock-in-trade, the sale proceeds thereof will form part of turnover.

In the given case, Concession Ltd. is engaged in manufacturing business. Therefore,

the tax audit would be applicable if the turnover exceeds ` 1 crore during the financial year 2017-18. The calculation of effective turnover for the prescribed limit purpose, in accordance with abovementioned conditions, is given below:

Particluars	Rs.
Recorded turnover during the year	` 1,13,00,000
Less: (i) Discount allowed in the Sales Invoice	(` 8,20,000)
(ii) Trade discount	(` 2,90,000)
(iii) Sales Return	(` 1,60,000)
Effective turnover	` 1,00,30,000

Conclusion: The effective turnover of Concession Ltd. is rupees one crore and thirty thousand only which is over and above the prescribed limit for tax audit under section 44AB of the Income Tax Act, 1961. Thus, the provisions related to tax audit are applicable to the company and is therefore liable for tax audit

3.RTP May 2018 Qn no.14(b)

Vijay Maniyar & Associates, a firm of Chartered Accountants, is of the view that under GST law, audit can only be undertaken by the Departmental officers and there is no scope of audit under said law for the Chartered Accountants. You are required to advise Vijay Maniyar & Associates on the same.

RTP Nov 18 Qn no.14(b)

XYZ Limited is looking for an auditor for getting its accounts audited as per GST. Being an expert in the indirect taxes field XYZ Limited is seeking your advice on types of audit envisaged as per GST Law. Explain.

ANSWER

Types of Audit: GST envisages three types of Audit by Chartered Accountants i.e.

- (1) Audit of accounts [Section 35(5) read alongwith section 44(2) and rule 80]
- (2) Audit by tax authorities wherein the commissioner or any officer authorised by him, can undertake audit of any registered person for such period, at such frequency and in such manner as may be prescribes (Sec 65 and rule 10)
- (3) Special audit wherein the registered person can be directed to get his records including books of account examined and audited by a chartered accountant or cost accountant during any stage of scrutiny inquiry investigation or any other proceedings depending upon the complexity of the case (Section 66 and rule 102) an order of assistant commissioner or above with the prior approval of the commissioner.

Audit of Accounts [Section 35(5) read alongwith section 44(2) and rule 80]

As per sub-section 5 of section 35 read alongwith section 44(2) and rule 80 of the CGST Rules, 2017 stipulates as follows:

Every registered person must get his accounts audited by a Chartered Accountant or a Cost Accountant if his aggregate turnover during a FY exceeds Rs. 2 crores.

Such registered person is required to furnish electronically through the common portal alongwith Annual Return a copy of:

- Audited annual accounts
- A Reconciliation Statement, duly certified, in prescribed FORM GSTR-9C.

It may be noted that Section 35(5) shall not apply to any department of central government or a state government or a local authority whose books of accounts are audited by comptroller and auditor general of india or an auditor appointed for auditing the books of local authorities under any law for the time being in force.

Reconciliation Statement will reconcile the value of supplies declared in the return furnished for the financial year with the audited annual financial statement and such other particulars, as may be prescribed.

Audit under Section 65 – Audit by tax authorities

The audit under Section 66 is a special audit to be conducted by a Chartered Accountant or Cost Accountant nominated by the Commissioner whereas the audit under Section 65 is a routine audit by the tax office.

Special Audit under section 66: Availing the services of experts is an age old practice of due process of law. These experts have done yeoman service to the process of delivering justice. One such facility extended by the Act is in Section 66 where an officer not below the rank of Assistant Commissioner, duly approved, may avail the services of a Chartered Accountant or Cost Accountant to conduct a detailed examination of specific areas of operations of a registered person. Availing the services of the expert be it a Chartered Accountant or Cost Accountant is permitted by this section only when the officer considering the nature & complexity of the business and in the interest of revenue is of the opinion that:

- Value has not been correctly declared; or
- Credit availed is not within the normal limits.

It would be interesting to know how these 'subjective' conclusions will be drawn and how the proper officers determines what is the normal limit of input credit availed.

Circumstances for Notice for Special Audit: An Assistant Commissioner who nurses an opinion on the above two aspects, after commencement and before completion of any scrutiny, enquiry, investigation or any other proceedings under the Act, may direct a registered person to get his books of accounts audited by an expert. Such direction is to be issued in accordance with the provision of Rule 102 (1) FORM GST ADT-03

The Assistant Commissioner needs to obtain prior permission of the Commissioner to issue such direction to the taxable person.

Identifying the expert is not left to the registered person whose audit is to be conducted but the expert is to be nominated by the Commissioner.

4.MTP Mar 2018 2(b) 5 Marks

Mr. A engaged in business as a sole proprietor presented the following information to you for the FY 16-17. Turnover made during the year ` 124 lacs. Goods returned in respect of sales made during FY 14-15 is ` 20 lacs not included in the above. Cash discount allowed to his customers ` 1 lac for prompt payment. Special rebate allowed to customer in the nature of trade discount ` 5 lacs. Kindly advise him whether he has to get his accounts audited u/s 44AB of the Income Tax Act, 1961.

Answer

Turnover limit for the purpose of Tax Audit: The following points merit consideration as stated in the Guidance note on Tax Audit issued by the Institute of Chartered Accountants of India-

- a. Price of goods returned should be deducted from the figure of turnover even if the return are from the sales made in the earlier years.
- b. Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.
- c. Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount.

Applying the above stated points to the given problem,

1. Total Turnover	124 Lacs
2. Less: (i) Goods Returned	20 Lacs
(ii) Special rebate allowed to customer in the nature of trade discount would be deducted	<u>5 Lacs</u>
Balance	<u>99 Lacs</u>

As the limit for tax audit is Rs.one crore, therefore, he would not be required to get his accounts audited under section 44AB of the Income Tax Act, 1961.

5.MTP Apr 2018 Qn no.2(b)

ABC Pvt. Ltd. and XYZ Pvt. Ltd. are the companies in which public are not substantially interested. During the previous year 2017-18, ABC Pvt. Ltd. received some property, being shares of XYZ Pvt. Ltd., the details of which are provided below:

No. of Shares:	1,000
Aggregate fair market value of shares:	Rs. 75,000

Consideration value:

Nil

The management of the company contends that the shares need not to be furnished in Form No. 3CD. As the tax auditor of ABC Pvt. Ltd., how would you deal with the matter?

Reporting for Receipt of Shares, the Aggregate Fair Market Value of Which Exceeds Rs. 50,000: In this case, ABC Pvt. Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2017-18, the company received property, being shares, for no consideration, the aggregate fair market value of which is Rs. 75,000.

Provisions and Explanations: A tax auditor has to furnish the details of shares received during the previous year, under clause 28 of Form 3CD, in case, the assessee has received any property, being share of a company not being a company in which public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2)(viiia) of the Income Tax Act, 1961.

Section 56(2)(viiia) provides that where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year any property being shares of a company not being a company in which the public is substantially interested,

- (x) without consideration, the aggregate fair market value of which exceeds Rs. 50,000, the whole of the aggregate fair market value of such property;
- (xi) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs. 50,000, the aggregate fair market value of such property as exceeds such consideration, shall be chargeable to income-tax under the head "Income from other sources".

The fair market value of shares means the value as determined in accordance with the method prescribed in Income Tax Rules, 1962.

Conclusion: As per the facts of the case, provisions and explanations given above, the income generated by ABC Pvt. Ltd., being whole of the aggregate fair market

value of shares received (i.e. Rs. 75,000), is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(viiia) of the Income Tax Act, 1961. Therefore, the tax auditor of ABC Pvt. Ltd. is required to furnish the details of such shares received under clause 28 of Form 3CD. The contention of the management of the company, for not reporting such receipt of shares, is not acceptable.

6.RTP Nov 18 Qn no.14(a)

You are doing the tax audit of a Limited Company. After submission of Tax Audit Report, management notices that there was apparent mistake of law and due to this mistake, revised the final accounts. As a tax auditor, company seeks your opinion whether the tax audit can also be revised or not.

RTP Nov 2019 Qn no 25(D)

State whether a Tax audit report can be revised and if so state those circumstances

ANSWER

Revision of Tax Audit Report:

- (I) Normally, the report of the tax auditor cannot be revised later.
- (II) However, when the accounts are revised in the following circumstances, the tax Auditor may have to revise his Tax audit report also.
 - (a) Revision of accounts of a company after its adoption in the annual general meeting.
 - (b) Change in law with retrospective effect.
 - (c) Change in interpretation of law (e.g.) CBDT Circular, Notifications, Judgments, etc.

The Tax Auditor should state it is a revised Report, clearly specifying the reasons for such revision with a reference to the earlier report.

Thus, the Tax Audit Report can be changed under the given circumstances.

7.MTP-OCT-18 Qn No 2(b) 4 Marks:

AB Ltd. is a company in which public are not substantially interested. During the previous year 2017-18, the company issued shares to residents of India and provides you the following data related to such issue:

No. of shares issued	1,00,000
Face Value	Rs. 10 per share
Fair Market Value (FMV)	Rs. 60 per share
Consideration received	Rs. 80 per share

The management of the company contends that, it is a normal issue of shares, thus, needs not to be reported. As the tax auditor of AB Ltd., how would you deal with the matter in your tax audit report?

Answer:

Reporting for issue of shares for value exceeding fair market value: In this case, AB Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2017-18, it receives consideration for issue of shares (i.e. Rs. 80 per share) which exceeds the face value (i.e. Rs. 10 per share) and fair market value of the shares (i.e. Rs. 60 per share).

A tax auditor has to furnish the details of shares issued during the previous year, under clause 29 of Form 3CD, in case, the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in

section 56(2)(viib) of the Income Tax Act, 1961.

Section 56(2)(viib) provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources".

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

As per the facts of the case, provisions and explanations given above, the income generated by AB Ltd., due to differences in consideration received and fair market value of shares issued, is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(viib) of the Income Tax Act, 1961.

Therefore, the tax auditor of AB Ltd. is required to furnish the details of shares issued under clause 29 of Form 3CD. The contention of the management of the company, behind non-reporting, that it is a normal issue of shares, is not acceptable.

8.Nov 18 Qn no 2(b)

While doing Tax Audit, under section 44AB of the. Income Tax Act, 1961, of the accounts of Glue Private Limited for the Assessment Year 2018-19, it was found that during the Financial Year 2017-18, Glue Private Limited had received 9,000 shares, the market value of which was ` 90,000 on the date of transfer, at a price of ` 45,000 from Stick Private Limited. The Management of Glue Private Limited maintained that the transaction was as per the terms of negotiations and there would be no cause for the Auditor to bring this matter in his Tax Audit Report - Comment.

Answer

Reporting for Receipt of Shares, the Aggregate Fair Market Value of Which Exceeds

Rs. 50,000: In this case, Glue Private Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2017-18, the company received property, being shares, for rupees 45000 as consideration, the fair market value of which is `90,000.

A tax auditor has to furnish the details of shares received during the previous year, under clause 28 of Form 3CD, in case, the assessee has received any property, being share of a company not being a company in which public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2) of the Income Tax Act, 1961.

Section 56(2) provides that where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year any property

being shares of a company not being a company in which the public is substantially interested,

- (i) without consideration, the aggregate fair market value of which exceeds ` 50,000, the whole of the aggregate fair market value of such property;
 - (ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding ` 50,000, the aggregate fair market value of such property as exceeds such consideration,
- shall be chargeable to income-tax under the head "Income from other sources".

As per the facts of the case, provisions and explanations given above, the income generated by Glue Private Ltd., is rupees 45,000 i.e. in excess of fair market value of shares received (i.e. ` 90,000), is lesser than rupees 50,000 as per section 56(2) of the Income Tax Act, 1961. Therefore, the tax auditor of Glue Private Ltd. is not required to furnish the details of such shares received under clause 28 of Form 3CD. The contention of the management of the company, for not reporting such receipt of shares, is in order.

9.MTP-Apr-19 Qn No 5(c) 6 Marks:

(i) While conducting the tax audit of A & Co. you observed that it made an escalation claim to one of its customers but which was not accounted as income. What is your reporting responsibility.

(ii) While writing the audit program for tax audit in respect of A Ltd., you wish to include possible instances of capital receipt if not credited to Profit & Loss Account which needs to be reported under clause 16(e) of form 3CD. Please elucidate possible instances.

Answer:

(i) Clause 16(c) of Form 3CD: A tax auditor has to report under clause 16(c) of Form 3CD on any escalation claim accepted during the previous year and not credited to the profit and loss account under clause 16(c) of Form 3CD.

The escalation claim accepted during the year would normally mean "accepted during the relevant previous year". If such amount are not credited to Profit and Loss Account the fact should be reported. The system of accounting followed in respect of this particular item may also be brought out in appropriate cases. If the assessee is following cash basis of accounting with reference to this item, it should be clearly brought out since acceptance of claims during the relevant previous year without actual receipt has no significance in cases where cash method of accounting is followed.

Escalation claims should normally arise pursuant to a contract (including contracts entered into in earlier years), if so permitted by the contract. Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims. Mere making claims by the assessee or claims under negotiations cannot constitute accepted claims. After ascertaining the relevant factors as outlined above, a decision whether to report or not, can be taken.

- (ii) The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD-
- (a) Capital subsidy received in the form of Government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.
- (b) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.
- (c) Compensation for surrendering certain rights.
- (d) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

10.RTP May 2019 Qn no 19

In terms of Sl. No. 5G of Form GSTR 9C, the turnovers included in the audited financial statement for the period April 2017 to June 2017 shall be declared and deducted from the annual turnover to arrive at the turnover as per the GST Laws.

Please specify which of the following supplies would form part of reporting under turnover for the period April 2017 to June 2017

- (a) Goods were manufactured and cleared from a factory on 1.6.2017 on sale or approval basis. The goods were not approved by the recipient and returned back on 25.12.2017.
- (b) Goods were manufactured and cleared from a factory located in Bangalore on 30.4.2017. The goods were cleared to its showroom located in Hyderabad and eventually been sold from there on 30.8.2017. The audit under the GST Law will be conducted for Bangalore GSTIN.
- (c) Continuous supply of service in the nature of telecommunication service has been provided for the period 1.6.2017 to 30.6.2017. The bill is raised on 3.7.2017. The bill is payable by the customer only on 21.7.2017. Should the revenue be recognised in the month of June 2017 and reduced from total turnover or should it form part of turnover for the period July 2017 to March 2018 since the due date for payment of consideration is 21.7 2017. The entity recognised the revenue in the month of June 2017

ANSWER

- (a) Since the goods were not approved and returned after the stipulated period of 6 months, the value of the said supplies would not be included in turnover in the audited financial statements. However, as per the 2nd

proviso to Section 142(12) of the CGST Act since the goods were returned after 6 months from appointed date (i.e. 1.6.2017), GST would be payable for the tax period December 2017. Though the transaction originated in the period April 2017 to June 2017, the turnover will not be reflected under this Sl.No. However, one may reflect such adjustment under Part II, sl. No. 5 Clause O – 'Adjustments in turnover due to reasons not listed above' as addition.

- (b) The said goods are liable to excise duty since the goods have been cleared on 30.4.2017. The goods would not form part of turnover as per the financial statements since it is a branch transfer. It would stand reflected as branch transfers under the State Level VAT laws. Since audit is being conducted for Bangalore GSTIN and since supply has occurred from Hyderabad GSTIN, it would not be necessary to make adjustments for the period April 2017 to June 2017.
- (c) As per proviso to Rule 3(b) of the Clause of Taxation Rules, 2011, the point of taxation in the impugned case would be the date on which bill has been raised i.e. 3.7.2017. Though invoice has been raised in the GST regime, service tax is payable since service has been provided during the currency of the Finance Act, 1994. The date for payment of service tax as per the machinery provision i.e. POTR, 2011 may be 3.7.2017 but the said service would be liable to service tax because the charge u/s 66B gets attracted for the period June 2017. Further as per S.142(11)(b) since if a transaction is liable for service tax, then tax would not be payable under the GST Laws. Hence the said amount should be deducted as turnover under this Sl. No. for the period April 2017 to June 2017.

11.May 2019 Qn no 5(b) 4 Marks

In the course of your tax audit assignment u/s 44AB of the Income Tax Act, 1961 of Dream Bank Ltd., you have instructed your assistant to find out receipt of capital nature which might not have been credited to Profit & Loss Account and needs to be reported in Para 16(e) of Form 3CD. Your audit assistant seeks your guidance in reporting the same. Specify any four illustrative examples of such receipt.

Capital Receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD:

- (a) **Guidance for reporting capital receipts:** Capital receipts are not generally credited to profit and loss account hence the auditor should take enough care to check out any transaction generating the capital receipts by –
- Enquiring whether the assessee is in receipt of any amount of capital nature during the previous year.

- Going through the financial statements, in particular reserve account, to ascertain whether the assessee has received any such receipts and credited them directly to reserve account.
 - If the assessee has received any amount of capital nature during the year under audit, then enquiring whether the assessee has credited such receipts to profit and loss account. State the fact and the amount involved.
 - Checking that any such receipts is accounted for in terms of method of accounting followed by the assessee.
- (b) **Illustrative examples of capital receipts:** The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD-
- (i) Capital subsidy received in the form of Government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.
 - (ii) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.
 - (iii) Compensation for surrendering certain rights.
 - (iv) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

12.RTP Nov 2019 Qn no20, MTP Oct 2019 Qn no 3(b) 6 Marks

You are doing Tax Audit of Private Limited Company for the financial year ending 31st March, 2019. During audit, you notice that the company is not regular in deposit of VAT/GST and there remains pendency every year. The details of VAT/GST payable are:

- (i) **GST payable as on 31/03/2018 of FY 2017-18 was Rs. 200 Lakh and out of which Rs.100 Lakh was paid on 15/09/2018 and Rs.50 Lakh on 30/03/2019 and balance of Rs.50 Lakh paid on 16/09/2019.**
- (ii) **GST payable of current financial year 2018-19 was Rs.100 lakh and out of this, RS. 40 Lakh was paid on 25/05/2018 and balance of Rs.60 Lakh remained unpaid till the due date of return.**

The date of Tax Audit report and due date of return was 30th September.

Now as a Tax Auditor, how/where the said transaction will be reflected in Tax Audit Report under Section 43B(a)?

Answer

Reporting in Tax Audit Report: Any amount of GST/Tax payable on the last day of previous year (opening balance) as well as on the last day of current year has to be reported in Tax Audit Report under clause 26(A) and 26(B) in reference of section 43B.

Clause 26 (A) dealt GST/VAT payable on the pre-existed of the first day of the previous year but was not allowed in the assessment of any preceding previous year and was either paid {clause 26(A) (a)}/ or/ and/ not paid during the previous year {clause 26(A)(b)}

The details will be as under in regard to opening balances:

Liability Pre-existed on the previous year.

Sr. No.	Section	Nature of Liability	Outstanding Opening balance not allowed in previous year	Amount paid/set-off during the year	Amount written back to P&L Account	Amount unpaid at the end Of the year
01	43B(a)	VAT/GST	100 lakh	50 lakh	0	50 lakh

It has been assumed that 50 lakh was allowed in last year as it was paid before the due date of return.

Liability incurred during the previous year

Sr. No.	Section	Nature of Liability	Amount incurred in previous year but remaining outstanding on last day of previous year.	Amount paid/set-off before the due date of filing return/date upto which reported in the tax audit report, whichever is earlier	Amount unpaid on the due of filing of return/date upto which reported in the tax audit report, whichever is earlier
01	43B(a)	VAT/GST	100 lakh	40 lakh	60 lakh

13.Nov 2019 Qn no 4(c) 4 Marks

Mr. PK is conducting the Tax audit under section 44 AB of the Income Tax Act, 1961 of MG Ltd. for the year ended 31st March 2019. There is a difference of opinion between Mr. PK and the Management in respect of certain information to be furnished in Form No. 3CD. As a tax auditor, Mr. PK has to report whether the statement of particulars in Form 3CD are true and correct and the same is to be annexed to the report in Form No. 3CA. Advise on the matters to be considered by Mr. PK while furnishing the particulars in Form No. 3CD.

Answer

- (a) The statement of particulars given in Form No. 3CD as annexure to the audit report contains forty-one clauses. The tax auditor has to report whether the particulars are true and correct. This Form is a statement of particulars required to be furnished under section 44AB. The same is to be annexed to the reports in Forms No. 3CA and 3CB in respect of a person who carries on business or profession and whose accounts have been audited under any other law and in respect of person who carries on business or profession but who is not required by or under any other law to get his accounts audited respectively.

While furnishing the particulars in Form No. 3CD it would be advisable for the tax auditor to consider the following:

- (i) If a particular item of income/expenditure is **covered in more than one of the specified clauses** in the statement of particulars, care should be taken to make a **suitable cross reference** to such items at the appropriate places.
- (ii) If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD, the **tax auditor should state both the view points** and also the relevant information in order to enable the tax authority to take a decision in the matter.
- (iii) If any particular clause in Form No. 3CD is not applicable, he should state that the same is not applicable.
- (iv) In computing the **allowance or disallowance, he should keep in view the law applicable** in the relevant year, even though the form of audit report may not have been amended to bring it in conformity with the amended law.
- (iii) In case the prescribed particulars are given in part or piecemeal to the tax auditor or relevant form is incomplete and the assessee does not give the information against all or any of the clauses, the **auditor should not withhold the entire audit report**. In such a case, he can

qualify his report on matters in respect of which information is not furnished to him. In the absence of relevant information, the tax auditor would have no option but to state in his report that the relevant information has not been furnished by the assessee.

- (iv) The information in Form No. 3CD should be **based on the books of accounts, records, documents, information and explanations** made available to the tax auditor for his examination.
- (v) In case the auditor relies on a **judicial pronouncement**, he may mention the fact as his observations in clause (3) of Form No. 3CA or clause (5) provided in Form No. 3CB, as the case may be.

14.RTP May 2020 Qn no 15(a)

ABC Printing Press, a proprietary concern, made a turnover of above ` 1.03 crore for the year ended 31.03.2019. The Management explained its auditor Mr. Z, that it undertakes different job work orders from various customers. The raw materials required for each job are dissimilar. It purchases the raw materials as per specification/ requirements of each customer and there is hardly any balance of raw materials remaining in the stock except pending work-in-progress at the year end. Because of variety and complexity of materials, it is impossible to maintain a stock- register. Give your comments.

Answer

Non-maintenance of stock register: The explanation of the entity for the use of varieties of raw materials for different jobs undertaken may be valid. But the auditor needs to verify the specified job-orders received and the different raw materials purchased for each job separately. The use of different papers (quality, quantity and size) ink, colour etc. may be examined. If possible, the auditor may also enquire with the other similar printers in the locality to ensure the prevailing custom. At the same time, he has to report and certify under clause 35(b) and clause 11(b) of Form 3CD read with the Rule 6G(2) of the Income-tax Act, 1961, about the details of stock and account books (including stock register) maintained. He must verify the closing stock of raw materials, work-in-progress and finished goods of the concern, at least on the date of its balance sheet. In case the said details are not properly maintained, he has to specifically mention the same with reasons for non-maintenance of stock register by the entity.

15.RTP May 2020 Qn no 15(b)

PQR Ltd is a textile company with aggregate turnover exceeding ` 2 crores. XYZ & Associates is a Chartered Accountant firm which has been appointed for GST audit of PQR Ltd. Mr Sandhu, Chartered Accountant from XYZ & Associates, observes on 23 July 2019 that PQR Ltd has not filed its GSTR 3B for the month of July & its GSTR- 1 return is also not complied with. What should Mr Sandhu advise the client before conducting GST audit of PQR Ltd.

Answer:

The auditor should advise the company to file all the GSTR-3B, GSTR-1 and annual

returns before conducting GST audit so that auditor can validate and verify the returns filed by the company, verification of ITC claimed, verification of output GST liability discharged by the company and for collation of return workings and reconciliations. Auditor needs to have a comprehensive picture of -

- (i) Understanding of the back-up of monthly returns as well as annual return and understanding of reports generated by the GSTN portal as well as internal records of the company.
- (ii) Understanding of the eligibility of Input Tax Credit (ITC) availed i.e. whether ITC availed by the company is creditable or not and understanding of reversal of ITC undertaken or applicable (if any).
- (iii)
- (iv) Understanding of the taxability of outward supplies and transactions covered under Reverse Charge Mechanism and other miscellaneous/ specific transactions and understanding of the positions taken on various transactions by the company.

Study Material

ILLUSTRATIONS

1. V Pvt Ltd is engaged in the business of providing corporate/professional training programs. It has an annual turnover of INR 69 crores. The company is subject to tax audit for which the work has been started by the tax auditor. For the financial year ending 31 March 2021, the company applied for GST registration for 2 new locations for which registration certificates have not yet been received by the company. However, the registration number is available on the portal of relevant authority which can be verified by checking the details of the company. In this case what should be the audit procedures to verify this registration number?

Solution: The tax auditor should verify the registration number for the locations for which registration certificates have not been received from online portal of the relevant authority. The auditor should also ensure that the details furnished while checking the registration number pertains to the company only. If the company has filed any returns for these locations, the auditor should enquire for the same from the management and should check those returns to verify the correctness of the registration numbers. In addition, the auditor should also obtain specific representation in respect of this point from the management.

2. Ploy Ltd., engaged in the leasing of goods carriage, appointed you as the tax auditor for the financial year 2020-21. How would you deal with the following payments to Mr. X, Mr. Y and Mr. Z (engaged in leasing of goods carriage) relating to the leasing transactions in your tax audit report:

- (i) Payments of 6 invoices of ` 5,000 each made in cash to Mr. X on 4th July, 2020.
- (ii) Payments of 2 invoices of ` 18,000 each made in cash to Mr. Y on 5th July, 2020 and 6th July, 2020 respectively.
- (iii) Payment of ` 40,000 made in cash to Mr. Z on 7th July, 2020 against an invoice for expenses booked in 2019-20.

Solution

Reporting of Payments Exceeding ` 35,000 in Cash: Disallowance under section 40A(3) of the Income Tax Act, 1961 is attracted if the assessee incurs any expenses in respect of which payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft, exceeds ` 10,000. However, in case of payment made for plying, hiring or leasing of goods carriage, limit is ` 35,000 instead of ` 10,000. Further, as per section 40A(3A) of the Income Tax Act, 1961, where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payments made to a person in a day, exceeds ` 10,000 (` 35,000 in case of plying, hiring or leasing of goods carriages).

However, exemption is provided under Rule 6DD having regard to nature and extent of banking facilities available and other relevant factors.

Subsequently, under clause 21(d)(A) and 21(d)(B) of Form 3CD, the tax auditor has to scrutinize on the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) and 40A(3A) respectively read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, the same has to be reported under abovementioned clauses.

Therefore, as per the provisions and explanations discussed above, the given cases are dealt as under-

- i Payments of 6 invoices of ` 5,000 each aggregating ` 30,000 made in cash on 4th July, 2020 need not be reported as the aggregate of payments do not exceed ` 35,000.
- ii (Payments of 2 invoices of ` 18,000 each made in cash on 5th July, 2020 and 6th July, 2020 respectively aggregating ` 36,000 need not be reported as the payment do not exceed ` 35,000 in a day.
- iii Payment of ` 40,000 made in cash against an invoice for expenses booked in 2019-20 is likely to be deemed to be the profits and gains of business or profession under section 40A(3A) of the Income Tax Act, 1961. Thus, the details of such amount needs to be furnished under clause 21(d)(B) of Form 3CD.

3.M/s. Mehtab & Co. a registered person received notice of audit in FORM GST ADT-01 on 15-Nov-2020, stating therein that the audit team from the department will visit their office on 21-Nov-2020 to conduct audit. The RP is expected the specified documents must be kept ready for audit. As a consultant of M/s. Mehtab & Co. what advise you will give to your Client?

Solution:

As a consultant of M/s. Mehtab & Co. we will advise that notice for audit by tax authorities shall be given for not less than 15 working days prior to the conduct of audit in FORM GST ADT-01. Therefore, the RP must intimate to the tax authorities that he may be given appropriate time before the necessary books of accounts and other records may be kept ready for the purposes of audit.

4.M/s. Ramaya Bhola (P) Ltd., a registered person is issued a notice in FORM GST ADT-03 for conduct of a special audit by M/s. Rohit & Associates, Chartered Accountants. The company claims that he is already subject to statutory audit by his regular CA under the Companies Act as well as tax audit under the Income Tax Act. Whether the special audit is still applicable on the company?

Solution:

Considering the special nature of GST audit under section 66 the audit having been conducted under other proceedings or under other laws; do not preclude the proper officer from exercising option under section 66.

5. Mr X, an articled trainee in JSA Associates, is assigned a GST Audit of Flex Industries, a branch in Delhi. He is confused with the applicability of GST audit on Flex Industries considering the definition of turnover in section 35(5). Flex Industries is a company with operations spread across India with aggregate turnover amounting to ` 8 crores (this turnover is spread across various cities) during the FY ended 31 March, 2019. Will GST audit be applicable on Flex Industries? If yes, substantiate section 35(5) in context of rule 80(3).

Solution: GST Audit will be applicable on Flex Industries. As per section 35(5) read with rule 80(3), the total turnover calculation for the applicability of GST audit must be done on a PAN India basis, which means that once the turnover under the PAN India level is more than ` 5 crores, all business entities registered under GST for that PAN will be liable for GST audit for the FY.

5. Krishna Enterprises, a textile shop with registered GST premises in Delhi, is having turnover of ` 1.55 crores, ` 1.45 crores and ` 1.50 crores for the quarters 2, 3 and 4 respectively of the FY 2018-19. He did not have good fortune in quarter 1 of 2018-19 for which his turnover was ` 70 lakhs. Mr. Vasudev, a chartered accountant, is appointed as tax consultant of Krishna Enterprises. He is perplexed whether GST audit is applicable for his client. If so, substantiate with relevant section.

Solution:

GST audit will be applicable to Krishna Enterprises. As per section 35(5) read with rule 80(3), if the annual turnover of a registered taxpayer is more than ` 5 crores during the year ended 31 March, 2019, he is required to get his accounts audited by a chartered accountant or cost accountant.

In the given case, the aggregate turnover during the year ended 31 March, 2019 was above ` 5 crores, hence, GST audit would be applicable to Krishna Enterprises.

6. SSM & Co. is a leading electronics company having multiple branches registered under GST in different States. The aggregate turnover of all such branches exceeded ` 5 crores during the FY ended 31 March, 2019. However, the Delhi branch had a turnover of ` 3.75 crores. Pankaj Gupta, Finance Officer of Delhi branch, contended that GST audit would not be applicable on Delhi branch as the turnover for that branch did not surpass the threshold. Whether the contention of Mr. Pankaj Gupta was correct or not. Substantiate.

Solution:

GST audit would be applicable on Delhi branch. As per section 35(5) read with rule 80(3), the aggregate turnover calculation must be PAN based, which means that once the turnover under the PAN is more than ₹ 5 crores, all business entities registered under GST for that PAN will be liable for GST audit for that FY. Contention of Mr. Pankaj, Finance Officer, was incorrect.

7. Mr. Anuj, a Chartered Accountant by profession, has been appointed as GST auditor for ABC Ltd. The management has asked Mr. Anuj for GST audit and to file GSTR-3B for the months of July and August 2019 and filing of annual return in FORM GSTR-9. Mr. Anuj contended that he has been appointed only for GST audit and the above are his scope limitations and cannot be conducted as the compliances and returns are to be filed by the management. In context of above dispute, you have to suggest whether the contention of Mr. Anuj is correct or not. Justify.

Solution:

GST auditor's prime responsibility on this engagement is limited to GST audit, audit of reconciliation statement between books of accounts vis-a-vis GST returns prepared by the Company. The GST auditor is, however, not responsible for any compliances like uploading GST periodic returns for the relevant audit period. Since, in the given situation, Management has asked the auditor Mr. Anuj to conduct besides GST Audit filing of GSTR-3B for the months of July and August 2019 and filing of annual return in FORM GSTR-9. Accordingly, Mr. Anuj has rightly refused that his scope is limited to GST Audit and the scope does not cover any of the management functions. In view of above, Contention of Management to Anuj is not tenable as preparation of annual returns and its filing was the responsibility of management.

**8. PQR Limited has exported goods to XYZ Limited located in USA. The value of goods is \$100,000. The exchange rate (Rs/\$) on the date of filing Shipping Bill is -
CBEC notified rate ₹ 65
RBI reference rate ₹ 68
At the time of receiving money, the bank exchanged the foreign currency at ₹ 70.**

Solution:

For the purpose of GST returns, the exchange rate would be ₹ 65 and the exports to be disclosed in the GST returns would be ₹ 65,00,000. For the purpose of accounting records, the exchange rate would be ₹ 68 and the exports recorded in the books would be ₹ 68,00,000. The difference in revenue being ₹ 3,00,000 would have to be reduced from the annual turnover as per the financials to arrive at the turnover as per FORM GSTR-9.

Additionally, difference in the amount booked in the accounts and actual amount received being ₹ 70 – ₹ 68 = 2 x \$1,00,000 = ₹ 2,00,000 would be credited to the Profit and Loss account as forex gain which again needs to be reduced from the annual turnover as per the financials to arrive at the turnover as per FORM GSTR-9.

**9. PQR Limited has exported goods to XYZ Limited located in USA. The value of goods is \$100,000. The exchange rate (Rs/\$) on the date of filing Shipping Bill is -
CBEC notified rate ₹ 65
RBI Reference rate ₹ 68**

At the time of receiving money, the bank exchanged the foreign currency at ₹ 66.

Solution:

For the purpose of GST Returns, the exchange rate would be ₹ 65 and the exports to be disclosed in the GST Returns would be ₹ 65,00,000. For the purpose of accounting records, the exchange rate would be ₹ 68 and the exports recorded in the books would be ₹ 68,00,000. The difference in revenue being ₹ 3,00,000 would have to be reduced from the annual turnover as per the

financials to arrive at the turnover as per FORM GSTR-9. Additionally, the difference in the amount booked in the accounts and actual amount received being ₹ 66 – ₹ 68 = (-) ₹ 2 x ₹1,00,000 = (-) ₹ 2,00,000 would be debited to the Profit and Loss account as forex loss which again needs to be added from the annual turnover as per the financials to arrive at the revenue as per FORM GSTR-9.

10.. GTA issued a consignment note on 1-Jan-2020. The consignment note charges GST @ 12%. The consignor has booked the GTA. The recipient has paid the freight to GTA on 'to collect' basis. Would this turnover be mentioned in S. No. 7D?

Solution :

The consignment note contains GST @ 12%, so reverse charge does not attract as per Notification No. 13/ 2017- CT (R) w.e.f. 22-Aug-2017. Hence, tax has to be paid by GTA under forward charge, and this transaction should not be entered in S. No. 7D.

11. GTA issued a consignment note on 1-Jan-2020. The consignment note does not charge GST. The consignor has booked the GTA. The recipient has paid the freight to GTA on 'to collect' basis. Would this turnover be mentioned in S. No. 7D?

Solution :

Since consignment note does not contain GST @ 12%, reverse charge provisions would apply. Tax is to be paid by the person liable to pay freight, that is, the recipient and not the GTA under forward charge. Because of this, while preparing GSTR-9C of the GTA, the impugned transaction has to be entered in S. No. 7D. But while preparing GSTR-9C of the recipient this transaction will not be entered in this S. No.

12. Advocate Mr. X, has provided legal services and charged GST of ₹ 18 on his invoice of ₹ 100. The advocate's client has paid ₹ 118 to the advocate. The advocate has remitted ₹ 18 to Government and is of the opinion that the aforesaid transaction should not be reduced in S. No. 7D. Is the stand taken by the advocate correct?

Solution :

Supplies made by a registered person, where the recipient is liable to pay tax under reverse charge, are to be declared in S. No. 7D. Legal services provided by the advocate to his client are liable for reverse charge (assuming all other conditions in reverse charge notification stands satisfied). Hence, the impugned transaction should be declared in S. No. 7D. GST wrongly collected and paid by the advocate under forward charge will not change the fact that the aforesaid service is liable to reverse charge and, hence, merits insertion in S. No. 7D.

13. The ITC as booked in purchase account is as follows: (a) ITC on purchase of raw material: ₹ 1,50,000 (Purchase value: 20,00,000) (b) ITC on purchase of consumable: ₹ 60,000 (Purchase value: 4,00,000) (c) ITC on purchase of food items for staff: ₹ 12,000 (Purchase value: 120,000) ITC availed by the registered person from the Purchase account: ₹ 2,22,000

Ans.

The reporting of the following transactions shall be made in this column: > Value of purchases: 25,20,000 > Amount of total ITC: 2,22,000 Amount of eligible ITC: ₹ 2,10,000

QUESTIONS

1. Mr. A engaged in business as a sole proprietor presented the following information to you for the FY 2018-19. Turnover made during the year ` 124 lacs. Goods returned in respect of sales made during FY 2017-18 is ` 20 lacs not included in the above. Cash discount allowed to his customers ` 1 lac for prompt payment. Special rebate allowed to customer in the nature of trade discount ` 5 lacs. Kindly advise him whether he has to get his accounts audited u/s 44AB of the Income Tax Act, 1961.

Answer

Turnover limit for the purpose of Tax Audit: The following points merit consideration as stated in the Guidance note on Tax Audit issued by the Institute of Chartered Accountants of India-

- (i) Price of goods returned should be deducted from the figure of turnover even if the return are from the sales made in the earlier years.
- (ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.
- (iii) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount.

Applying the above stated points to the given problem,

1.	Total Turnover	124 Lacs
2.	Less – (i) Goods Returned	20 Lacs
	(ii) Special rebate allowed to customer in the nature of trade discount would be deducted	<u>5 Lacs</u>
	Balance	<u>99 Lacs</u>

As the limit for tax audit is ` one crore, he would not be required to get his accounts audited under section 44AB of the Income Tax Act, 1961.

2. Comment with respect to computation of total sales, turnover or gross receipts in business exceeding the prescribed limit under Section 44 AB of Income Tax Act, 1961.

- (i) Discount allowed in the sales invoice
- (ii) Cash discount
- (iii) Price of goods returned related to earlier year
- (iv) Sale proceeds of fixed assets.

Answer

Computation of Sales, Turnover or Gross Receipts: In the context of section 44AB of the Income Tax Act, 1961, following considerations are required with regard to computation of sales, turnover or gross receipts in business exceeding the prescribed limit under section 44AB of the Income Tax Act, 1961-

- (i) Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted from the turnover.
- (ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. Therefore, should not be deducted from the turnover.
- (iii) Price of goods returned should be deducted from the turnover even if the returns are from the sales made in the earlier year/s.

Sale proceeds of fixed assets would not form part of turnover since these are not held for resale.

3. Write a short note on - Method of accounting in Form No. 3CD of Tax Audit.

Answer

Method of accounting in Form No. 3CD of Tax Audit: Clause 13 of Form No. 3CD of the tax audit requires to state method of accounting employed in the previous year. It also requires to state the change in method of accounting vis-à-vis the preceding year. If so, details of change and the effect on the profit or loss are to be stated. Also details of deviation thereof if any, from accounting standards prescribed under section 145 and the effect thereof on the profit or loss are stated. Section 145 provide that method of accounting be either cash or mercantile. Hybrid system is not permitted

4. ABC Printing Press, a proprietary concern, made a turnover of above ` 1.03 crore for the year ended 31.03.2019. The Management explained its auditor Mr. Z, that it undertakes different job work orders from various customers. The raw materials required for each job are dissimilar. It purchases the raw materials as per specification/ requirements of each customer and there is hardly any balance of raw materials remaining in the stock except pending work- in-progress at the year end. Because of variety and complexity of materials, it is impossible to maintain a stock-register. Give your comments.

Answer

The explanation of the entity for the use of varieties of raw materials for different jobs undertaken may be valid. But the auditor needs to verify the specified job-orders received and the different raw materials purchased for each job separately. The use of different papers (quality, quantity and size) ink, colour etc. may be examined. If possible, the auditor may also enquire with the other similar printers in the locality to ensure the prevailing custom. At the same time, he has to report and certify under clause 35(b) and clause 11(b) of Form 3CD read with the Rule 6G(2) of the Income-tax Act, 1961, about the details of stock and account books (including stock register)

maintained. He must verify the closing stock of raw materials, work-in-progress and finished goods of the concern, at least on the date of its balance sheet. In case the said details are not properly maintained, he has to specifically mention the same with reasons for non-maintenance of stock register by the entity.

5. A Co-operative Society having receipts above ` 1 crore gets its accounts audited by a person eligible to do audit under Co-operative Societies Act, 1912, who is not a Chartered Accountant. State with reasons whether such audit report can be furnished as tax audit report under Section 44AB of the Income-tax Act, 1961?

Answer

Furnishing Audit Report of a Co-operative Society: As per Section 44AB read with Explanation to Section 288(2) of the Income Tax Act, 1961, “accountant” means a chartered accountant within the meaning of the Chartered Accountants Act, 1949, and includes, in relation to any State, any person who by virtue of the provisions of section 141 of the Companies Act, 2013, is entitled to be appointed to act as an auditor of companies registered in that State.

Accordingly, the person who is not a Chartered Accountant as mentioned in the question, though is eligible to act as auditor of Cooperative Society under the Cooperative Society Act, 1912, but is not eligible to carry out tax audit under Section 44AB of the Income Tax Act, 1961.

Hence, such audit report cannot be furnished as tax audit report under Section 44AB of the Income-tax Act, 1961.

An auditor should conduct routine checking during the course of audit of a public trust, in the following manner:

- (i) Check the books of account and other records having regard to the system of accounting and internal control;
- (ii) Vouch the transactions of the trust to satisfy that:
 - the transaction falls within the ambit of the trust the transaction is properly authorized by the trustees or other delegated authority as may be permissible in law;
 - all incomes due to the trust have been properly accounted for on the basis of the system of accounting followed by the trust;
 - all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting followed by the trust;
 - amounts shown as applied towards the object of the trust are covered by the objects of trust as specified in the document governing the trust.
- (iii) Obtain trial balance on the closing date duly certified by the trustee;
- (iv) Obtain Balance Sheet and Profit & Loss Account of the trust authenticated by

the trustees and check the same with the trial balance with which they should agree.

6.State whether a Tax audit report can be revised and if so state those circumstances

Answer

Revision of Tax Audit Report:

- (a) Normally, the report of the tax auditor cannot be revised later.
- (b) However, when the accounts are revised in the following circumstances, the tax auditor may have to revise his tax audit report also.
 - (i) Revision of accounts of a company after its adoption in the annual general meeting.
 - (ii) Change in law with retrospective effect.
 - (iii) Change in interpretation of law (e.g.) CBDT Circular, Notifications, Judgments, etc.

The Tax Auditor should state it is a revised report, clearly specifying the reasons for such revision with a reference to the earlier report.

7. ABC Ltd is a printing company with aggregate turnover exceeding rupees 2 crores. XYZ & Associates is a Chartered Accountant firm which has been appointed for GST audit of ABC Ltd. Mr Sandhu, Chartered Accountant from XYZ & Associates, observes on 23 July 2019

Answer

The auditor should advise the company to file all the GSTR-3B, GSTR-1 and annual returns before conducting GST audit so that auditor can validate and verify the returns filed by the company, verification of ITC claimed, verification of output GST liability discharged by the company and for collation of return workings and reconciliations. Auditor needs to have a comprehensive picture of -

- (i) Understanding of the back-up of monthly returns as well as annual return and understanding of reports generated by the GSTN portal as well as internal records of the company.
- (ii) Understanding of the eligibility of Input Tax Credit (ITC) availed i.e. whether ITC availed by the company is creditable or not and understanding of reversal of ITC undertaken or applicable (if any).

- (iii) Understanding of the taxability of outward supplies and transactions covered under Reverse Charge Mechanism and other miscellaneous/ specific transactions and understanding of the positions taken on various transactions by the company

(iv)

8. Draft an audit programme for conducting the audit of a Public Trust registered under section 12A of the Income-tax Act, 1961.

ANSWER:

An auditor should conduct routine checking during the course of audit of a public trust, in the following manner:

(i) Check the books of account and other records having regard to the system of accounting and internal control;

(ii) Vouch the transactions of the trust to ensure that:

- the transaction falls within the ambit of the trust;
 - the transaction is properly authorized by the trustees or other delegated authority as may be permissible in law;
 - all incomes due to the trust have been properly accounted for on the basis of the system of accounting followed by the trust;
 - all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting followed by the trust;
 - amounts shown as applied towards the object of the trust are covered by the objects of trust as specified in the document governing the trust.
- (iii) Obtain trial balance on the closing date duly certified by the trustee;

(iv) Obtain Balance Sheet and Profit & Loss Account of the trust authenticated by the trustees and check the same with the trial balance with which they should agree.

9 Mr. PK would be conducting the Tax audit under section 44 AB of the Income Tax Act, 1961 of MG Ltd. for the year ending 31st March 2021. There is a difference of opinion between Mr. PK and the Management in respect of certain information to be furnished in Form No. 3CD. As a tax auditor, Mr. PK has to report whether the statement of particulars in Form 3CD are true and correct and the same is to be annexed to the report in Form No. 3CA. Advise on the matters to be considered by Mr. PK while furnishing the particulars in Form No. 3CD.

ANSWER:

- i. If a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, care should be taken to make a suitable cross reference to such items at the appropriate places.
- ii. If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD, the tax auditor should state both the view points and also the relevant information in order to enable the tax authority to take a decision in the matter.
- iii. If any particular clause in Form No. 3CD is not applicable, he should state that the same is not applicable.

iv. In computing the allowance or disallowance, he should keep in view the law applicable in the relevant year, even though the form of audit report may not have been amended to bring it in conformity with the amended law.

v. In case the prescribed particulars are given in part or piecemeal to the tax auditor or relevant form is incomplete and the assessee does not give the information against all or any of the clauses, the auditor should not withhold the entire audit report. In such a case, he can qualify his report on matters in respect of which information is not furnished to him. In the absence of relevant information, the tax auditor would have no option but to state in his report that the relevant information has not been furnished by the assessee.

vi. The information in Form No. 3CD should be based on the books of accounts, records, documents, information and explanations made available to the tax auditor for his examination.

vii. In case the auditor relies on a judicial pronouncement, he may mention the fact as his observations in clause (3) of Form No. 3CA or clause (5) provided in Form No. 3CB, as the case may be.

10. A is the proprietor of a firm M/s ABC & Co. The firm is expecting a turnover of ` 900 lakhs during the financial year ending 31/03/2021. The firm sold land and building during the year for a consideration of ` 15 lakhs, whose value for stamp duty purposes was ` 16 lakhs. As' the Tax Auditor of the said firm, is the above required to be reported? If yes, how will you report the same?

ANSWER:

Reporting Requirement Under Clause (17) & (29B) of Form 3CD: As per Clause 17 of Form 3CD, the tax auditor is required to furnish detailed information in case if any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, as under:

Details of property	Consideration received or accrued	Value adopted or assessed or assessable
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The auditor should obtain a list of all properties transferred by the assessee during the previous year. He may also verify the same from the statement of profit and loss or balance sheet, as the case may be. Further, the auditor has to furnish the amount of consideration received or accrued, during the relevant previous year of audit, in respect of land/building transferred during the year as disclosed in the books of account of the assessee.

For reporting the value adopted or assessed or assessable, the auditor should obtain from the assessee a copy of the registered sale deed in case, the property is registered. In case the property is not registered, the auditor may verify relevant documents from relevant authorities or obtain third party expert like lawyer, solicitor representation to satisfy the compliance of section 43CA / section 50C of the Act. In exceptional cases where the auditor is not able to obtain relevant documents, he may state the same through an observation in his report 3CA/CB. In addition, as per clause 29(B) (w.e.f. assessment year 2019-20), in case of an immovable property, where the stamp duty value exceeds the consideration by less than the higher of (i) rupees 50,000 or (ii) 5% of the consideration, the difference is not chargeable to tax. Therefore, for any immovable property, where the stamp duty value is up to 105% of the sale consideration, no addition can be made under section 56(2)(x).

In the given case, M/s. ABC & Co., has sold land and building during the year for a consideration of rupees 15 lakhs which is less than stamp duty value i.e. rupees 16 lakhs. Further, it is also more than the higher of, 5% of consideration 15 lakhs i.e. 75,000 rupees or 50,000 rupees. Hence, tax auditor is required to report on the same under Clause 17 and clause 29(B) of Form 3CD.

11. How will you verify the income & expenditure of earlier years credited/debited in the current year for reporting under clause 27(b) of Form 3CD while carrying out Tax Audit u/s 44AB of the Income Tax Act, 1961?

ANSWER:

- **Particulars of income or expenditure of prior period credited or debited to the profit and loss account.**

It may be noted that information under this clause would be relevant only in those cases where the assessee follows mercantile system of accounting.

Under cash system of accounting, expenses debited/ income credited to the profit and loss account would be current year's expenses/income even though they may relate to earlier years. The tax auditor should maintain the following information in his working papers file for the purpose of reporting in the format provided in the e-filing utility:

12. MM & Co., a footwear manufacturer is registered with GST in Delhi and its branches registered in Punjab & Haryana. Its turnover for the FY ended 31st March, 2019 is: Delhi: ` 1.8 crore, Punjab: ` 1.2 crore and Haryana: ` 2.7 crore. However, the branch registered in Punjab is making only exempt supplies. The management of the company is of the view that GST audit is not applicable on them. Whether, their contention is correct or not. Substantiate

ANSWER:

GST audit will be applicable on MM & Co. As per section 35(5) read with rule 80(3), the aggregate turnover calculation for the applicability of GST audit must be done on a PAN India basis, which means that once the turnover under the PAN India level is more than ` 5 crores, all business entities registered under GST for that PAN will be liable for GST audit for the FY.

Further, aggregate turnover includes exempted supplies. Therefore, any person making exempt supplies which is registered under GST will also be liable for GST audit.

Thus, in the given case, the contention of the management is not correct. The aggregate turnover of the company is ` 5.7 crore. Thus, each branch is liable for GST audit.

13. Mr. A was appointed as an auditor of M/s. XYZ Co. During the course of audit he finds that the company has availed an excess ITC of ` 50 lakh. Accordingly, he made recommendations in Part V of GSTR-9C, The management of the company refused to pay the excess ITC and argued that auditors recommendations are not binding. Comment.

The management contention is correct. The auditor has only a recommendatory power, for recommendations given by the auditor may or may not be acceptable to the registered person. The registered person has the option to accept, reject or partially accept the recommended additional tax liability. In line with such recommendations, though not explicitly stated anywhere in the relevant Form or GST law –

- (i) the registered person can choose to make the payment of the additional tax liability in full or in part;
- (ii) the registered person can even choose to reject the complete recommendations of the auditor and not make the payment at all.

14. Mr. John, made an outward supply of ` 4.00 lakhs to M/s. Taj Enterprises on 30th April, 2020 on a credit period of 15 days. However, M/s. Taj Enterprises made the payment to Mr. John after 45 days along with interest for 30 days delayed payment @ 12%. As such, Mr. John received total payment of ` 4,04,000/- along with interest. However, while filing Form GSTR-3B/ Form GSTR-1, Mr. John declared his outward supplies at ` 4.00 lakhs. Even while filing Form GSTR-9, Mr. John did not discharge his tax liability. As a GST auditor in Form GSTR-9C, what action is recommended by the auditors. Comment.

ANSWER:

In terms of section 15(2)(d) while computing value of taxable supply the transaction value shall include interest or late fee or penalty for delayed payment of any consideration for any supply. Since, Mr. John did not pay tax on interest component, he made violation of valuation provisions. Mr. John was having option to discharge such liability at the time of filing of Form GSTR-9, which he did not avail. Therefore, the GST auditor may recommend him to discharge such liability at the time of making reconciliation statement in Form GSTR-9C.

15. CA Natraj, proprietor of Satyam & Co., Chartered Accountants, while doing GST audit in Form GSTR-9C, recommended additional liability of ` 1.5 crore to be paid by PQR Co. Ltd. on account of supplies not declared in regular returns in Form GSTR-3B/ Form GSTR-1 and also in annual return in Form GSTR-9. The company agreed to pay the liability. On the date of payment, it had ITC of ` 1 crore in its electronic credit ledger which the company wants to use for making the payment and balance amount to be paid in cash. Comment.

ANSWER:

The management is not correct in doing so. If the registered person chooses to make the payment of any additional liability as recommended by the auditor, the company may make such payment through FORM DRC-03. However, such liability shall be paid through electronic cash ledger only

16. M/s. Ramo & Co (P) Ltd. while appointing M/s. Jatin Prasad & Associates, a CA firm, as their GST auditors for the FY 2020-21 claims that only a GST Practitioner CA firm is eligible for doing audit under GST law in terms of section 35(5) of the Act. Comment.

ANSWER:

The GST Act/ Rules do not vest a GST practitioner with the power to audit under section 35(5). The power to audit is granted only to a chartered accountant or cost accountant who is in practice. Therefore, a chartered accountant is not required to be registered as a GST practitioner for the purpose of certifying FORM GSTR-9C. Therefore, the contention of the company that only a GST Practitioner CA is eligible for GST audit is not correct.

17. State the consequences of not filing of Annual Return in Form GSTR-9 and not getting the GST Audit done u/s. 35(5) of the Act, in Form GSTR-9C?

ANSWER:

Section 47(2) provides that in case of failure to submit the annual return within the specified time, a late fee shall be levied. The said late fee would be ` 100 per day during which such failure continues subject to a maximum of a quarter percent of the turnover in the State/UT. There would be an equal amount of late fee under the respective SGST/ UTGST Act.

However, there is no specific penalty prescribed in the GST Law for not getting the accounts audited by a chartered accountant or a cost accountant. Therefore, in terms of section 125 of the CGST Act, the registered person may be subjected to a penalty of up to ` 25,000/-. This section deals with the general penalty that gets attracted where any person, who contravenes any of the provisions of this Act, or any rules made thereunder for which no penalty is separately provided. Similar provision also exists under the SGST/ UTGST Act as well. As such, penalty of up to ` 25,000/- shall be imposed under the SGST/ UTGST Act. It is possible that since the annual return in FORM GSTR-9 is to be accompanied with the auditor's report in FORM GSTR-9C, if not done it may amount to non-filing of annual return and late fee also may be levied.

18. What are the objectives of Special Audit under section 66 of the CGST Act. Can it be invoked in a routine manner by proper officer?

ANSWER:

The objectives of Special Audit under section 66 of the CGST Act is that if at any stage of scrutiny, inquiry, investigation or any other proceedings before him, any officer not below the rank of Assistant Commissioner, having regard to the nature and complexity of the case and the interest of revenue, is of the opinion that the value has not been correctly declared or the credit availed is not within the normal limits, he may, with the prior approval of the Commissioner, direct such registered person by a communication in writing to get his records including books of account examined and audited by a chartered accountant or a cost accountant as may be nominated by the Commissioner. Therefore, it cannot be invoked in a routine manner by proper officer.

19. Write a short note on differences in Audit by Tax Authorities and the Special Audit?

ANSWER:

There are differences in Audit by Tax Authorities and the Special Audit. Such differences can be analysed as under-

- (1) The audit by tax authorities is conducted by the revenue officers whereas special audit is conducted by the CA/ Cost Accountants on the penal of the department.
- (2) The audit by tax authorities is conducted by the revenue officers either the taxpayer's office or at their own office whereas special audit is conducted by the CA/ Cost Accountants at the taxpayer's office.
- (3) The audit by tax authorities can be invoked in a routine manner by the revenue officers whereas special audit is invoked with the prior approval of the Commissioner if the nature of business of the auditee is found to be complex.
- (4) The audit by tax authorities is to be completed within 3 months which is further extendable by another 6 months, whereas special audit is to be completed within 90 days which is further extendable by another 90 days.

20. State the scope of audit under GST, whether inspection or fait accompli?

ANSWER:

The scope of inspection by the tax authorities is much wider which may entail inspection, search and seizure at the business premises and the vehicles of the **taxable person**. Such powers are used by the authorities in special circumstances when the proper officer not below the rank of Joint Commissioner has reason to believe that there is evasion of tax by the taxpayer.

As compared to inspection, the scope of audit is very limited up to *fait accompli* in the case of **registered person**. *Fait accompli* is a thing that has already happened or has been decided before those affected about it, leaving them with no option but to accept or reject it. E.g. the results were presented to shareholders as a *fait accompli*. Therefore, the auditors are not having powers to inspect the premises or vehicles of the registered person but to make the checking of the records, books of accounts, audited financial statements or the returns etc. filed by him.

21. The GST department endeavours to collect legitimate taxes while requiring the taxpayers to file FORM GSTR-9 and FORM GSTR-9C. Can you draw a comparative view of these two forms?

ANSWER:

COMPARATIVE VIEW OF FORM GSTR-9 AND GSTR-9C

S. No.	FORM GSTR-9	FORM GSTR-9C
1.	It is annual report of a formal or official character giving information	It is auditor's report reconciling audited financial statements with FORM GSTR-9
2.	Enacted under section 44 read with rule 80	Enacted under section 35(5)/ 44 read with rule 80
3.	Filing of FORM GSTR-9 is mandatory for all registered persons without any threshold limit. [Upto 2.00 crore optional]	To be filed only if the aggregate turnover in a FY exceeds the prescribed limit which 5.00 crore at present.
4.	Not required to be filed by a Casual Taxable Person, Non-Resident Taxable Person, Input Service Distributor, Unique Identification Number Holders, Online Information and Database Access Retrieval Service, Composition Dealers, persons required to deduct taxes under section 51 and persons required to collect taxes under section 52.	Not required to be filed by a Casual Taxable Person, Non-Resident Taxable Person, Input Service Distributor, Unique Identification Number Holders, Online Information and Database Access Retrieval Service, Composition Dealers, persons required to deduct taxes under section 51, persons required to collect taxes under section 52, Government Department subject to CAG audit and foreign airline company.
5.	No need to annex financials	Financials to be annexed
S6.	The annual return is to be filed by the registered person.	Reconciliation statement in FORM GSTR-9C is to be given by auditors and to be filed by the registered person.
7.	The annual return is to be prepared based on consolidated information from periodical returns like FORM GSTR-3B/ FORM GSTR-1.	The reconciliation statement is to be prepared for reconciling the information in the annual return viz. a viz. the audited annual financial statement.
8.	The annual return is to be verified by the registered person.	The reconciliation statement is to be certified by the auditors

22. Whether filing of Annual Return in Form GSTR-9 is mandatory for all registered persons? If not then what are the exceptions?

ANSWER:

Filing of Annual Return in Form GSTR-9 is mandatory for all registered persons except the following-

- Casual taxable persons
- Input service distributors
- Non-resident taxable persons
- Persons paying TDS/ TCS under section 51/ 52 of the Act
- Person supplying online information and database access retrieval services
- Persons having GTO < 2.00 crore are having option to file and not to file the Annual Return

Multiple Choice Question

Jain Ltd is a medium sized company having operations in Ghaziabad and Lucknow. The corporate office of the company is based at Delhi. During the year due to certain migration in the ERP package of the company, the financial statements were finalized very late but were filed with the regulatory authorities on time as per the requirements of the statute. For the financial year ended 31 March 2018, the due date of filing income tax return of the company was 31 October 2018 and tax audit was also applicable to the company.

Since the company was facing internal disturbances, its tax audit could not get completed on time and the company decided to submit its income tax return on time and form 3CD and tax audit report later on (i.e. after the due date of filing income tax return once that is properly audited).

Please suggest which of the following would be correct in this case.

- Company is doing right by filing income tax return on time without tax audit report.
- Company's move is not right. Income tax return should be filed along with tax audit report.
- Company is doing the right thing by filing income tax return on time. In

the given situation, the company may choose not to file tax audit report for the current year.

(d) Company should take written advise from a tax consultant about this and should attach that along with income tax return if tax audit report is not being filed.

Answer : (b) Company's move is not right. Income tax return should be filed along with tax audit report.

Nisha Ltd is engaged in the business of trading of chemicals. Nisha Ltd is a small size company but on the basis of turnover criteria, tax audit becomes applicable to the company. The company has been filing its income tax returns on time in the previous years and understands that the objective of the tax audit is to ensure that proper books of accounts are maintained by the assesses. Considering the fact that company is also required to get its accounts audited as per the requirements of the Companies Act 2013, it would like to avail exemption from tax audit. If that is not possible then the company would go for tax audit report from an accountant who is cost effective. In this context, please suggest which of the following should be correct.

- a) Company can avail tax audit exemption in the given situation.
- b) Company cannot avail tax audit exemption but it may be exempt from submitting the tax audit report from a Chartered Accountant.
- c) Company can avail tax audit exemption, however, the statutory auditor in that case would be required to cover the same in his statutory audit report.
- d) Company cannot avail tax audit exemption and would need to get this done from a Chartered Accountant.

Answer: (d) Company cannot avail tax audit exemption and would need to get this done from a Chartered Accountant.

RJ & Associates have been the statutory auditors of SH & Co, a partnership firm, for many years. Tax audit of SH & Co was performed by KJ & Associates. During the year ended 31 March 2018, KJ & Associates resigned as tax auditors of SH & Co due to their personal reasons. SH & Co appointed RJ & Associates as its tax auditor for the year ended 31 March 2018. The engagement letter of RJ & Associates as statutory auditors of SH & Co was already signed and RJ & Associates moved ahead without signing another engagement letter for tax audit since most of the terms related to engagement were covered in the engagement letter of statutory audit except additional scope and fee which was principally agreed between both the parties. Please suggest which of the following is correct in the given situation.

- a) RJ & Associates need not sign another engagement letter for tax audit.

- b) RJ & Associates need to sign another engagement letter for tax audit.
- c) RJ & Associates need not sign another engagement letter for tax audit. However, they should ensure that the same thing is covered in the engagement letter for next year i.e. year ending 31 March 2019.
- d) RJ & Associates need not sign another engagement letter for tax audit if the fee for tax audit is within the range of 5-10% of statutory audit fee.

Answer : (b) RJ & Associates need to sign another engagement letter for tax audit

ABC & Co LLP is a firm of Chartered Accountants having 5 partners. The firm specializes in taxation work and also has large no of statutory audits and tax audits of corporate entities and non-corporate entities. During the financial year ended 31 March 2018, the firm has received various requests for new tax audits. On the basis of limit assigned in respect of tax audit assignments by a Chartered Accountant/ firm of Chartered Accountants, please suggest which of the following would be correct.

- a) Firm can accept 300 tax audits assignments (in total) to be signed by its 5 partners.
- b) Firm can accept 300 tax audits of corporate entities and 300 tax audits of non-corporate entities to be signed by its 5 partners.
- c) Firm can accept 300 tax audits of corporate entities, 300 tax audits of non-corporate entities and more by outsourcing the same to Chartered Accountants outside the firm, however, all these will be signed by its 5 partners.
- d) Since the firm specializes in taxation work, it cannot accept 300 tax audit assignments.

Answer: (a) Firm can accept 300 tax audits assignments (in total) to be signed by its 5 partners.

AOP Pvt Ltd is currently engaged in closing its books of accounts for the financial year ended 31 March 2019. The company has always been a compliance-savvy and has also engaged consultants for the same. The business of the company has been stable over the years and profitability has been good over the last 3 years.

The company got registered for GST on time. Since registration the company has been filing statement of returns GSTR 3B. However, Annual Return in GSTR 9 has not been filed by the company.

Proper Officer issued a notice for failure to file Annual Return within 15 days. Even then, no Annual Return was filed by the company within the time permitted. Please advise

- a) In such a case, the company becomes a 'non-filer'.
- b) In such a case, the company would remain fully compliant.

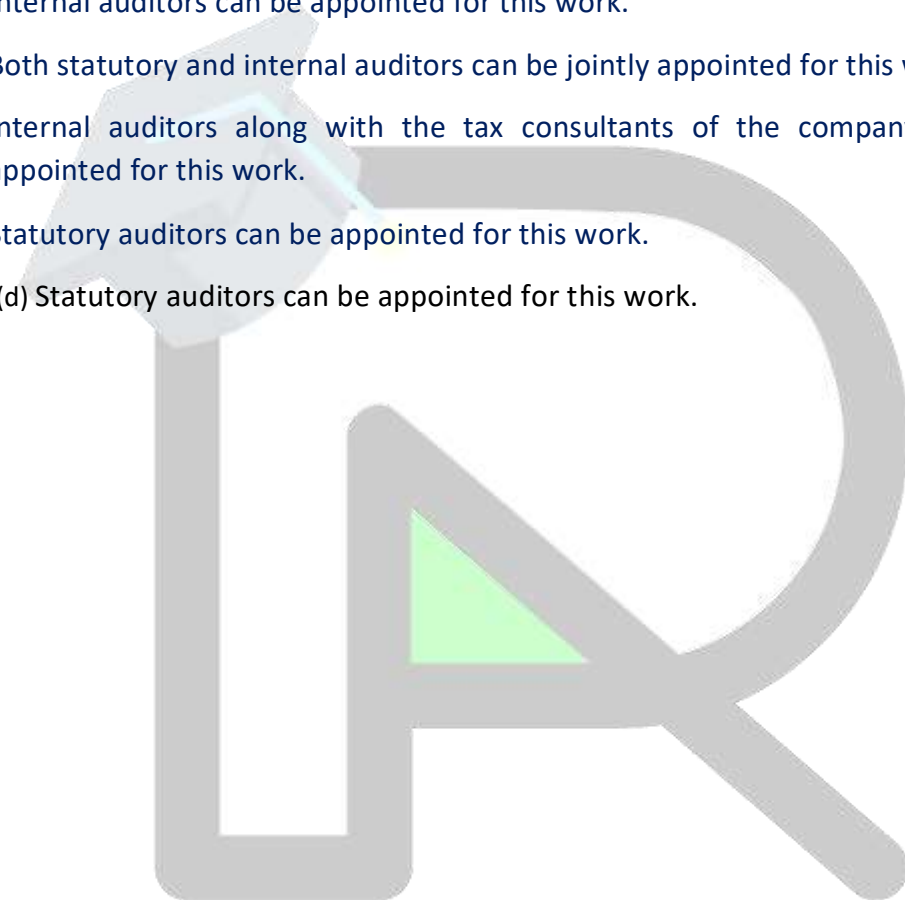
- c) The Proper Officer would be required to discuss this matter with the GST auditors of the company.
- d) GST auditor may resign in this situation.

Answer: (a) In such a case, the company becomes a 'non-filer'

Rajeev Ltd is a listed company having business of production of motion pictures. For the year ended 31 March 2018, the company wanted to appoint GST auditor. For the purpose, somebody who is familiar with the business of the company/industry was to be preferred for appointment i.e. who would have worked with the company in the past to avoid efforts/ duplication in terms of providing the information to get the GST audit completed. The company had following options for the same. Please advise.

- a) Internal auditors can be appointed for this work.
- b) Both statutory and internal auditors can be jointly appointed for this work.
- c) Internal auditors along with the tax consultants of the company can be appointed for this work.
- d) Statutory auditors can be appointed for this work.

Answer: (d) Statutory auditors can be appointed for this work.



Chapter – 13 Audit of Public sector Undertakings

Multiple Choice Questions

MTP Mar 2019 Qn no 8

In Case of PSU, Direct Reporting Engagement does not include

- (a) Performance audits
- (b) compliance audits
- (c) Financial audits
- (d) Comprehensive Audit

Answer: (c) Financial audits

MTP Apr 2019 QN no 4

A Public Limited Company is having its Head Office at Mumbai and the employees from various branch offices used to visit Mumbai for official meetings. So, the company decided to construct guest house for their employees staying in Mumbai, as the stay in hotel was very expensive. The management took all sanctions to construct the building and the expenditure was incurred in conformity with the rules and regulations. The building was ready for use by the year 2015 on which a total expenditure of Rs. 5 crores was done, but it was not used by the employees and they continued to stay in hotel. From the financial 2015-16 onwards the expenses were booked in company's profit and loss account for the upkeep and maintenance of the building and the hotel charges paid for the stay of employees. The company was having a separate internal audit department but one of the directors demanded propriety audit to ensure compliance with section 186 of the Companies Act, 2013 and ensure that the transactions represented by books are prejudicial to the interests of the company. Do you think that there is any need for propriety audit?

- (a) Propriety audit is not required when the company is already having a separate internal audit department and these areas can be covered in the scope of internal auditors.
- (b) The director has no right to demand propriety audit, as in the case of Public Limited Company only Government is authorised to decide on whether a propriety audit is required or not.
- (c) Propriety audit is concerned with the scrutiny of executive decisions and actions affecting the company's financial and profit & loss situation. So, in the above case it is required as huge expense has been done on construction of building and even then it was not used, which had a major impact on company's profit and loss statement.
- (d) There is no need of propriety audit as the management took all sanctions to construct the building and the expenditure was incurred in conformity with the rules and regulations.

Answer: (c) Propriety audit is concerned with the scrutiny of executive decisions and actions affecting the company's financial and profit & loss situation. So, in the above case it is required as huge expense has been done on construction of building and even then it was not used, which had a major impact on company's profit and loss statement.

RTP May 2018 Qn no.16

1. Being an expert in the field of government audit, you are required to briefly explain the powers of Comptroller and Auditor General of India with respect to supplementary audit and test audit as stated under section 143(6) and 143(7) of the Companies Act, 2013.

ANSWER

Powers of Comptroller and Auditor-General of India

Supplementary audit under section 143(6)(a) of the Companies Act, 2013:

The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct.

Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013: Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Test audit under section 143(7) of the Companies Act, 2013: Without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

2.MTP Mar 18 Qn no.4(e) 4 Marks

ABG & Co., a Chartered Accountant firm has been appointed by C & AG for performance audit of a Sugar Industry. List out the factors to be considered generally by ABG & Co., while planning a performance audit of Sugar Industry?

Answer

Factors to be considered while planning the Performance Audit: While planning a performance audit of Sugar Industry, the auditors should take care of certain factors which are listed below:

- (i) to consider significance and the needs of potential users of the audit report.
- (ii) to obtain an understanding of the program to be audited.
- (iii) to consider legal and regulatory requirements.
- (iv) to consider management controls.
- (v) to identify criteria needed to evaluate matters subject to audit.
- (vi) to identify significant findings and recommendations from previous audits that could affect the current audit objectives. Auditors should determine if management has corrected the conditions causing those findings and implemented those recommendations.
- (vii) to identify potential sources of data that could be used as audit evidence and consider the validity and reliability of these data, including data collected by the audited entity, data generated by the auditors, or data provided by third parties.
- (viii) to consider whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives.
- (ix) to provide sufficient staff and other resources to do the audit.
- (x) to prepare a written audit plan.

3.MTP APR 2018 Qnn 4(E) 4 Marks

The areas covered in comprehensive audit vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations.' You are required to list down some of the broad areas to be examined in comprehensive audit.

RTP May 2019 Qn no 20(b)

Write short note on the areas covered under Comprehensive audit

ANSWER

Areas to be Examined: The areas covered in comprehensive audit will naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the broad areas are listed below-

- ◆ Comparison of overall capital cost of the project with the approved planned costs.
- ◆ Production or operational outputs vis-à-vis under-utilisation of the installed capacity.

- ◆ Systems of project formulation and implementation.
- ◆ Planned rate of return.
- ◆ Cost control measures.
- ◆ Research and development programmes.
- ◆ System of repairs and maintenance.
- ◆ Adequate purchase policies.
- ◆ Effective and economical procedures.
- ◆ Project planning.
- ◆ Undue waste, unproductive time for men and machines, wasteful utilisation or even non- utilisation of resources.

4.RTP Nov 18 Qn no.16 RTP May 2020 Qn 16 (b)

“A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.” Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

Answer

According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:

- (i) **Economy-** It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (**e.g. human, financial and material**) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

- (ii) **Efficiency-** It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

Auditing efficiency embraces aspects such as whether:

- (a) sound procurement practices are followed;
- (b) resources are properly protected and maintained;
- (c) human, financial and other resources are efficiently used;
- (d) optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner

- (e) public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
 - (f) efficient operating procedures are used; and
 - (g) the objectives of public sector programmes are met cost-effectively.
- (iii) **Effectiveness**- It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

In auditing effectiveness, performance audit may, for instance:

- (a) assess whether the objectives of and the means provided (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;
- (b) determine the extent to which a program achieves a desired level of program results;
- (c) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to the policy or to other causes;
- (d) identify factors inhibiting satisfactory performance or goal-fulfilment;
- (e) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes;
- (f) assess the effectiveness of the program and/or of individual program components;
- (g) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- (h) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;
- (i) assess compliance with laws and regulations applicable to the program; and
- (j) identify ways of making programmes work more effectively.

5.MTP-OCT-18 Qn No 4(e) 5 Marks:

The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees. In view of above, you are required to list down any four role.

Answer:

C&AG's Role – The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees.

- His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;

- He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;
- The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations. The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature ;

- (iv) In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

This ensures that the Audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

6.NOV 18 Qn no 4(e) 4 Marks

Sunlight Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Goa with a new technology for a cost of ` 5,750 crore. The project had seen delay in commencement and cost overrun. State the matters that a Comprehensive Audit by C&AG may cover in reporting on the performance and efficiency of this project.

Answer

Matters covered in Reporting in case of Comprehensive Audit are: To facilitate a proper consideration, the reports of the C&AG on the audit of PSUs are presented to the Parliament in several parts consisting of results of comprehensive appraisals of selected undertakings conducted by the Audit Board etc. Some of the issues examined in comprehensive audit are:

- (i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?
- (ii) Have the accepted production or operational outputs been achieved? Has there been under-utilization of installed capacity or shortfall in performance and, if so, what has caused it?
- (iii) Has the planned rate of return been achieved?
- (iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?

- (v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
- (vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?
- (vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?
- (viii) If the enterprise has an adequate system of repairs and maintenance?
- (xi) Are procedures effective and economical?
- (x) Is there any poor or insufficient or inefficient project planning?

7.May 2019 Qn no 4(C) 5 Marks

On receipt of statutory audit report on 30-03-2018 of M/s Sunlight Ltd., a government company, C&AG on 25-05-2018 appointed M/s Veeru & Associates to conduct supplementary audit u/s 143(6)(a) of the Companies Act, 2013. They submitted their report to C&AG as per their scope of work. The Company held its AGM on 01-09-2018 but directors did not think it necessary to discuss supplementary auditor's report and comment of the C&AG. Is the approach of the directors of Sunlight Ltd. correct? Guide the company with the provisions related to supplementary audit.

Answer

The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,

- (i) **conduct a supplementary audit under section 143(6)(a)**, of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
- (ii) **comment upon or supplement such audit report under section 143(6)(b)**: It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

In view of above provisions, the approach of directors of Sunlight Ltd. is not correct. They are required to mandatorily send the Supplementary Audit Report and comments of C&AG to every member of the company etc. as prescribed and also be placed before the annual general meeting of the company in the same manner as in case of audit report. Since in the given case neither the report has been distributed nor discussed in the Annual General Meeting, the directors of the company will be liable for contravention of aforesaid sections.

8.MTP-Aug-18 Qn No 4(e) 4 Marks:

“The C&AG may direct the appointed auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India.” What are the relevant sections of the Companies Act, 2013 and steps involved in auditor of Government Companies?

MTP-OCT-18 Qn No 3(c) 4 Marks:, Nov 2019 Qn no 6(a) 4 Marks

"The C & AG may direct the appointed auditor about the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India". What are the relevant sections of the Companies Act, 2013 and steps involved in the audit of Government Companies?

The following steps are involved in the audit of government companies:

- ❑ **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013** - Statutory auditors of Government Companies are appointed or re-appointed by the C&AG. There is thus, a departure from the practice in vogue in the case of private sector companies where appointment or re-appointment of the auditors and their remuneration are decided by the members at the annual general meetings. In the case of government companies, though the appointment of statutory auditors is done by the C&AG, the remuneration is left to the individual companies to decide based on certain guidelines given by the C&AG in this regard.
- ❑ **The C&AG may direct the appointed auditor** on the manner in which the accounts of the Government company are required to be audited and the auditor so appointed has to submit a copy of the audit report to the Comptroller and Auditor-General of

India. The report, among other things, includes the directions, if any, issued by the C&AG, the action taken thereon and its impact on the accounts and financial statement of the company.

The report under section 143(5) is in addition to the reports issued by the Statutory Auditors under various other clauses of section 143.

- ❑ **Supplementary audit under section 143(6)(a) of the Companies Act, 2013** - The Comptroller and Auditor-General of India shall **within 60 days** from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statements of the government company by such person or persons as he may authorize in this behalf and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the C&AG may direct.
- ❑ **Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013** - Any comments given by the C&AG upon, or in supplement to, the audit report issued by the statutory auditors **shall be sent by the company to every person entitled** to copies of audited financial statements **under sub-section (1) of section 136** of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be **placed before the annual general meeting of the company** at the same time and in the same manner as the audit report.
- ❑ **Test audit under section 143(7) of the Companies Act, 2013** -Without prejudice to the provisions relating to audit and auditor, the C&AG may, in case of any company covered under **sub-section (5) or sub-section (7) of section 139** of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of **section 19A of the Comptroller and Auditor- General's (Duties, Powers and Conditions of Service) Act, 1971**, shall apply to the report of such test audit.

9.MTP-OCT-19 Qn No 3(a) 4 Marks:

The Comptroller and Auditor General assists the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness for managements' information. Explain stating clearly the issues examined in comprehensive audit.

RTP May 2020 Qn no 16(b)

XYZ & Co., a CA. firm was appointed by C&AG to conduct comprehensive audit of ABC Public undertaking. C&AG advised to cover areas such as investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc. Discuss stating the issues examined in comprehensive audit.

Answer:

Issues examined in Comprehensive Audit: Some of the issues examined in comprehensive audit are-

- (i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?
- (ii) Have the accepted production or operational outputs been achieved? Has there been under utilisation of installed capacity or shortfall in performance and, if so, what has caused it?
- (iii) Has the planned rate of return been achieved?
- (iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
- (v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
- (vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?
- (vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?
- (viii) If the enterprise has an adequate system of repairs and maintenance?
- (ix) Are procedures effective and economical?
- (x) Is there any poor or insufficient or inefficient project planning?

The efficiency and effectiveness audit of public enterprises is conducted on the basis of certain standards and criteria. Profit is not the key criterion on performance; management's performance in the economical and efficient use of public funds and in the achievement of objectives is more relevant. Public enterprises have been set up with certain socio-economic purposes and for fulfillment of certain objectives. The objectives vary from enterprise to enterprise. Audit appraisal analyses the performance of an enterprise to bring out the extent to which the objectives for which the enterprise was set up have been served.

10.RTP May 2020 Qn no 16 (b)

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

Answer:

According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:

- (i) **Economy** - It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (e.g. human, financial and material) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

Study Material

ILLUSTRATIONS

1. The Managing Director of X Ltd is concerned about high employee attrition rate in his company. As the internal auditor of the company he requests you to analyze the causes for the same. What factors would you consider in such analysis?

Solution

The factors responsible for high employee attrition rate are as under:

- (i) Job Stress & work life imbalance;
- (ii) Wrong policies of the Management;
- (iii) Unbearable behaviour of Senior Staff;
- (iv) Safety factors;
- (v) Limited opportunities for promotion;
- (vi) Low monetary benefits;
- (vii) Lack of labour welfare schemes;
- (viii) Whether the organization has properly qualified and experienced personnel for the various levels of works?
- (ix) Is the number of people employed at various work centres excessive or inadequate?
- (x) Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?

2. XYZ, a manufacturing unit does not accept the recommendations for improvements made by the Operational Auditor. Suggest an alternative way to tackle hostile management.

Solution

Alternative Way to Tackle the Hostile Management: While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.

QUESTIONS

1. What are the principles involved regarding "Propriety audit" in the case of Public Sector Undertaking?

Answer

1. Companies Act, lays down special provisions regarding audit of accounts of public sector undertakings registered as Government Companies. Section 143 of the Companies Act, 2013 empowers C&AG to conduct supplementary or test audit. Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to efficiency, economy and effectiveness with which these operate and fulfill their objectives and goals. Another aspect of audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct. On an analysis, these tests boil down to tests of economy, efficiency and faithfulness. Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure. Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company, with special regard to public interest and commonly accepted customs and standards of conduct. It is also seen whether every officer has exercised the same vigilance in respect of expenditure incurred from public money, as a person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances. Some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

- (i) The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
- (ii) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
- (iii) Public moneys should not be utilised for the benefit of a particular person or section of the community.
- (iv) Apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

It may be stated that it is the responsibility of the executive departments to enforce economy in public expenditure. The aim of propriety audit is to bring to the notice of the proper authorities of wastefulness in public administration and cases of improper; avoidable and in fructuous expenditure.

2. Write a short explanatory note on –

- (a) **Areas of propriety audit under Section 143(1) of the Companies Act, 2013.**
- (b) **Role of C&AG in the Audit of a Government company.**

Answer

Areas of Propriety Audit under Section 143(1): Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to -

- i. whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
- ii. whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made;
- iii. where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- iv. whether loans and advances made by the company have been shown as deposits;
- v. whether personal expenses have been charged to revenue account;
- vi. where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.

- (b) **Role of C&AG in the Audit of a Government company:** Role of C&AG is prescribed under sub section (5), (6) and (7) of section 143 of the Companies Act, 2013.

In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 i.e.

appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to:

- (i) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
- (ii) comment upon or supplement such audit report.

It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Test Audit: Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

3. Ceta Ltd. is a company in which 54% of the paid up share capital is held by Rajasthan Government. The company is engaged in the business of providing consultancy services in relation to construction projects. The audit of the financial statements of Ceta Ltd. for the financial year ended 31 March 2020 got completed with lot of intervention of Comptroller & Auditor General of India, wherein C&AG was giving directions to the auditors on the manner in which audit should be conducted in respect of certain areas. Further, it also received comments from C&AG on the audit report of the auditors. Ceta Ltd is seeking advice to go against C&AG so that they can avoid unnecessary interference of C&AG. You are required to advise Ceta Ltd. with respect to role of C&AG in the audit of a Government company.

ANSWER:

The following steps are involved in the audit of government companies: (a) **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013** - Statutory auditors of Government Companies are appointed or re-appointed by the C&AG. There is thus, a departure from the practice in vogue in the case of private sector companies where appointment or re-appointment of the auditors and their remuneration are decided by the members at the annual general meetings. In the case of government companies, though the appointment of statutory auditors is done by the C&AG, the remuneration is left to the individual companies to decide based on certain guidelines given by the C&AG in this regard. The C&AG may direct the appointed auditor on the manner in which the accounts of the Government company are required to be audited and the auditor so appointed has to submit a copy of the audit report to the Comptroller and Auditor-General of India. The report, among other things, includes the directions, if any, issued by the C&AG, the action taken thereon and its impact on the accounts and financial statement of the company. The report under section 143(5) is in addition to the reports issued by the Statutory Auditors under various other clauses of section 143. (b) **Supplementary audit under section 143(6)(a) of the Companies Act, 2013** - The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statements of the government company by such person or persons as he may authorize in this behalf and for the purposes of such audit, require information or additional information to be furnished to such form, as the C&AG may direct. (c) **Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013** - Any comments given by the C&AG upon, or in supplement to, the audit report issued by the statutory auditors shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the

same manner as the audit report. **(d) Test audit under section 143(7) of the Companies Act, 2013** - Without prejudice to the provisions relating to audit and auditor, the C&AG may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

4.BT Ltd , a company wholly owned by central government was disinvested during the previous year, resulting in 40% of the shares being held by public. The shares were also listed on the BSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the BSE etc. Sam, the FM of the company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

ANSWER:

Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the *total voting power* is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them. The listing of company's shares on a stock exchange is irrelevant for this purpose and hence Sam's opinion is not correct.

5.You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task?

ANSWER:

Determining Audit Criteria - Audit criteria are the standards used to determine whether a program meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit criteria are reasonable and attainable standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed.

The audit criteria may be sought to be obtained from the following sources:

- (i) procedure manuals of the entity.
- (ii) policies, standards, directives and guidelines.
- (iii) criteria used by the same entity or other entities in similar activities or programmes.
- (iv) independent expert opinion and know how.
- (v) new or established scientific knowledge and other reliable information. (vi) general management and subject matter literature and research papers.

Multiple Choice Question

Setir Ltd is a company in which 59% of the paid up share capital is held by Punjab Government. The company is engaged in the business of providing consultancy services in relation to construction projects.

The Punjab Government is also planning to induct funds in the company in future, if required.

Nocri Ltd is a company controlled by Setir Ltd. The business of Nocri Ltd is construction and has an annual turnover of INR 2500 crores approx.

The audit of the financial statements of Nocri Ltd for the financial year ended 31 March 2019 got completed but Nocri Ltd observed that during the course of audit, there was lot of intervention of Comptroller & Auditor General of India, wherein C&AG was giving directions to the auditors on the manner in which audit should be conducted in respect of certain areas.

Further, it also received comments from C&AG on the audit report of the auditors. Nocri Ltd is seeking legal opinion to go against C&AG so that they can avoid unnecessary interference of C&AG and is also looking to have new auditors appointed by Nocri Ltd with whom they will have an engagement letter with the terms that those auditors don't accept any interference of C&AG which the existing auditors have not been able to avoid.

In this context, please advise which of the following should be correct?

- (a) The stand of the existing auditors should have been better i.e. not to accept any interference of C&AG.
- (b) Management could have planned the audit work better by including the same terms in engagement letter with existing auditors instead of appointing another auditors.
- (c) C&AG involvement could have been accepted if this was the audit of Setir Ltd but not in case of Nokri Ltd and hence Nokri Ltd should also reach out to its parent company to get this resolved.
- (d) Stand of Nokri Ltd is wrong as the C&AG may get involved in the audit of Nokri Ltd.

Answer: (d) Stand of Nokri Ltd is wrong as the C&AG may get involved in the audit of Nokri Ltd.

CGN Ltd is a large company engaged in the business of oil exploration in India. The Tamil Nadu Government and the Central Government hold 37% and 20% respectively of the paid up share capital of this company.

The C&AG appointed the statutory auditors of this company as per requirements of the

Companies Act 2013. The company had a concern regarding this appointment because company wanted to appoint another auditors as per their assessment, however, considering the legal hassles which would have got involved, the company decided to go ahead with this.

The audit of the financial statement for the year ended 31 March 2019 got completed by the auditors appointed by the C&AG. Subsequent to this, the C&AG also issued an order to conduct test audit of the accounts of the company which was objected by the management of the company.

The management objected saying that the complete set of financial statements have been audited by auditors appointed by the C&AG and hence this order is not acceptable because this would lead to duplication of work.

Moreover, the management has also written to the C&AG that for the next financial year, the existing auditors should either resign so that the management may bring in their own auditors or the C&AG should have faith in the work of the auditors appointed by them. Please suggest how to resolve this matter.

- a) The management's stand is not correct. The C&AG may order test audit as per the requirements of the Companies Act 2013.
- b) The management's stand is not correct. The C&AG may order test audit as per the requirements of the Indian Penal Code.
- c) The management is correct and in this situation they get the right to appoint another auditor considering the fact that the C&AG has lost faith in the work of auditors appointed by them.
- d) Such type of matters should be taken to arbitration as per the requirements of the Arbitration Act.

Answer: (a) The management's stand is not correct. The C&AG may order test audit as per the requirements of the Companies Act 2013

NOP Ltd is a joint venture of Central Government and a private company and is engaged in the business of distribution of electricity in Chennai. The Central Government holds 51% shares of the company.

The company is acknowledged for its consumer-friendly practices. Initially it was completely owned by the Government and was running into significant losses but after the joint venture, the aggregate technical and commercial losses of the company showed a record decline.

The operations of the company have improved significantly as claimed by the management of the company.

The C&AG wants to conduct the performance audit of one of the departments of the company through a subordinate office of Indian Audit and Accounts Department.

For this purpose, the audit programme has also been finalized and the Accountant

General has intimated the company that the audit would start within a day's time. The company is concerned because the programme which has been received from the Accountant General is quite detailed and would involve significant time. Further the management of the company is quite surprised as to why this audit should be conducted as this is not a company subject to such types of audits as per law.

The management of the company would like to have your inputs in respect of this matter. Please guide.

- a) The notice for such type of audit should give reasonable time to the management to prepare themselves. Further it should not be a detailed audit requiring significant time of the company.
- b) The C&AG may conduct such type of audits in respect of NOP Ltd which would get covered in this criteria, however, the notice for conducting such type of audit should give reasonable time to the management to prepare themselves
- c) In case of a joint venture such type of audit cannot be performed as per the Companies Act 2013. The company should write to the Registrar of Companies in respect of this matter and till that time no audit can be started.
- d) In case of a joint venture such type of audit cannot be performed as per the Companies Act 2013. Further wherever this is applicable that is only for a small period of time. The company should write to the Ministry of Corporate Affairs in respect of this matter.

Answer: (b) The C&AG may conduct such type of audits in respect of NOP Ltd which would get covered in this criteria, however, the notice for conducting such type of audit should give reasonable time to the management to prepare themselves

AJ Petroleum & Refining Ltd is a Maharatna Central Public Sector Undertaking (PSU) in India having its registered office in Uttranchal.

It is engaged in the business of oil refining, pipeline transportation & marketing, exploration & production of crude oil & gas, petrochemicals, gas marketing and other downstream operations.

The PSU has global aspirations for which its management is working on various plans/programmes so that the same can be achieved in future. It is also planning to pursue diverse business interests by setting up of various joint ventures with reputed business partners from India and abroad to explore global opportunities.

Considering these objectives and other factors, the C&AG directed the performance audit in respect of its certain activities/ functions which has been in progress. Before starting the audit, the detailed scope and composition of audit team was shared with the management of the company and tentative timelines were also given with which the

management was fine. However, during the course of the audit the audit team changed its audit programme to achieve the desired objectives which was approved by the competent authority, however, the management was not happy with those changes.

The management wants the audit team to conclude the audit with the same scope as this is a special type of audit wherein such flexibility cannot be accepted as that would defeat the purpose of the law. However, the audit team has a different view. Please guide.

- a) Changes in audit programme in such type of audits are not acceptable as specified by the Companies Audit and Auditors Rules 2014.
- b) Changes in audit programme in such type of audits are not acceptable as specified by the Companies Audit and Auditors Rules 2014 and the Ministry of Law.
- c) Changes in audit programme in such type of audits can be accepted provided those are discussed with the management and approved by the Competent Authority.
- d) The C&AG should get involved in this matter after taking permission from the Central Government and would require to change the audit team if the scope requires any changes as the same should have been properly assessed by the audit team before commencing the audit.

Answer: (c) Changes in audit programme in such type of audits can be accepted provided those are discussed with the management and approved by the Competent Authority

In Case of PSU, Direct Reporting Engagement does not include

- a) Performance audits
- b) Compliance audits
- c) Financial audits
- d) Comprehensive Audit

Answer: (c) Financial audits

Chapter -14 Liabilities of auditor

RTP Nov 2019 QN no 5

Kshitij and a group of persons subscribed to the shares of JNN Ltd. JNN Ltd. had issued a prospectus for issuance of shares against which these persons had subscribed the shares. It was later on found that some information as included in the prospectus was misleading. These persons filed a case against the company covering all the parties who were responsible for the prospectus on the ground that the information contained in the prospectus was misleading and they suffered losses by relying on that information.

The company consulted this matter with its legal consultants in respect of the course of action to be taken and also consulted that if the outcome of the case goes against the company then which all parties may be held liable and what could be the other consequences.

The prospectus included auditor's report who had also given his clearance. Some of the experts were also involved in respect of the information on which the litigation was filed.

Subsequently, it was proved that the contention of Kshitij and those persons was correct. It was held that the directors, promoters of the company and the experts involved would be liable to pay compensation to all these persons who had sustained losses or any damage.

The auditors of the company were also asked to make good the losses but they refused with an argument that it is limited to directors, promoters and experts.

In this context, please suggest which of the following statement is correct.

- (a) The argument of the auditors is valid. As per the final outcome of the litigation the auditors were not held liable. However, on moral grounds the auditors should contribute towards the losses suffered by any person.
- (b) The argument of the auditors is valid. Since the final outcome of the litigation did not held them liable, they cannot be asked to contribute towards the losses suffered by any person.
- (c) The argument of the auditors is not valid. The final outcome of the litigation covers the experts and hence the auditors also get covered to contribute towards the losses suffered by the persons.
- (d) The outcome of the litigation seems to be completely wrong. The directors and experts were held liable but along with that the statutory auditors, internal auditors, tax auditors, Company Secretary, tax consultants and the legal advisors should also have been held liable. Further the promoters cannot be held liable in such matters.

Answer: Option C

May 2018 5(b) -4 Marks

1.The Auditor of M/s Quick Limited succumbed to the pressure of the management in certifying the financials with an over stated figure of turnover by not adhering to the cut-off principles of the time scale for the transactions of the year. On taking cognizance of this act of the auditor, the Tribunal under the Companies Act, 2013 initiated the proceedings against him. Briefly list the powers of the Tribunal in this respect including those relating to making orders against the Auditor found to be guilty

MTP Apr 18 Qn no.6(B) 4 Marks

Elucidate the power of Tribunal to change the auditor of a company if found acted in a fraudulent manner as provided under sub-section (5) of section 140 of the Companies Act, 2013.

MTP-OCT-19 Qn No 5(b) 5 Marks:

Vivan Ltd is a company engaged in the business of software development. It is one of the largest companies in this sector with a turnover of INR 25,000 crores. The operations of the company are increasing constantly, however, the focus of the management is more on cost cutting in the coming years to improve its profitability. In respect of the financial statements of the company which are used by various stakeholders, some fraud was observed in respect of assets reported therein due to which those stakeholders suffered damages. As a result, those stakeholders applied to Tribunal for change of auditor on the basis that auditor is colluded in the fraud.

Elucidate the power of Tribunal to change the auditor of a company if found acting in a fraudulent manner as provided under sub-section (5) of section 140 of the Companies Act, 2013.

RTP Nov 2019 Qn no 17

Anvisha Ltd. is a company engaged in the business of software development. It is one of the largest companies in this sector with a turnover of ` 25,000 crores. The operations of the company are increasing constantly, however, the focus of the management is more on cost cutting in the coming years to improve its profitability. In respect of the financial statements of the company which are used by various stakeholders, some fraud was observed in respect of assets reported therein due to which those stakeholders suffered damages. As a result, those stakeholders applied to Tribunal for change of auditor on the basis that auditor is colluded in the fraud.

Elucidate the power of tribunal to change the auditor of a company if found acted in a fraudulent manner as provided under sub-section (5) of section 140 of the Companies Act, 2013.

Answer

Power of Tribunal in case Auditor acted in a Fraudulent Manner: As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447 of the said Act.

It is hereby clarified that in the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

2.RTP May 2018 Qn no. 9

In assessment procedure of M/s Cloud Ltd., Income Tax Officer observed some irregularities. Therefore, he started investigation of Books of Accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through books he found that M/s Cloud Ltd. used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the Institute of Chartered Accountants of India saying Mr. Old had negligently performed his duties. Comment.

Answer

Liability of Auditor: "It is the auditor's responsibility to audit the statement of accounts and prepare tax returns on the basis of books of accounts produced before him. Also if he is satisfied with the books and documents produced to him, he can give his opinion on the basis of those documents only by exercising requisite skill and care and observing the laid down audit procedure.

In the instant case, Income tax Officer observed some irregularities during the assessment proceeding of M/s Cloud Ltd. Therefore, he started investigation of books of accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through the books, he found that M/s Cloud Ltd. Used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the ICAI saying Mr. Old had negligently performed his duties.

Mr. Old, the auditor was not under a duty to prepare books of accounts of assessee and he should, of course, neither suggest nor assist in the preparations of false accounts. He is responsible for the books produced before him for audit. He completed his audit work with official set of books only.

In this situation, as Mr. Old, performed the auditing with due skill and diligence; and, therefore, no question of negligence arises. It is the duty of the Department to himself investigate the truth and correctness of the accounts of the assessee.

MTP Mar 18 Qn no.6(b) 4 Marks

Mr. Fresh, a newly qualified chartered accountant, wants to start practice and he requires your advice, among other things, on criminal liabilities of an auditor under the Companies Act, 2013. You are required to briefly explain the same to Mr. Fresh.

The circumstances in which an auditor can be prosecuted under the Companies Act, and the penalties to which he may be subjected are briefly stated below:

- (i) **Criminal liability for Misstatement in Prospectus** - As per Section 34 of the Companies Act, 2013, where a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.

This section shall not apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

- (ii) **Punishment for false statement** - According to Section 448 of the Companies Act, 2013 if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement —
- (a) which is false in any material particulars, knowing it to be false; or
- (b) which omits any material fact, knowing it to be material, he shall be liable under section 447.

Punishment for Fraud- As per Section 447 of the Companies Act, 2013, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

It may be noted that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

It may also be noted that when the fraud where the fraud involved is less than ten lakh rupees or 1% of the turnover of the company, whichever is lower and doesn't involve public interest, any person guilty of fraud shall be punishable with imprisonment for a term which may extend to 5 Years or with a fine which may extend to Rs. 50,00,000 or both.

3.MTP-Aug-18 Qn No 6(b) 4 Marks:

Mr. Ram, a Chartered Accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivers to the Income Tax Authorities a false declaration. Discuss briefly the liabilities of Mr. Ram under Income Tax Act, 1961.

Answer:

False Declaration as Authorized Representative: In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable **under section 278** of the Income Tax Act 1961. Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine. In the instant case, Mr. Ram, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration, thus, he would be liable under section 278 of the Income Tax Act, 1961.

4.MTP-OCT-18 Qn No 6(b) 5 Marks:

Indicate the precise nature of auditor's liability in the following situations and support your views with authority, if a misstatement had occurred in the prospectus issued by the company.

Answer:

Under section 35 of the Companies Act, 2013 -

Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

- (a) is a director of the company at the time of the issue of the prospectus;
- (b) has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
- (c) is a promoter of the company;
- (d) has authorised the issue of the prospectus; and
- (e) is an expert referred to in sub-section (5) of section 26,

shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

- (2) No person shall be liable under sub-section (1), if he proves—
 - (a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent, or
 - (b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.
 - (c) that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder.
- (3) Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

It may be noted that the term “expert” as defined in Section 2(38) of the Companies Act, 2013 includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force. Also that under Section 26 of the

Act a statement may be considered to be untrue, not only because it is so but also if it is misleading in the form and context in which it is included.

The liability would arise if the written consent of the auditor to the issue of the prospectus, including the report purporting to have been made by him as an “expert” has been obtained.

Criminal liability for Misstatement in Prospectus

The circumstances in which an auditor can be prosecuted under the Companies Act, and the penalties to which he may be subjected are briefly stated below:

Criminal liability for Misstatement in Prospectus - As per Section 34 of the Companies Act, 2013, where a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.

This section shall not apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

Punishment for false statement - According to Section 448 of the Companies Act, 2013 if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement —

- | |
|--|
| (a) which is false in any material particulars, knowing it to be false; or |
| (b) which omits any material fact, knowing it to be material, |

he shall be liable under section 447

Punishment for Fraud- As per Section 447 of the Companies Act, 2013, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud [involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower] shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud: It may be noted that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years. It may also be noted that where the fraud involves an amount

less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.].

Under section 448, an auditor is liable for criminal prosecution, if he, in any return, certificate, balance sheet, prospectus, statement or other document required by or for the purpose of the Act, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material. If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act.

5.Nov 2018 Question no 6(b) 4 Marks

What are the liabilities of a Chartered Accountant under Income Tax Act, 1961 for furnishing an incorrect statement in any report or certificate required to be submitted by him under the Act?

Answer

Liability of an Auditor under Income Tax Act: Liabilities of a Chartered Accountant under the Income Tax Act of 1961 for furnishing an incorrect statement in any report or certificate required to be submitted by him under the Act are as below:

Under Section 278: "If a person abets or induces in any manner another person to make and deliver an account or a statement or declaration relating to any income [or any fringe benefits] chargeable to tax which is false and which he either knows to be false or does not believe to be true or to commit an offence under sub-section (1) of section 276C, he shall be punishable,-

Section 278 of the Income Tax Act, 1961:

- in a case where the amount of tax, penalty or interest which would have been evaded, if the declaration, account or statement had been accepted as true, or which is willfully attempted to be evaded, exceeds [twenty five] hundred thousand rupees, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;
- in any other case, with rigorous imprisonment for a term which shall not be less than three months but which may extend to [two] years and with fine

Under Rule 12A of the Income Tax Rules: Under this rule a Chartered Accountant who as an authorised representative has prepared the return filed by the assessee, has to furnish to the Assessing Officer, the particulars of accounts, statements and other documents supplied to him by the assessee for the preparation of the return.

Where the Chartered Accountant has conducted an examination of such records, he has also to submit a report on the scope and results of such examination. The report

to be submitted will be a statement within the meaning of Section 277 of the Income Tax Act. Thus, if this report contains any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years and to a fine.

Under Section 271J of the Income Tax Act: As per new section inserted by the Finance Act, 2017 if an accountant or a merchant banker or a registered valuer, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made there under, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of ten thousand rupees for each such report or certificate by way of penalty. [section 271J]

6.RTP May 2019 Qn no 17

Indicate the precise nature of auditor's liability in the following situations and support your views with authority, if any:

- (I) **Certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor who in turn brought the same to the knowledge of the Managing Director of the company. In the subsequent year huge defalcation came to the notice of the management. The origin of the same was traced to the earlier year. The management wants to sue the auditor for negligence and also plans to file a complaint with the Institute.**
- (II) **Based upon the legal opinion of a leading advocate, X Ltd. made a provision of Rs. 3.5 crores towards Income Tax liability. The assessing authority has worked out the liability at ` 5 crores. It is observed that the opinion of the advocate was inconsistent with legal position with regard to certain revenue items.**

ANSWER

- (I) In the given case, certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor and brought the same to the knowledge of the Managing Director of the company. In the subsequent year, a huge defalcation took place, the ramification of which stretched to the earlier year. The management of the company desires to sue the statutory auditor for negligence. The precise nature of auditor's liability in the case can be ascertained on the basis of the under noted considerations:
 - (a) Whether the defalcation emanated from the weaknesses noticed by the statutory auditor, the information regarding which was passed on to the management; and
 - (b) Whether the statutory auditor properly and adequately extended the audit programme of the previous year having regard to the weaknesses noticed.

SA 265 on “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management” clearly mentions that, “The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies. The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis”. The fact, however, remains that, weaknesses in the design of the internal control system and non-compliance with identified control procedures increase the risk of fraud or error. If circumstances indicate the possible existence of fraud or error, the auditor should consider the potential effect of the suspected fraud or error on the financial information. If the auditor believes the suspected fraud or error could have a material effect on the financial information, he should perform such modified or additional procedures as he determines to be appropriate. Thus, normally speaking, as long as the auditor took due care in performing the audit work, he cannot be held liable.

The fact that the matter was brought to the notice of the managing director may be a good defence for the auditor as well. According to the judgement of the classic case. In re Kingston Cotton Mills Ltd., (1896) it is the duty of the auditor to probe into the depth only when his suspicion is aroused. The statutory auditor, by bringing the weakness to the notice of the managing director had alerted the management which is judicially held to be primarily responsible for protection of the assets of the company and can put forth this as defence against any claim arising subsequent to passing of the information to the management. In a similar case S.P. Catterson & Sons Ltd. (81 Acct. L. R.68), the auditor was acquitted of the charge.

- (II) SA 500 on "Audit Evidence" discusses the auditor's responsibility in relation to and the procedures the auditor should consider in, using the work of an expert as audit evidence. 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, e.g., legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc. Before relying on advocate's opinion, the auditor should have seen that opinion given by the management's expert is prima facie dependable. The question states very clearly that the opinion of the advocate was inconsistent with legal position with regard to certain items. It is, perhaps, quite possible that auditor did not seek reasonable assurance as to the appropriateness of the source data, assumptions and methods used by the expert properly.

In fact, SA 500 makes it incumbent upon the part of the auditor to resolve the inconsistency by discussion with the management and the expert. In case, the expert's' work does not support the related representation in the financial information the inconsistency in legal opinions could have been detected by the auditor if he had gone through the same. This seems apparent having regard to wide difference in the liability worked out by the assessing authority. Under the circumstance, the auditor should have rejected the opinion and insisted upon making proper provision.

Study Material

7. Indicate the precise nature of auditor's liability in the following situations and support your views with authority, if any:

(i) **Certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor who in turn brought the same to the knowledge of the Managing Director of the company. In the subsequent year huge defalcation came to the notice of the management. The origin of the same was traced to the earlier year. The management wants to sue the auditor for negligence and also plans to file a complaint with the Institute.**

(ii) **Based upon the legal opinion of a leading advocate, X Ltd. made a provision of ` 3 crores towards Income Tax liability. The assessing authority has worked out the liability at ` 5 crores. It is observed that the opinion of the advocate was inconsistent with legal position with regard to certain revenue items.**

Answer

(i) In the given case, certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor and brought the same to the knowledge of the Managing Director of the company. In the subsequent year, a huge defalcation took place, the ramification of which stretched to the earlier year. The management of the company desires to sue the statutory auditor for negligence. The precise nature of auditor's liability in the case can be ascertained on the basis of the under noted considerations:

(a) Whether the defalcation emanated from the weaknesses noticed by the statutory auditor, the information regarding which was passed on to the management; and

(b) Whether the statutory auditor properly and adequately extended the audit programme of the previous year having regard to the weaknesses noticed.

SA 265 on "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" clearly mentions that, "The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant

deficiencies. The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis". The fact, however, remains that, weaknesses in the design of the internal control system and non-compliance with identified control procedures increase the risk of fraud or error. If circumstances indicate the possible existence of fraud or error, the auditor should consider the potential effect of the suspected fraud or error on the financial information. If the auditor believes the suspected fraud or error could have a material effect on the financial information, he should perform such modified or additional procedures as he determines to be appropriate. Thus, normally speaking, as long as the auditor took due care in performing the audit work, he cannot be held liable. The fact that the matter was brought to the notice of the managing director may be a good defence for the auditor as well. According to the judgement of the classic case in re Kingston Cotton Mills Ltd., (1896) it is the duty of the auditor to probe into the depth only when his suspicion is aroused. The statutory auditor, by bringing the weakness to the notice of the managing director had alerted the management which is judicially held to be primarily responsible for protection of the assets of the company and can put forth this as defence against any claim arising subsequent to passing of the information to the management. In a similar case S.P. Catterson & Sons Ltd. (81 Acct. L. R.68), the auditor was acquitted of the charge.

(ii) SA 500 on "Audit Evidence" discusses the auditor's responsibility in relation to and the procedures the auditor should consider in, using the work of an expert as audit evidence. 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, e.g., legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc. Before relying on advocate's opinion, the auditor should have seen that opinion given by the expert is prima facie dependable. The question states very clearly that the opinion of the advocate was inconsistent with legal position with regard to certain items. It is, perhaps, quite possible that auditor did not seek reasonable assurance as to the appropriateness of the source data, assumptions and methods used by the expert properly.

In fact, SA 500 makes it incumbent upon the part of the auditor to resolve the inconsistency by discussion with the management and the expert. In case, the experts' work does not support the related representation in the financial information the inconsistency in legal opinions could have been detected by the auditor if he had gone through the same. This seems apparent having regard to wide difference in the liability worked out by the assessing authority. Under the circumstance, the auditor should have rejected the opinion and insisted upon making proper provision.

8. Write a short note on - Auditor's liability in case of unlawful acts or defaults by clients.

Answer

Auditor's liability in case of unlawful Acts or defaults by clients: The auditor's basic responsibility is to report whether in his opinion the accounts show a true and fair view and in discharging his responsibility he has to see as to how the particular situations affected his position. The general thinking with regard to unlawful acts or defaults by clients appears to be that the auditor should not 'aid or abet' but he is apparently not under any legal obligation to disclose the offence. A professional accountant would himself be guilty of a criminal offence if he advises his client to commit any criminal offence or helps or encourages in planning or execution of the same or conceals or destroys evidence to obstruct the course of public justice or positively assists his client in evading prosecution. A professional accountant in his capacity as auditor, accountant, or tax representative has access to a variety of information concerning his clients. On some occasions, he may acquire knowledge that his client has been guilty of some unlawful act, default, fraud, or other criminal offence. The duty of the professional accountant in such a case would depend upon the actual circumstances of the situation. Due consideration should be given to the exact nature of services that a professional accountant is rendering to his client, i.e. is he representing the client in income-tax proceedings or is he acting in the capacity of an auditor or an accountant or a consultant.

The Institute of Chartered Accountants of India has considered the role of chartered accountants in relation to taxation frauds by an assessee and has made the following major recommendations:

- (i) A professional accountant should keep in mind the provisions of Section 126 of the Evidence Act whereby a barrister, an attorney, a pleader or a Vakil is barred from disclosing any communication made to him in the course of and for the purpose of his employment.
- (ii) If the fraud relates to past years when the accountant did not represent the client, the client should be advised to make a disclosure. The accountant should also be careful that the past fraud does not in any way affect the current tax matters.
- (iii) In case of fraud relating to accounts examined and reported upon by the professional accountant himself, he should advise the client to make a complete disclosure. In case the client refuses to do so, the accountant should inform him that he is entitled to dissociate himself from the case and that he would make a report to the authorities that the accounts prepared or examined by him are unreliable on account of certain information obtained later. In making such a report, the contents of the information as such should not be communicated unless the client consents in writing.

- (iv) In case of suppression in current accounts, the client should be asked to make a full disclosure. If he refuses to do so, the accountant should make a complete reservation in his report and should not associate himself with the return.

However, it can be argued that the auditor has a professional obligation to ensure that the client is fully aware of the seriousness of the offence and to seriously consider full disclosure of the matter.

It has been clearly established in various case laws that the auditor is expected to know the contents of documents and records and ascertain whether the affairs of the client are being conducted in an unlawful manner. It is in the course of the work, he comes across any unlawful acts, it is his duty to bring it to the notice of the client as also to make a disclosure in his report in appropriate cases. In this regard, one has to bear in mind the consequence of the act in relation to the professional code to which an auditor is subjected. Under the code, an auditor cannot disclose confidential information unless permitted by the client or unless required by law. Each case has to be judged on its circumstances. However, in every case he has to assess the implications of the unlawful act or default on the true and fair character of the accounting statements.

The question of liability of an auditor for unlawful acts or defaults by clients should be considered in the light of the broad parameters given above. However, it appears that if an auditor was aware of any unlawful act having been committed by client in respect of accounts audited by him and the unlawfulness was not rectified by proper disclosure or any other appropriate means, the auditor owes a duty to make a suitable report. If he does not, he may be held liable, if the true and fair character of the accounts has been vitiated.

9.Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.

Answer

Duties & Responsibilities of an Auditor in case of Material Misstatement resulting from Management Fraud: Misstatement in the financial statements can arise from fraud or error. The term fraud refers to an 'Intentional Act' by one or more individuals among management, those charged with governance. The auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements.

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

Fraud involving one or more members of management or those charged with the governance is referred to as “management fraud”. The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity.

Further, an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees

Auditor’s opinion on the financial statements is based on the concept of obtaining reasonable assurance, hence in an audit, the auditor does not guarantee that material misstatements will be detected.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount(s) as may be prescribed, is being or has been committed in the co. by its officers or employees, the auditor shall report the matter to the Central Government (in case amount of fraud is ` 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ` 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, 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.

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor shall:

- i. Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- ii. Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- iii. If the auditor withdraws:

- (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
- (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

4. In assessment procedure of M/s Cloud Ltd., Income Tax Officer observed some irregularities. Therefore, he started investigation of Books of Accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through books he found that M/s Cloud Ltd. used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the Institute of Chartered Accountants of India saying Mr. Old had negligently performed his duties. Comment.

Answer

Liability of Auditor: "It is the auditor's responsibility to audit the statement of accounts and prepare tax returns on the basis of books of accounts produced before him. Also if he is satisfied with the books and documents produced to him, he can give his opinion on the basis of those documents only by exercising requisite skill and care and observing the laid down audit procedure.

In the instant case, Income tax Officer observed some irregularities during the assessment proceeding of M/s Cloud Ltd. Therefore, he started investigation of books of accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through the books, he found that M/s Cloud Ltd. Used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the ICAI saying Mr. Old had negligently performed his duties.

Mr. Old, the auditor was not under a duty to prepare books of accounts of assessee and he should, of course, neither suggest nor assist in the preparations of false accounts. He is responsible for the books produced before him for audit. He completed his audit work with official set of books only.

In this situation, as Mr. Old, performed the auditing with due skill and diligence; and, therefore, no question of negligence arises. It is the duty of the Department to himself investigate the truth and correctness of the accounts of the assessee.

5. On the advice of Management of Quick Ltd., the auditor of the Company overlooked and did not report on shifting of certain current year's sales transactions to the next year. The National Company Law Tribunal (NCLT) wants to take action against the auditor. Describe the powers of the NCLT under Section 140(5) of the Companies Act, 2013 for such action and consequences for the auditor.

ANSWER:

False Declaration as Authorized Representative: In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income Tax Act 1961.

Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine. In the instant case, Mr. Prince, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration, thus, he would be liable under section 278 of the Income Tax Act, 1961.

6. State the nature of liability as provided in the Companies Act, 2013 for an auditor for not appropriately dealing with a misstatement appearing in audited financial statements or a false statement in Audit Report.

ANSWER:

Nature of Liability as per the Companies Act, 2013: Under section 448 of the Companies Act, 2013, an auditor is liable for criminal prosecution, if he, in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material.

If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act. (Refer Para 5 for section 447)

Thus, in view of above, an auditor will be held liable for criminal prosecution for not appropriately dealing with a misstatement appearing in audited financial statements or a false statement in Audit Report assuming that it was known to auditor.

7. CA Prince, a Chartered Accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivers to the Income Tax Authorities a false declaration. What are the liabilities of CA. Prince under Income Tax Act, 1961?

ANSWER:

False Declaration as Authorized Representative: In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income Tax Act 1961.

Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

In the instant case, Mr. Prince, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration, thus, he would be liable under section 278 of the Income Tax Act, 1961.

Multiple Choice Questions

OPE Ltd issued a prospectus in respect of an IPO which had the auditor's report on the financial statements for the year ended 31 March 2019. The issue was fully subscribed.

During this year, there was an abnormal rise in the profits of the company for which it was found later on that it was because of manipulated sales in which there was participation of Whole-time director and other top officials of the company. On discovery of this fact, the company offered to refund all moneys to the subscribers of the shares and sued the auditors for the damages alleging that the auditors failed to examine and ascertain any satisfactory explanation for steep increase in the rate of profits and related accounts.

The company emphasized that the auditor should have proceeded with suspicion and should not have followed selected verification. The auditors were able to prove that they found internal controls to be satisfactory and did not find any circumstance to arouse suspicion.

The company was not able to prove that auditors were negligent in performance of their duties. Please suggest your views on this.

- (a) The stand of the company was correct in this case. Considering the nature of the work, the Auditors should have proceeded with suspicion and should not have followed selected verification.
- (b) The approach of the auditors look reasonable in this case. The auditors found internal controls to be satisfactory and also did not find any circumstance to arouse suspicion and hence they performed their procedures on the basis of selected verification.

(c) In the given case, the auditors should have involved various experts along with them to help them on their audit procedures. Prospectus is one area wherein management involves various experts and hence the auditors should also have done that. In the given case, by not involving the experts the auditors did not perform their job in a professional manner. If they had involved experts like forensic experts etc, the manipulation could have been detected. Hence the auditors should be held liable.

(d) In case of such type of engagements, the focus is always on the management controls. If the controls are found to be effective then an auditor can never be held liable in respect of any deficiency or misstatement or fraud.

Answer: (b) The approach of the auditors look reasonable in this case. The auditors found internal controls to be satisfactory and also did not find any circumstance to arouse suspicion and hence they performed their procedures on the basis of selected verification

Kshitij and a group of persons subscribed to the shares of JNN Ltd. JNN Ltd had issued a prospectus for issuance of shares against which these persons had subscribed the shares.

It was later on found that some information as included in the prospectus was misleading. These persons filed a case against the company covering all the parties who were responsible for the prospectus on the ground that the information contained in the prospectus was misleading and they suffered losses by relying on that information.

The company consulted this matter with its legal consultants in respect of the course of action to be taken and also consulted that if the outcome of the case goes against the company then which all parties may be held liable and what could be the other consequences.

The prospectus included auditor's report who had also given his clearance. Some of the experts were also involved in respect of the information on which the litigation was filed.

Subsequently, it was proved that the contention of Kshitij and those persons was correct. It was held that the directors, promoters of the company and the experts involved would be liable to pay compensation to all these persons who had sustained losses or any damage.

The auditors of the company were also asked to make good the losses but they refused with an argument that it is limited to directors, promoters and experts.

In this context, please suggest which of the following statement is correct.

- a) The argument of the auditors is valid. As per the final outcome of the litigation the auditors were not held liable. However, on moral grounds the auditors should contribute towards the losses suffered by any person.

- b) The argument of the auditors is valid. Since the final outcome of the litigation did not hold them liable, they cannot be asked to contribute towards the losses suffered by any person.
- c) The argument of the auditors is not valid. The final outcome of the litigation covers the experts and hence the auditors also get covered to contribute towards the losses suffered by the persons.
- d) The outcome of the litigation seems to be completely wrong. The directors and experts were held liable but along with that the statutory auditors, internal auditors, tax auditors, Company Secretary, tax consultants and the legal advisors should also have been held liable. Further the promoters cannot be held liable in such matters.

Answer: (c) The argument of the auditors is not valid. The final outcome of the litigation covers the experts and hence the auditors also get covered to contribute towards the losses suffered by the persons.

JK Ltd is a company engaged in the business of software development. It is one of the largest companies in this sector with a turnover of INR 25,000 crores. The operations of the company are increasing constantly, however, the focus of the management is more on cost cutting in the coming years to improve its profitability.

In respect of the financial statements of the company which are used by various stakeholders, some deficiencies were observed in respect of assets reported therein due to which those stakeholders suffered damages. As a result, those stakeholders went for a civil action against the company including all the parties who had the responsibility in respect of those financial statements.

The statutory auditors of the company were also roped in. The statutory auditors went against this civil action and were able to prove that there was no professional negligence on their part.

It was decided that the loss was occasioned through the negligence of directors and the fault of the auditor in failing to verify the asset was considered to be only technical.

On the basis of above mentioned facts, what should be the correct option out of the following?

- a) A penalty should be levied on the auditors but that should not be equivalent to the damages suffered by the stakeholders. The damages would be required to be made good by the directors of the company.
- b) Both the auditors and the directors should be held liable in respect of the deficiencies identified. Both of them should compensate these stakeholders in respect of the damages and a further penalty of INR 10 lakhs would be imposed on them.

c) Auditors and directors should be held liable in this case. Further because the fault of directors is bigger, they would be subject to a penalty of INR 10 crores or losses suffered by the stakeholders, whichever is higher.

d) Since the fault of the auditor is limited to technical in nature, he cannot be held liable for any penalty or damages. However, he would not be allowed to work for this company and any other company in similar industry for a period of next 5 years as per the requirements of the Companies Act 2013.

Answer : (a) A penalty should be levied on the auditors but that should not be equivalent to the damages suffered by the stakeholders. The damages would be required to be made good by the directors of the company

KKR Ltd is a medium-sized company engaged in the business of e-commerce. The company's operations have remained stable over the years and its profitability has been going down. The company also ventured into different markets over the last few years but that has not helped much in terms of growth of business or increasing the profitability. The company's immediate plan is to expand its operations with focus on increasing the profitability.

The company was looking for funds to achieve this objective and issued a prospectus to the public to subscribe to its shares.

The financial statements of the company for the year ended 31 March 2018 included in the prospectus showed a very different picture of the company particularly in respect of its profits.

It was later on found that some of the information contained in the prospectus was misstated i.e. it was untrue and misleading to attract the public to subscribe the shares of the company.

Legal action was taken by the stakeholders against the company including its auditors and the company's management/ directors were confident that they would not be required to face any action considering the fact that the financial statements were duly audited by a reputed firm of Chartered Accountants. If at all problem arises, it would be the responsibility of the auditors. Please advise whether anyone can be held liable in this matter or not. If yes, what action can be taken against him/them? If no, what should be the corrective action?

a) The understanding of the directors is correct and the auditors should be held liable under section 447 of the Companies Act.

b) The understanding of the directors is wrong. They would be held liable under section 447 of the Companies Act and not the auditors because responsibility for the prospectus lies with the management.

c) This may lead to criminal liability wherein every person who authorises the issue of such prospectus shall be liable under section 447 of the Companies Act.

d) This may lead to civil liability wherein every person who authorises the issue of

such prospectus shall be liable under section 447 of the Companies Act.

Answer: (c) This may lead to criminal liability wherein every person who authorises the issue of such prospectus shall be liable under section 447 of the Companies Act.

Vimal Kumar, a Chartered Accountant by profession, has been into practice for the over 6 years. He developed a specialization in respect of matters related to Income Tax and hence got various clients to whom he was advising.

Other than the taxation work, Vimal was also good in accounting matters but he could not develop his business/ clientele the accounting services over the period.

He used to represent his clients in respect of income tax returns.

For one of his clients, he, as an authorised representative, prepared the return of income and furnished the same and other required documents (the particulars of accounts, statements and other documents supplied to him by the assessee for the preparation of the return) to the Assessing Officer. He had also conducted an examination of those records and submitted a report on the scope and results of his examination.

The assessee in this case was a very old client of Vimal and also used to pay him very good remuneration. In order to provide some benefits to the assessee, Vimal provided certain information to the assessing officer which was found to be false later on.

In the given case, which of the following options should apply?

- a) Since Vimal only acted as a representative of the assessee, he cannot be held liable. The assessee is the primary person responsible and accordingly the assessee would be liable to rigorous imprisonment which may extend to seven years and to a fine.
- b) The given matter does not only relate to submission of the return of income but also covers an examination of those records and a report on the scope and results of examination by a Chartered Accountant. Because of the professional responsibilities placed on a CA, it becomes his duty to carry out all the tasks in an objective manner free from any bias. Hence Vimal would be liable to a penalty of ` seven crores and imprisonment of seven years.
- c) Vimal would be liable to rigorous imprisonment which may extend to seven years and to a fine.
- d) Vimal and his assessee would be liable to a penalty which may extend to ` 1 crore. Further because of the fact that the particulars submitted with the assessing officer belong to the assessee, hence the assessee would also be liable to imprisonment for three years under the Indian Penal Code.

Answer : (c) Vimal would be liable to rigorous imprisonment which may extend to seven years and to a fine.

CHAPTER 15 Internal Audit, Management and Operational Audit

Multiple Choice Questions

MTP Mar 2019 Qn no 2 (1 Mark)

Prakash Limited has around 25 branch offices and all the branch offices were on company's own land and building. Company has the Policy that all the original title deeds for land and building owned by the company will be kept in the custody of authorised official at company's head office and a certified copy of the same is kept with the respective branch for verification. You have been appointed as the internal auditor for the branches of the company and during the course of audit you observed that the original title deeds of some of the branch office are kept in the branch under the custody of branch officials itself. What action will you take in such case?

- (a) It is not a material discrepancy, so the auditor is not required to take any action in such case.
- (b) The auditor should inform the internal auditor of the Head Office for the compliance of the same.
- (c) The auditor should ask the branch office/official to send original title deed to the authorised official at Head Office of the company immediately and submit the Internal Audit Report once the confirmation received from Head office of company.
- (d) As an internal auditor, report the matter in the Internal Audit Report and check for the compliance of the same in the next audit period.

Answer: (d) As an internal auditor, report the matter in the Internal Audit Report and check for the compliance of the same in the next audit period.

MTP Mar 2019 Qn no 13 (2 Marks)

Management of HFC Ltd. noticed a sudden increase in expense under the head "wages & salaries" for the year 2015-16 and 2016-17. The management felt a need to get the management audit done in order to identify the reason for the sudden increase. Mr. Arsh Gupta, Chartered Accountant was appointed as management auditor by the company on 15th April 2017. What areas do you think the auditor need to verify for the purpose?

- (a) Check the payroll sheet prepared as per approved pay and allowances; verify the overtime sanctioned and authorised; and verify the payment process followed by the company for the payment of wages & salaries to employees.
- (b) Overtime authorised and the payment done to employees are the main areas need to be verified by the auditor.

- (c) Auditor should first understand the HR Policy of the company. Then verify all the authorised vouchers for overtime payments done during the year; verify the payroll preparation and reconcile the gross pay in terms of increments/promotions & resignations; verify the appointments made during the year as per HR Policy and payments made to agencies providing contractual staff.
- (d) Auditor need to verify the new appointments i.e. of company's payroll or outsourced staff and the overtime allowance paid to employees.

Answer :(c) Auditor should first understand the HR Policy of the company. Then verify all the authorised vouchers for overtime payments done during the year; verify the payroll preparation and reconcile the gross pay in terms of increments/promotions & resignations; verify the appointments made during the year as per HR Policy and payments made to agencies providing contractual staff.

MTP Mar 2019 QN no 14 (2 Marks)

An educational institute was collecting fees from their students by cash/ cheque / draft and through net banking. Institute follows the policy to account for the fees received in the year of receipt only and for the cheques or drafts received but not deposited in bank or credited in bank account, should be shown in reconciliation statement. The internal auditor of branches noticed that at some branches only the fees received up to 25th March are accounted for in the same year and the receipts after that date are carried forward to be accounted for in the next financial year. The fees collected in these branches between 25th to 31st March amounted to Rs. 15 lakhs for the year 2017-18 and the collection for the financial year ended 31st March 2018 amounted to Rs. 115 crores. The auditor was of the view that it will not give a true and fair view on institute's revenue for the year. What do you think should be the next step of the auditor?

- (a) The branches have accounted for those receipts in the next financial year so the auditor can ignore the observation.
- (b) Auditor should report the matter in Executive Summary paragraph and highlight it as significant internal control lapse.
- (c) Internal auditor can discuss the matter with the management to take a strict action against the branches not following institute's policy.
- (d) Auditor should get the accounts modified and report the matter in action taken report.

Answer:(d) Auditor should get the accounts modified and report the matter in action taken report.

MTP Mar 2019 Qn no 15 (2 Marks)

AFM coaching institute was accepting fees from its students in cash or cheque or online transfer for an amount up to Rs.10000/-, and if the amount of fees is above Rs.10000/- by cheque or online transfer only. In the year 2017 the institute's total fees collection was of Rs.82 crores. Your firm has been appointed the internal auditor by the Institute and during the verification of vouchers for fee receipts you noticed that

cash receipts of approximately Rs.5 lakhs were directly credited in bank account instead of routing through cash account. Management explained that since the deposit slips used for fees received in cash or cheque are same, the accountant has erroneously shown them in the bank account but he has always tallied the cash at day end and those cash receipts were deposited in the bank account same day. Whether the auditor will consider the discrepancy as material for audit report?

- (a) The auditor should disclose the fact with his comment in the audit report as it is material for giving a true and fair view on financial statements.
- (b) It is not a material discrepancy as the total receipts amount will remain the same and the fees collected in cash are deposited in bank account only.
- (c) The auditor should verify that whether such cash receipts reflects in bank statement on the same day and cash ledger reconciles with the cash book on the respective dates or not. If it is followed then auditor can include the matter in observation paragraph with his comments else disclose the matter as major internal control lapse.
- (d) Auditor can ask the management to give a representation letter in writing.

Answer: (c) The auditor should verify that whether such cash receipts reflects in bank statement on the same day and cash ledger reconciles with the cash book on the respective dates or not. If it is followed then auditor can include the matter in observation paragraph with his comments else disclose the matter as major internal control lapse.

MTP Apr 2019 QN no 18 (2 Marks)

Rajaram is appointed as internal auditor for a finance company with 15 branches across the states. He needs to conduct a branch visit in the coming week. Based on management inputs and past year audit reports, he has shortlisted four branches.

Rajaram is not able to decide which branch visit he should prioritize as an internal auditor. Based on the branch information given below, which branch should Rajaram visit first?

- a. Sonpur – 15 people; two instances of fraud in the last year; regional manager present in the branch for supervision
- b. Chandpur – 12 people; no fraud, no visit by internal auditor in last two years due to set processes
- c. Rampur – 18 people; no fraud, 6 of 20 employees are new joiners in the last 6 months; newly opened branch
- d. Laxmanpur–10 people; 1 fraud in the last year, all 10 are long term employees of the company; no audit visit in the last year

Answer: Option (d) Laxmanpur–10 people; 1 fraud in the last year, all 10 are long term employees of the company; no audit visit in the last year

MTP Oct 2019 QN no 14 (2 Marks)

Employees of LIG Ltd. have to travel frequently for business purposes, so the company entered into a contract with a Simon Travels Ltd. for managing booking, cancellation and other services required by their employees. As per contract terms, Simon travels has to raise its monthly bills for the tickets booked or cancelled during the period and the same are paid by LIG Ltd. within 15 days of the bill date. The bills raised by Simon travels were of huge amount, so the management of LIG Ltd. decided to get an audit conducted of the process followed for booking/ cancellation of tickets and verify the accuracy of bills raised by the travel agency. Which audit do you feel the management should opt for?

- (a) Internal audit, as it relates to examine the operational efficiency of the organisation.
- (b) Management audit, as it is an audit desired by the management.
- (c) Performance audit so as to assess the performance of the Simon travels appointed by the organisation.
- (d) Operational audit, as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Simon travels for the organisation.

Answer: (d) Operational audit, as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Simon travels for the organisation.

Descriptive Questions

May 2018 6(e) 4 Marks

1.The Operational Audit is carried out effectively when the Operational Auditor responds with positive traits in a scenario which is blended with behavioural issues. Explain few positive traits that help to conclude an Operational Audit,a success.

Answer

- (a) **Positive Traits that help to conclude an Operation Audit A success:** The operational auditor should possess some very essential personal qualities to be effective in his work:

In areas beyond accounting and finance, his knowledge ordinarily would be rather scanty and this is a reason which should make him even more inquisitive.

He should ask the who, why, how of everything. He should try to visualise whether simpler alternative means are available to do a particular work.

He should try to see everything as to whether that properly fits in the business frame and organisational policy. He should be persistent and should possess an attitude of scepticism.

He should not give up or feel satisfied easily. He should imbibe a constructive approach rather than a fault-finding approach and should give a feeling that his efforts are to help attaining an improved operation and not merely fault finding.

If the auditor succeeds in giving a feeling of help and assistance through constructive criticism, he will be able to obtain co-operation of the persons who are involved in the operations. This will itself be a tremendous achievement of the operational auditor. He should try to develop a team comprised of people of different backgrounds. Involvement of technical people in operational auditing is generally helpful.

2.RTP May 2018 Qn no.17

(a) Mr. Anand is appointed as statutory auditor of Xerox Ltd. Xerox Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhanu as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhanu, internal auditor as stated above in view of auditing standards.

(b) DLF Ltd., a manufacturing unit does not accept the recommendations for improvements made by the Operational Auditor. Suggest an alternative way to tackle the hostile management.

Direct Assistance from Internal Auditor: As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following:

- Assessing the risks of material misstatement;
- Evaluating the sufficiency of tests performed;
- Evaluating the appropriateness of management's use of the going concern assumption;
- Evaluating significant accounting estimates; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

(b) While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

The Participative Approach comes to the help of the auditor. In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor do not have to force any change on the auditee.

Hence, Operational Auditor of DLF manufacturing unit should adopt above mentioned participative approach to tackle the hostile management of DLF

3.MTP Mar 2018 5(b) 4 Marks

Mr. 'P' have been appointed as operational auditor of M/s Books & Magazine Ltd. and observed a totaling error in invoice of ` 1,000. He has not taken care of the same saying that this is out of scope of his work. Comment.

Scope of Operational Audit: Operational auditing is a systematic process involving logical, structured and organized series of procedures. It concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvement in future.

The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems, and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects, and grasp technical matters.

In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues; he will have to get the assistance of norms and standards in every operating field to be able to objectively judge a situation. The norms and standards should be such as are generally acceptable or developed by the company itself.

To a traditional internal auditor, a loss of ` 1,000 caused by a wrong totaling of invoice is important and this is that he looks for. But for an auditor engaged in the review of operations, carrying out of a proper maintenance programme of the machines is of greater importance because considerable production loss due to machine breaks down can thus be prevented. In both the cases, the auditor's objective is to see that the business and its profitability do not suffer from avoidable loss, but, nevertheless, there is a distinct difference in approach. But it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls.

Hence, contention of operational auditor that totaling error in invoice of ` 1,000 is out of scope is not correct as operational audit is being carried out to ensure that all the management functions like planning, organizing, staffing, directing and controlling are working effectively and efficiently. Such kind of error is very much in scope because such an existence of error indicates that control system (controlling function) is not sound.

4.MTP Mar 18 Qn no.5(e) 4 Marks

New Life Hospital is a multi-speciality hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. According to you, which basis system of control has been violated? Also advise the other general conditions pertaining to such system which needs to be maintained and checked by the management.

Answer

Basic system of Control: Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof. In the given case of New Life Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.

The general condition pertaining to the internal check system may be summarized as under-

- (i) No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iii) Every member of the staff should be encouraged to go on leave at least once a year.
- (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
- (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
- (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
- (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
- (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
- (x) Procedures should be laid down for periodical verification and testing of
different sections of accounting records to ensure that they are accurate.

5.MTP Apr 18 Qn no 2(d) 5 Marks

As an internal auditor for a large manufacturing concern, you are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.

ANSWER

The Internal Audit Programme in connection with Plant and Machinery and Tools and dies may be on the following lines:

- (i) **Internal Control Aspects:** The following may be incorporated in the audit programme to check the internal control aspects-
- (a) Maintaining separate register for hired assets, leased asset and jointly owned assets.
 - (b) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.
 - (c) All movements of assets are accurately recorded.
 - (d) Authorisation be obtained for –
 - (1) a declaring a fixed asset scrapped.
 - (2) selling a fixed asset.
 - (e) Check whether additions to fixed asset register are verified and checked by authorised person.
 - (f) Proper recording of all additions and disposal.
 - (g) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.
 - (h) Regular review of adequate security arrangements.
 - (i) Periodic inspection of assets is done or not.
 - (j) Regular review of insurance cover requirements over fixed assets.
- (ii) **Assets Register:** To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.
- (iii) **Cost Report and Journal Register:** To review the cost relating to each plant and machinery and to verify items which have been capitalised.
- (iv) **Code Register:** To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.
- (v) **Physical Verification:** To see physical verification has been conducted at frequent intervals.
- (vi) **Movement Register:** To verify (a) whether Movement Register for movable equipments and
(b) log books in case of vehicles, etc. are being maintained properly.
- (vii) **Assets Disposal Register:** To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.
- (viii) **Spare Parts Register:** To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.

- (ix) **Review of Maintenance:** To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.
- (x) **Review of Obsolescence:** To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.
- (xi) **Review of R&D:** To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

6.MTP Apr 18 Qn no.5(b) 4 Marks

Munch Ltd. is a public company having Rs. 40 lacs paid up capital in previous financial year which raised to Rs. 60 lacs in current financial year under audit. The company had turnover of previous three consecutive financial years being Rs. 49 crores, Rs. 145 crores and Rs. 150 crores. During the previous year, Munch Ltd. borrowed a loan from a public financial institution of Rs. 110 crores but squared up Rs. 20 crores by the year end. The company does not have any internal audit system. In view of the management, internal audit system is not mandatory.

You are required to state the provisions related to applicability of internal audit as per the Companies Act, 2013 and comment upon the contention of the management of the company

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

- (A) every listed company;
- (B) every unlisted public company having-
 - (1) paid up share capital of fifty crore rupees or more during the preceding financial year; or
 - (2) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (3) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
 - (4) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- (C) every private company having-
 - (1) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (2) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, Munch Ltd. is a public company. The company borrowed a loan from a public financial institution of Rs. 110 crores during the previous year. At the year end, the loan outstanding after being squared up is Rs. 90 crores (Rs. 110 crores - Rs. 20 crores) which is less than the minimum prescribed limit of Rs. 100 crores for applicability of internal audit. Although, the outstanding loan at previous year end is Rs. 90, it was Rs. 110 crores at some point of time which is the requirement of the section (refer Rule 13(B)(3) as mentioned above).

Hence, Munch Ltd. has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit. Consequently, the contention of the management of the company is not tenable.

7.MTP Apr 18 Qn no 5(E) 4 Marks

Yex Ltd. has five entertainment centers to provide facilities for public especially for children and youngsters at 5 different locations in the peripheral of 200 kms. Collections are made in cash. Specify the adequate control system towards collection of money.

Answer

Control System over Selling and Collection of Tickets: In order to achieve proper internal control over the sale of tickets and its collection by the Yex Co. Ltd., following system should be adopted -

- (i) **Printing of tickets:** Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.
- (ii) **Ticket sales:** The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.
- (iii) **Daily cash reconciliation:** Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.
- (iv) **Daily banking:** Each day's collection should be deposited in the bank on next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.

- (v) **Entrance ticket:** Entrance tickets should be cancelled at the entrance gate when public enters the centre.
- (vi) **Advance booking:** If advance booking of facility is made available, the system should ensure that all advance booked tickets are paid for.
- (vii) **Discounts and free pass:** The discount policy of the Y Co. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.
- (viii) **Surprise checks:** Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.

8.MTP-OCT-19 Qn No 5(c) 5 Marks:

BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2018-19. In order to review internal controls of the Sales Department of the company, you visited the Department and noticed the work division as follows:

- (1) **An officer was handling the sales ledger and cash receipts.**
- (2) **Another official was handling dispatch of goods and issuance of Delivery challans.**
- (3) **One more officer was there to handle customer/ debtor accounts and issue of receipts.**

As an internal auditor, you are required to briefly discuss the general condition pertaining to the internal check system prevalent in internal control system. Do you think that there was proper division of work in BSF Limited? If not, why?

Answer:

The general condition pertaining to the internal check system may be summarized as under:

- (i) no single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iii) Every member of the staff should be encouraged to go on leave at least once a year.
- (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v) There should exist an accounting control in respect of each class of

- assets, in addition, there should be periodical inspection so as to establish their physical condition.
- (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
 - (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
 - (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
 - (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
 - (x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.

In the given scenario, Company has not done proper division of work as: **(i)** the receipts of cash should not be handled by the official handling sales ledger and **(ii)** delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

9.RTP Nov 18 Qn no 17

Many modern enterprises have become huge and sophisticated. This has resulted in decentralisation of their activities and different type of audits. You are required to explain the difference to the management:

- (a) Internal & Operational Audit.
- (b) Management Audit & Operational Audit.
- (c) Financial Audit & Operational Audit.

Difference between Internal & Operational Audit: There probably may not be much of difference in viewing operational audit as a review and appraisal of operations of an organisation carried on by a competent independent person. Auditing whether carried on by an internal staff or by an external person, should necessarily be an independent activity to maintain its objectivity and usefulness.

The difference in the approach of both these audits is illustrated below:

1. **Perception** - Traditionally, internal auditors have been engaged in a sort of protective function, deriving their authority from the management. They view and examine internal controls in the financial and accounting areas to ensure that possibilities of loss,

wastage and fraud are not there; they check the accounting books and records to see, whether the internal checks are properly working and the resulting accounting data are reliable.

For example - when the auditor looks into the vouchers to see whether they corroborate the entries in the cash book or physically examines the cash in hand he is doing his traditional protective function. The moment he concerns himself to see whether customers' complaints are duly attended to or whether cash balance is excessive to the need, he comes to the operational field.

Also he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would be interested in such matters as reorder policy, obsolescence policy and the overall inventory management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

- 2. Issues** - The basic difference that exists in conceptualisation of the technique of operational auditing is in the auditor's role in recommending corrections or in installing systems and controls. According to Lindberg and Cohn, such a situation would be in conflict with the role of operational auditor. In this connection, the views of the Institute of Internal Auditors, in the context of internal audit are relevant. According to that Institute, "the internal auditor should be free to review and appraise policies, plans, procedures and records; but his review and appraisal does not in any way relieve other persons in the organisation of the responsibilities assigned to them.

However, a further distinction should be observed between traditional internal auditing and operational auditing - this lies in the attitude and approach to the whole auditing proposition. Every aspect of operational auditing programme should be geared to management policies, management objectives and management goals.

- 3. Objectives** - The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems and prospects and its environment.

Above all, his mind should be open and active so as to be able to perceive problems and prospects and grasp technical matters. In

carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues. The norms and standards should be such as are generally acceptable or developed by the company itself.

Performance yardsticks can be found in the management objectives, goals and plans, budgets, records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments.

For Example: The standards relating to objectives for a government company are quite different from those of a private sector company. Similarly standards of performance of a well equipped company which also adequately looks after the well-being of employees may be significantly different from a company which offers scanty welfare facilities or is ill-equipped.

Today, however, the concept of modern internal auditing suggests that there is no difference in internal and operational auditing. In fact, the scope of internal auditing is broad enough to embrace the areas covered by operational auditing as well. The modern internal auditing performs both protective as well as constructive functions.

Difference between Management Audit & Operational Audit

Management audit is concerned with the “Quality of managing”, whereas operational audit focuses on the “Quality of operations”.

- ◆ Management audit is the “**Audit of management**” while operational audit is the “Audit for the management”.
 - ◆ The basic difference between the two audits, then, is not in method, but in the level of appraisal. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfilment of plans in conformity with the prescribed policies.
- (c) **Differences between Financial and Operational Auditing** - The major differences between financial and operational auditing can be described as follows:
- **Purpose** - The financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes on

effectiveness and efficiency of operations for future performance.

- **Area** - Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization.
- **Reporting** -The financial audit report is sent to all stock holders, bankers and other persons having stake in the Organisation. However the operational audit report is primarily for the management.
- **End Task** - The financial audit has reporting the findings to the persons getting the report as its end objective, however, the operational auditing is not limited to reporting only but includes suggestions for improvement also.

10.MTP-OCT-18 Qn No 5(b) (1)4 Marks:

XYZ Yarns Ltd. is a manufacturing company engaged in manufacturing of different types of yarns. Its annual turnover is Rs. 100 Crores and net profit Rs. 10 crores. It has two manufacturing units. Company is facing difficulties in maintaining adequate system of internal control. Company wants to appoint Internal Auditor who would help in the above task and also various other functions including compliance. In view of above, you are required to explain the main responsibility of Internal Auditors.

Answer:

Main responsibility of internal auditor must be :

- to maintain adequate system of internal control by a continuous examination of accounting procedures, receipts and disbursements and to provide adequate safeguards against misappropriation of assets.
- to operate independently of the accounting staff and must not in any way divest himself of any of the responsibilities placed upon him.
- Not to involve himself in the performance of executive functions in order that his objective outlook does not get obscured by the creation of vested interest.
- to observe facts and situations and bring them to notice of authorities who would otherwise never know them; also, they critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected.

- to associate closely with management and his knowledge must be kept up to date by his being kept informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies. He must enjoy an independent status.

In addition, the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit. It may also be noted that the Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

11.Nov 18 Qn no 3(b) 5 Marks

The Board of Directors of XYZ Ltd. is concerned with decreasing operating efficiency in material consumption. As an Auditor entrusted with investigating the causes for this poor state, what may be the areas of your focus in this respect.

Answer

Decreasing Operating Efficiency in Material Consumption: It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximized at the minimum of inputs, or input is minimized for any given quantity and quality of output.

- The auditor should make an analytical procedure to compare the material consumption with output for the current year as well as previous years.
- The internal control system should be studied.
- The auditor should have discussions/ inquiry with different personnel of the company including production personnel.
- The production process, scheduling, machine usage, material mix should be studied.
- A reconciliation of variation as to various causes – Price, quantity efficiency are to be analyzed.
- The budget, standard costing and other MIS reports should be called for and studied.
- Internal audit report should be thoroughly studied and whether any pilferage, fraud etc. were noticed. These are to be looked into.
- The key material should be picked up for detailed study of their ordering, receipts, issue, normal loss yield percentage etc.

12.Nov 18 Qn no5(b)

Internal auditor makes an appraisal of organization structure to ensure that it is in harmony with the objectives of the entity, besides checking of financial transactions and operational activities of the entity- Elaborate.

Answer

Review of the Organisation Structure - The internal auditor should conduct an appraisal of the organisation structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith. For this purpose:

- He should review the manner in which the activities of the enterprise are grouped for managerial control. It is also important to review whether responsibility and authority are in harmony with the grouping pattern.
- The internal auditor should examine the organization chart to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others.
- He should particularly see that the responsibilities of managerial staff at headquarters do not overlap with those of chief executives at operating units. He should examine whether there is a satisfactory balance between authority and responsibility of important executives.
- The internal auditor should examine the reasonableness of the span of control of each executive (the number of sub-ordinates that an executive controls). He should examine whether there is a unity of command i.e., whether each person reports only to one superior.
- Where dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed. This must be made known to all concerned.
- Finally, he should evaluate the process of managerial development in the enterprise. This is a vital aspect in a fast growing enterprise.

13.Nov 18 Qn no 5(e) 4 Marks

In the use of standardized Internal Control Questionnaire (ICQ), certain basic assumptions about elements of a good internal control system are taken into account. List down few such assumptions.

Answer

Basic Assumption about Elements of Good Control in Standardized Internal Control Questionnaire: In the use of standardized internal control questionnaire, certain basic assumptions about elements of good control are taken into account. These are -

- (i) Certain procedures in general used by most business concerns are essential in achieving reliable internal control. This is a time-tested assumption. Deposit into bank of the entire receipts of a day or daily balancing of the cash book and ledgers or periodic reconciliation with the control accounts are examples of widely used practices which are considered good internal control practices. Besides, basic operations giving rise to these practices exist in all businesses irrespective of their nature.

- (ii) Organisations are such that permit an extensive division of duties and responsibilities. The larger the organisation, the greater is the scope of such division.
- (iii) Employees concerned with accounting function are not assigned any custodial function.
- (iv) No single person is thrust with the responsibility of completing a transaction all by himself.
- (v) There should always be evidence to identify the person who has done the work whether involving authorisation, implementation or checking.
- (vi) The work performed by each one is expected to come under review of another in the usual course of routine.
- (vii) There is proper documentation and recording of the transactions.

14.RTP May2019 Qn no 22(a)

Employees of GIG Ltd. have to travel frequently for business purposes, so the company entered into a contract with a Simony Travels Ltd. for managing booking, cancellation and other services required by their employees. As per contract terms, Simony travels has to raise its monthly bills for the tickets booked or cancelled during the period and the same are paid by GIG Ltd. within 15 days of the bill date. The bills raised by Simony travels were of huge amount, so the management of GIG Ltd. decided to get an audit conducted of the process followed for booking/ cancellation of tickets and verify the accuracy of bills raised by the travel agency. Which audit do you feel the management should opt for? Also briefly discuss the qualities the auditor should possess for such audit.

Answer

Operational audit, (functional audit) as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Simony travels for the organisation.

The operational auditor should possess some very essential personal qualities to be effective in his work:

1. In areas beyond accounting and finance, his knowledge ordinarily would be rather scanty and this is a reason which should make him even more inquisitive.
2. He should ask the who, why, how of everything. He should try to visualise whether simpler alternative means are available to do a particular work.
3. He should try to see everything as to whether that properly fits in the business frame and organisational policy. He should be persistent and should possess an attitude of skepticism.

4. He should not give up or feel satisfied easily. He should imbibe a constructive approach rather than a fault-finding approach and should give a feeling that his efforts are to help attaining an improved operation and not merely fault finding.
5. If the auditor succeeds in giving a feeling of help and assistance through constructive criticism, he will be able to obtain co-operation of the persons who are involved in the operations. This will itself be a tremendous achievement of the operational auditor. He should try to develop a team comprised of people of different backgrounds. Involvement of technical people in operational auditing is generally helpful.

15.RTP Nov 2019 Qn no 22

(a) Perfect Steel Ltd. has reported a higher turnover of ` 560 crores in the year 2018-19 as compared to earlier years but its sales return has also increased to 10% from only 4% upto the last year. The management is concerned about the high sales returns and feels a need to get the operational audit done for sales and production department of the company. The company is also having an internal audit system in the company. Elaborate the possible reason/s, why management is getting operational audit done when internal audit has already been done for both the departments by stating the shortcomings of conventional information sources.

(b) You are also required to discuss the difference in the approach of both of these audits.

Answer

Why Operational Audit?: The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company where the management is at a distance from actual operations due to layers of delegation of responsibility, separating it from actualities in the organisation.

Operational audit is considered as a specialised management information tool to fill the void that conventional information sources fail to fill. Conventional sources of management information are departmental managers, routine performance report, internal audit reports, and periodic special investigation and survey. These conventional sources fail to provide information for the best direction of the departments all of whose activities do not come under direct observation of managers. The shortcomings of these sources can be stated as under:

- Executives and managers are too preoccupied with implementation of plans and achieving of targets. They are left with very little time to collect information and locate problems. They may come across problems that have come to surface but they are hardly aware of problems that are brewing and

potential.

- Managers or their aides are generally relied upon for transmitting information than for booking for information or for analysing situations.
- The information that is transmitted by managers is not necessarily objective - often it may be biased for various reasons.
- Conventional internal audit reports are often routine and mechanical in character and have a definite leaning towards accounting and financial information. They are also historical in nature.
- Other performance reports contained in the annual audited accounts and the routine reports prepared by the operating departments have their own limitations. The annual audited accounts are good as far as an overall evaluation is concerned in monetary terms.

Example:

Sales may be shown at a higher monetary value compared to the previous year and this may apparently suggest that the functioning of the sales department is satisfactory. But this may have been caused by a number of factors inspite of a really bad performance on the sales front. This fact may not be readily known unless one cares to analyse the sales data by reference to notes and explanations to the accounts and other related accounting data. Even a study of this nature may not fully reveal the weakness. It is quite possible that the established market for sales has been lost partly while some fortuitous sales have compensated the loss

Example:

The routine weekly production report may include production 'that is subsequently rejected by the quality control staff, or to avoid showing a bad production performance; even the partly produced goods may also be included. Remember, all this can happen inspite of specific management instructions about the basis on which the production report is to be made out.

Another important point may be noticed in the matter of routine departmental reports. The busy management people, who can afford time only to glance over the performance reports, cannot be expected to make an integrated reading of several reports or to undertake an analysis of such reports. What they need is reliable, unmanipulated and objective report which they would like to look into to understand the situation.

- Operations of controls in a satisfactory manner cannot be relied upon to bring to light the environmental conditions. Controls are specific and their satisfactory operation is related to the specific situation under control. Also monitoring of the breakdown or non-operation of controls is a periodic phenomenon.

- Surveys and special investigations, no doubt, are very useful but these are at the best occasional in character. Also, they are costly, time consuming and keep the departmental key personnel busy during the period they are on. These are basically an attempt to carry out a post-mortem rather than to enlighten the management about the ways on improvement or for better performance or to give a signal for dangers and disasters to come.

(B) The difference in the approach of both of these audits is illustrated below:

1. **Perception** - Traditionally, internal auditors have been engaged in a sort of protective function, deriving their authority from the management. They view and examine internal controls in the in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are not there; they check the accounting books and records to see, whether the internal checks are properly working and the resulting accounting data are reliable.

For example - when the auditor looks into the vouchers to see whether they corroborate the entries in the cash book or physically examines the cash in hand he is doing his traditional protective function. The moment he concerns himself to see

whether customers' complaints are duly attended to or whether cash balance is excessive to the need, he comes to the operational field.

Also, he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would be interested in such matters as reorder policy, obsolescence policy and the overall inventory management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

2. **Issues** - The basic difference that exists in conceptualisation of the technique of operational auditing is in the auditor's role in recommending corrections or in installing systems and controls. According to Lindberg and Cohn, such a situation would be in conflict with the role of operational auditor. In this connection, the views of the Institute of Internal Auditors, in the context of internal audit are relevant. According to that Institute, "the internal auditor should be free to review and appraise policies, plans, procedures and records; but his review and appraisal does not in any way relieve other persons in the organisation of the responsibilities assigned to them.

However, a further distinction should be observed between traditional internal auditing and operational auditing - this lies in the attitude and approach to the whole auditing proposition. Every aspect of operational auditing programme should be geared to management policies, management objectives and management goals.

3. **Objectives** – The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems and prospects and its environment.

Above all, his mind should be open and active so as to be able to perceive problems and prospects and grasp technical matters. In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues. The norms and standards should be such as are generally acceptable or developed by the company itself.

Performance yardsticks can be found in the management objectives, goals and plans, budgets, records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments.

For example - The standards relating to objectives for a government company are quite different from those of a private sector company. Similarly,

standards of performance of a well equipped company which also adequately looks after the well-being of employees may be significantly different from a company which offers scanty welfare facilities or is ill-equipped.

Today, however, the concept of modern internal auditing suggests that there is no difference in internal and operational auditing. In fact, the scope of internal auditing is broad enough to embrace the areas covered by operational auditing as well. The modern internal auditing performs both protective as well as constructive functions.

Study Material

17.State the important aspects to be considered by the External auditor in the evaluation of Internal Audit Function.

Answer

Evaluation of Internal Audit Functions by External Auditor: The external auditor's general evaluation of the internal audit function will assist him in determining the extent to which he can place reliance upon the work of the internal auditor. The external auditor should document his evaluation and conclusions in this respect. The important aspects to be considered in this context are:

- (a) **Organisational Status** - Whether internal audit is undertaken by an outside

agency or by an internal audit department within the entity itself, the internal auditor reports to the management. In an ideal situation his reports to the highest level of management and is free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.

- (b) **Scope of Function** - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate, acts upon internal audit recommendations.
- (c) **Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.
- (d) **Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers

18.AB Pvt. Ltd. company having outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint internal auditor. Please guide him for applicability of the same and who can be appointed as internal auditor and what work would be reviewed by him.

Answer

Applicability of Internal Audit: Section 138 of the Companies Act, 2013 states that every private limited company is required to conduct internal audit if its outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In view of above provisions, AB Pvt. Ltd. is under compulsion to conduct internal audit as its loans or borrowings are falling under the prescribed limit.

Who can be appointed as Internal Auditor- The internal auditor shall either be a chartered accountant or a cost accountant, whether engaged in practice or not, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.

The internal auditor may or may not be an employee of the company.

19. Write a short note on Summary Written Report.

ANSWER:

Summary written reports - These summary reports are also referred to as 'flash' reports'. In a number of companies, the practice has developed of issuing an annual (or sometimes more frequent) report summarising the various individual reports issued and describing the range of their content. These summary reports in some cases are primarily for audit committees of Boards of Directors, but in other cases for higher level management. They are especially useful to top level managers who do not actively review the individual reports. They are also useful to the general auditor in seeing his total reporting effort with more perspective and on an integrated basis.

20. The main objective of operational auditing is to verify the fulfillment of plans, and sound business requirements while in financial auditing, the concentration is more in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are minimized or removed. Analyze and Explain stating clearly major differences between Financial and Operational Auditing.

ANSWER:

The purpose of systems and procedures is to help management in the planning and accomplishment of organisational goals, in communicating their requirements, and in assisting the personnel in carrying out the requirements. The review of systems and procedures is to improve the methods, to get away from the old ways and traditional routines and to reduce the cost in completing and processing the paperwork - eliminating waste, duplication and inefficiencies. In reviewing any system or procedure, the management auditor must concern himself with its purpose as well as its design and then he must decide on its merits as the best serving the interests of the enterprise. In the study of the systems and procedural functions, the auditor should ask himself:

1. Is the function properly located in the organisation?
2. Do the staff personnel have the necessary training and experience to perform the work?
3. Has a definite programme been established and has been taken for its attentive accomplishment?
4. Is productivity satisfactory?

The evaluation of a system or a procedure actually includes three separate considerations. First, is the system or procedure meeting all of the current requirements? Second, is it operating effectively? And third, what is the degree of effectiveness? To determine whether the system or procedure is meeting current requirements, the following among other things should be considered:

1. Is the system or procedure designed to promote the achievement of the company's objectives, and is it accomplished effectively?
2. Does the system or procedure operate within the framework of the organisational structure?
3. Does the system or procedure adequately provide methods of control in order to obtain maximum performance with the least expenditure of time and effort?
4. Do the routines designated in the system or procedures indicate performance in a logical sequence?

5. Does the system or procedure provide the means for effective coordination between one department and another?
6. Have all required functions been established?
7. Has the necessary authority been designated to carry out responsibilities?
8. Can any changes be made to improve effectiveness?

The important thing is to make sure that the system or procedure is designed to meet the desired results.

21. Mr. A is appointed as a statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

(a) Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.

ANSWER:

(a) Direct Assistance from Internal Auditor: As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following:

- ☑ Assessing the risks of material misstatement;
- ☑ Evaluating the sufficiency of tests performed;
- ☑ Evaluating the appropriateness of management's use of the going concern assumption;
- ☑ Evaluating significant accounting estimates; and
- ☑ Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of above, Mr. A cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

(b) Will your answer be different if Mr. A asks direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

ANSWER:

(b) Direct Assistance from Internal Auditor in case of External Confirmation Procedures: SA 610 "Using the Work of Internal Auditor", provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned.

Further, in accordance with SA 505, "External Confirmation" the external auditor is required to maintain control over external confirmation requests and evaluate the results

of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

22. M/s ABC & Co., Chartered Accountants have been approached by PQR Ltd., a company engaged in iron and steel manufacturing industry. The company has been facing following operational issues:

(a) Penal interest for delayed payments to the overseas vendors despite having enough cash flows; and

(b) Despite having regular production and enough inventory, delays in shipping the final goods to the customers leading to its deteriorating vendor rating.

As a partner of M/s ABC & Co., through detailed discussion with the Senior Manager of PQR Ltd., you have concluded that all these delays are because of long decision-making cycles in the company. As a consultant to the Company, would you recommend Management Audit or Operational Audit?

ANSWER:

A comparison between the Management Audit & the Operational Audit is as follows: Management audit is concerned with the “Quality of managing”, whereas operational audit focuses on the “Quality of operations”. Management audit is the “Audit of management” while the operational audit is the “Audit for the management”. The focus of Management Audit is on “Quality of Decision Making” rather than the effectiveness or efficiency of operations.

The basic difference between the two audits, then, is not in method, but in the level of appraisal. In a management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfillment of plans in conformity with the prescribed policies.

Since, the delays in payments and consequent penal interest payments and the delays in shipping and the consequent deteriorating vendor ratings are happening because of the delays in decision-making process of the management. Therefore, it appears that this is not just an internal control or operational issue but an issue of management process.

Therefore, management audit would be recommended in this case.

23. The PQR Ltd. has come across many instances where it could buy products at lesser cost than the actual procurement price it paid. The management believes that the adequate purchase policy is in place including the requirements of three quotations from registered vendors, appropriate vendor vetting and rating mechanism, however, the on-ground implementation of the purchase policy might be defective. Further, it has observed that there might be some employees involved in choosing the higher cost vendors as well. The company approaches you to advise the type of audit it should get done: Management or Operational. Please advise through a comparison between both the audits.

ANSWER:

Since it is not the Management's Decisions that are creating the operational bottlenecks. The Purchase Policy and Procedure seem to be in place, the missing part is the operational implementation by the process employees. Therefore, the Operational Audit is recommended in this case.

24. The Marketing Department of XYZ Ltd. has been consistently showing a lower performance whereas the cost of the department is increasing in spurts over the years. The management believes that since the marketing department is under a regular radar of the CFO, an audit might result in the employee hostility. Also, an operational audit of Marketing Department was done two years back however, the recommendations of the previous audit were not followed by the concerned employees. Please advise the management if another audit is the solution and whether only one-time operational audit is enough? Further, advise on the ways to deal with the employee hostility.

ANSWER:

The Operational Audit is not one-time activity. It should be viewed as a continuous improvement cycle:

The continuous improvement cycle of Operational Audit can be depicted through Plan, Do, Check and Act diagram.

All the significant operations must be subjected to the scrutiny of operational audit, at least, once in three years. Therefore, the operational audit should be done in the current scenario. However, to deal with the employee hostility the participative approach of the audit should be adopted:

In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes a co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When the participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor, it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor does not have to force any change on the auditee.

Multiple Choice Question

1. The Board of Directors of Young Ltd., a listed company, appointed Mr. Old, a Cost Accountant (not in practice), to conduct internal audit of the functions and activities of the company. The job of Mr. Old would be of an independent management function, involving a continuous and critical appraisal of the functioning of the company with a view to suggest improvements thereto and add

value to and strengthen the overall governance mechanism of the company, including the entity's strategic risk management and internal control system. However, some of the officers of the company are against the appointment of a Cost Accountant who is not in practice as an internal auditor. State whether those officers are correct or not in their view point by referring the provisions of the Companies Act, 2013?

- (a) The view point of the officers are correct because as per section 138 of the Companies Act, 2013, the internal auditor shall be a chartered accountant.
- (b) The view point of the officers are correct because as per section 138 of the Companies Act, 2013, the internal auditor shall a cost accountant in practice.
- (c) The view point of the officers are correct because as per section 138 of the Companies Act, 2013, the internal auditor shall be an employee of the company.
- (d) The view point of the officers are not correct because as per section 138 of the Companies Act, 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board.

Answer: (d) The view point of the officers are not correct because as per section 138 of the Companies Act, 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board

2. Employees of GIG Ltd. have to travel frequently for business purposes, so the company entered into a contract with a Simony Travels Ltd. for managing booking, cancellation and other services required by their employees. As per contract terms, Simony travels has to raise its monthly bills for the tickets booked or cancelled during the period and the same are paid by GIG Ltd. within 15 days of the bill date. The bills raised by Simony travels were of huge amount, so the management of GIG Ltd. decided to get an audit conducted of the process followed for booking/ cancellation of tickets and verify the accuracy of bills raised by the travel agency. Which audit do you feel the management should opt for?

- a) Internal audit, as it relates to examine the operational efficiency of the organisation.
- b) Management audit, as it is an audit desired by the management.
- c) Performance audit so as to assess the performance of the Simony travels appointed by the organisation.
- d) Operational audit, as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Simony travels for the organisation

Answer: (d) Operational audit, as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Simony travels for the organisation

CHAPTER – 16 Due Diligence, Investigation and Forensic audit

DUE DILIGENCE

MTP Apr 2019 Qn no 15 2 Marks

1. Yellow Steels Ltd. was engaged in the business of manufacturing and selling steel products. The company was having sales offices at different locations in and outside India. The company decided to have a sales office at Kanpur on their own land. A Managing Committee of some officers from the company was formed in order to get a building constructed at land in Kanpur. Budget of Rs.35 crores was approved by the company for the same and it was proposed to complete the construction within two years. Rs. 32 crores were already released by the company within a year of start of the project and the managing committee raised a demand for Rs. 5 crores for further payments to vendors. The management of Yellow Steels wants to get the verification done of all the expenses incurred on site and identify the reasons for increase in construction cost. Which of the following will suffice the purpose of management?

- a) The management should go for operational audit, as it will evaluate the effectiveness, efficiency and economy of operations done at the construction site.
- b) The management should get a Forensic Audit done in order to rule out any possibility of fraud or any other financial crime.
- c) A Financial Due Diligence is required to be done as no fraud has been reported and the management just want to analyse the books of accounts and other financial matters pertaining to financial matters at site.
- d) A management audit should be done to ensure that the increase in cost of construction is not due to any discrepancies in the formulation of objectives, plans and policies of the top management.

Answer: C A Financial Due Diligence is required to be done as no fraud has been reported and the management just want to analyse the books of accounts and other financial matters pertaining to financial matters at site.

Descriptive Questions

1. MAY 2018 3(d) 5 Marks

KDK Bank Ltd., received an application from a pharmaceutical company for take over of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. KDK Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.

ANSWER

Over-Valued Assets: In case of due diligence exercise, the area of analysis in order to ensure that the assets are not stated at over-valued amounts are:

- Uncollected/uncollectable receivables.
- Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- Litigated assets and property.
- Investments carried at cost though realizable value is much lower.
- Investments carrying a very low rate of income / return.
- Infructuous project expenditure/deferred revenue expenditure etc.
- Group Company balances not reconciled.
- Intangibles having no reliable value

2.MTP-OCT-18 Qn No 3(b) 5 Marks:

A German Company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of more than 65% of the industrial gas business in India, request you to conduct a “Due Diligence” of this Indian Company and submit your Report. As due Diligence Auditor, discuss the key areas you will cover in your review.

Answer:

Due Diligence – Key Areas: The German company engaged in the business of manufacturing and distribution of industrial gases wishing to acquire a listed Indian company has commissioned the Due Diligence Audit to assess the strengths and weaknesses of this company. It is quite important for the acquirer to assess the proposal from different angles and specifically as per terms of the assignment and also see whether proposed merger would create operational synergies. On the other hand, financial due diligence review would be performed after the commercial valuation. Accordingly, while a preliminary review might be performed during initial stages of the restructuring exercise and may in fact, be performed simultaneously with the commercial evaluation, at a later stage, financial due diligence may be performed on the books of account and other information directly pertaining to the financial matters of the entity. In addition, a legal due diligence may be required where legal aspects of functioning of the entities are reviewed; for example, the legal aspects of property owned by the entity or compliance with various statutory requirements under various laws. Like other due diligence exercises, environmental and personnel due diligence are also carried out in order to establish whether

various propositions with regard to environment and personnel of the enterprise under review are appropriate. In any case, it is quite important to look behind the veil of initial information provided by the company and to assess the benefits and costs of the proposed acquisition/merger by inquiring into all relevant aspects of the past, present and future of the business to be acquired. Some of the significant key areas which shall be covered under the review are as under:

- (1) **Historical Background:** The accountant should begin the financial due diligence review by looking into the history of the company and the background of the promoters. The details of how the company was set up and who were the original promoters have to be gone into, before verification of financial data in detail. An eye into the history of the company may reveal its turning points, survival strategies adopted from time to time, the market share enjoyed by and changes therein, product life cycle and adequacy of resources. It could also help the accountant in determining whether, in the past, any regulatory requirements have had an impact on the business of the said company. This could, inter alia, include the nature of business(es), location of production facilities, warehouses, offices, products or services and markets.
- (2) **Significant Accounting Policies:** The accountant should study the accounting policies being followed by the target and ascertain whether any accounting policy is inappropriate. The accountant should also see the effects of the recent changes in the accounting policies. The

target might have changed its accounting policies in the recent past keeping in view its intention of offering itself for sale.

The overall scope has to be based on the accounting policies adopted by the management. The accountant has to look at the main effect of accounting policies on the overall profitability and their correctness. It is reiterated that the accountant should mainly look at all material changes in Accounting Policies in the period subjected to review very carefully.

The accountant's report should include a summary of significant accounting policies used by the target, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the target are different from those adopted by the acquiring enterprise, the effect of such differences.

- (3) **Review of Financial Statements:** An evaluation of the profit reported by the company would be largely based upon its operating results. Any extraordinary item of income or expense that might have affected the operating results would require close examination. It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period. It is

important that the trading results for the past four to five years are compared and the trend of normal operating profit arrived at. The normal operating profits should further be benchmarked against other similar companies. Besides the above, and based on the trend of operating results, the accountant has to advise the acquiring enterprise, through due diligence report, on the indicative valuation of the business. The exercise to evaluate the balance sheet of the company has to take into consideration the basis upon which assets have been valued and liabilities have been recognised. The net worth of the business has to be arrived at by taking into account the impact of over/under valuation of assets and liabilities.

(4) **Taxation** - Tax due diligence is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. It is important to check if the company is regular in paying various taxes to the Government. The accountant has to also look at the tax effects of the merger or acquisition.

(5) **Cash Flow:** A review of historical cash flows and their pattern would reflect the cash generating abilities of the target company and should highlight the major trends. It is important to know if the company is able to meet its cash requirements through internal accruals or does it have to seek external help from time to time. **It is necessary to check that:**

- (a) Is the company able to honour its commitments to its trade payables, to the banks, to government and other stakeholders
- (b) How well is the company able to turn its trade receivables and inventories
- (c) How well does it deploy its funds
- (d) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?

(6) **Financial Projections:** The accountant should obtain from the target company the projections for the next five years with detailed assumptions and workings. He should ask the target to give projections on optimistic, pessimistic and most likely bases.

Management and Employees - In most of the companies which are available for take over the problem of excess work force is often witnessed. It is important to work out how much of the labour force has to be retained. It is also important to judge the job profile of the administrative and managerial staff to gauge which of these match the requirements of the new incumbents. Due to complex set of labour laws applicable to them, companies often have to face protracted litigation from its workforce and it is important to gauge the likely impact of such

litigation. The aspects whether all employee benefits like PF, Gratuity, ESI and superannuation have been properly paid/funded. The pay packages of the key employees will be thoroughly reviewed since this can be a crucial factor in future employee costs.

- (7) **Statutory Compliance:** During a due diligence this is one aspect that has to be investigated in detail. It is important therefore, to make a list of laws that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance it could lead to punitive charges under the law. These may have to be quantified and factored into the financial results of the company.

3.MTP-Mar 2019 Qn No 5(b) 4 Marks:

A Ltd who is one of the leading manufacturer of kids clothing is interested to acquire B Ltd. B Ltd is currently a manufacturer of women' clothing. As a professional consultant in due diligence and valuation, A Ltd entrusted you to value B Ltd. The valuation of B Ltd is dependent on future maintainable sales. Discuss the factors you would consider in assessing the future maintainable turnover of B Ltd?

Answer:

In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

- (i) **Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
- (ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- (iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
- (iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

Investigation

Multiple Choice Questions

MTP Oct 2019 Qn no 15 (2 Marks)

1.ZARI & Associates is a partnership firm and has been in existence for the last 15 years. The firm is engaged in consultancy business related to various areas and has built a good name for itself over the period.

Some of the clients of the firm are very old who have been continuing since its existence. The business of the firm has gone through various phases some of them were very bad. But currently the business is going very well and the firm is looking to expand its operations into different geographies. For this, the firm's management decided that some of its senior partners will move to new offices and new partners would be inducted.

A team of new partners is in discussion with the senior old partners regarding their joining the firm.

The new partners would be interested to know whether the terms offered to them are reasonable having regard to the nature of the business, profit records, capital distribution, personal capacity of the existing partners, socio-economic setting etc. and whether they would be able to derive continuing benefits in the shape of return of capital to be contributed and remuneration of services to be offered. In addition, they also want to ascertain whether the capital to be contributed by them would be safe and applied usefully or not.

For this purpose, an investigation of the business of the firm was set up on behalf of these new partners.

At the time of scrutiny of the record of profitability of the firm's business, the investigating accountant picked up records of last 4-5 years wherein he observed 2 years which were unusual because the profits during those 2 years were highly erratic and fluctuating. The investigating accountant, therefore, went into the profits of last 7-8 years to iron out the fluctuation. He also examined the provisions of the partnership deed particularly the composition of partners, their capital contribution, drawing rights, retirement benefits and goodwill. He also asked for details of jobs/ contracts in hand and the range of current clientele of the firm for his examination. Some of these procedures of the investigating accountant were not found appropriate by the senior partners of the firm and they advised the investigating accountant not to go beyond his scope. In the given situation, which of the following is correct:

- a. The investigating accountant should not have asked for the records of the profits of last 7-8 years as that would be too much of the information for his review. Also the details of jobs/ contracts in hand and the range of current clientele of the firm are confidential and hence does not get covered in his scope.
- b. After finding 2 years which were unusual because the profits during those 2 years were highly erratic and fluctuating, the investigating accountant should have reported the matter to the new partners

instead of asking for more details related to the profits of last 7-8 years. Also he is not required to examine the provisions of the partnership deed as these details would have already been discussed with the new partners and they would have checked that.

- c. The procedures of the investigating accountant looks completely reasonable considering his scope of work. Further, no changes are required in his work approach.
- d. At the outset, it can be said that investigation in the given case was not required. However, even if the new partners decided to carry out the investigation it should have been limited to mainly inquiry procedures by the investigating accountant. The investigating accountant could have also reviewed the manner of computation of goodwill which doesn't seem to have been performed on the basis of the above mentioned facts.

Answer: (c) The procedures of the investigating accountant looks completely reasonable considering his scope of work. Further, no changes are required in his work approach.

MTP Mar 2018 3(b) 5 Marks RTP May 2020 Qn no 18

1.A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not. Decide the points you will cover in your investigation before submitting your report to the General Manager.

RTP Nov 18 Qn no 18

A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

List out the points you will cover in your investigation before submitting your report to the General Manager.

ANSWER

Investigation on Behalf of the Bank for Advances: A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. **On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points:**

- (i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.
- (ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.
- (iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.
- (iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- (v) The history of growth and development of the company and its performance during the past 5 years.
- (vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

- (a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
 - (i) Sales to Average Inventories held.
 - (ii) Sales to Fixed Assets.
 - (iii) Equity to Fixed Assets.
 - (iv) Current Assets to Current Liabilities.
 - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.

- (vi) Equity to Long Term Loans.
 - (vii) Sales to Book Debts.
 - (viii) Return on Capital Employed.
- (c) Enter in a separate part of the statement the break-up of annual sales product- wise to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank- The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

(1) **Fixed assets** - A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.

(2) **Inventory** - The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued.

Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.

If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

(3) **Trade Receivables, including bills receivable** - Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

- (i) debts due in respect of which the period of credit has not expired;
- (ii) debts due within six months; and

(iii) debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

- (4) **Investments** - The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.
- (5) **Secured Loans** - Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.
- (6) **Provision of Taxation** - The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears to be inadequate, the fact should be stated along with the extent of the shortfall.
- (7) **Other Liabilities** - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.
- (8) **Insurance** - A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.
- (9) **Contingent Liabilities** - By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report. Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

2.MTP Apr 2018 Qn no.3(b) 5 Marks

Dalal, Banerji and Mallick are partners in a firm sharing profits and losses in the ratio 2:2:1. The partners have agreed to take Mr. Mistri as a partner with effect from 1st April, 2018 as 1/4th partner. What are the important steps involved while conducting investigation on behalf of Mr. Mistri, the incoming partner?

Steps involved while conducting investigation on behalf of an incoming partner:

The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm—manufacturing, trading or rendering a service.

Primarily, an incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of the existing partners, socio-economic setting, etc., and whether he would be capable of deriving continuing benefit in the shape of return on capital to be contributed and remuneration for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully.

Broadly, the steps involved are the following:

- (a) Ascertainment of the history of the inception and growth of the firm.
- (b) Study of the provisions of the deed of partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.
- (c) Scrutiny of the record of profitability of the firm's business over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits. Particular attention should, however, be paid to the nature of partners' remuneration, which may be excessive or inadequate in relation to the nature and profitability of the business, qualification and expertise of the partners and such other factors as may be relevant.
- (d) Examination of the asset and liability position to determine the tangible asset backing for the partner's investment, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and those for pending tax assessment. In case of firms rendering services, the question of tangible asset backing usually is not important, provided the firm's profit record, business coverage and standing of the partners are of the acceptable order.
- (e) Position of orders at hand and the range and quality of clientele should be thoroughly examined, which the firm is presently operating.
- (f) Position and terms of loan finance would call for careful scrutiny to assess its usefulness and implication for the overall financial position; reason for its absence should be studied.

- (g) It would be interesting to study the composition and quality of key personnel employed by the firm and any likelihood of their leaving the organisation in the near future.
- (h) Various important contractual and legal obligations should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. Full import of such standing agreements would be gauged before a final decision is reached.
- (i) Reasons for the offer of admission to a new partner should be ascertained and it should be determined whether the same synchronises with the retirement of any senior partner whose association may have had considerable bearing on the firm's success.
- (j) Appraisal of the record of capital employed and the rate of return. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organisation structure, if any, envisaged along with the admission of the partner.
- (k) It would be useful to have a first hand knowledge about the specialisation, if any, attained by the firm in any of its activities.
- (l) Manner of computation of goodwill on admission as also on retirement, if any, should be ascertained.
- (m) Whether any special clause exists in the deed of partnership to allow admission in future of a new partner, who may be specified, on concessional terms.
- (n) Whether the incomplete contracts which will be transferred to the reconstituted firm will be a liability or a loss.

It would always be worthwhile to remember that, in a partnership, personal considerations count predominantly over other considerations and assessment of standing of the firm, standing and reliability of other partners, their personal reputation and the goodwill enjoyed by the products/services are important.

On the basis of the broad frame of considerations as given above, the investigating accountant should devise his own considerations in each case which may be quite diverse. Additional considerations may come up in the case of service-rendering firms where profit and business record, goodwill of the firm and of individual partners would assume greater significance.

Again, in the case of industrial firms, the network of customers, their scatter, size, etc., would be relevant for consideration.

3.RTP May 2019 Qn no 23

Mr Sharma is reviewing the anti-fraud controls for a construction company. The company has witnessed a few frauds in the past mainly in the nature of material stolen from the sites and fake expense vouchers.

Mr. Sharma is evaluating options for verifying the process to reveal fraud and the corrective action to be taken in such cases. As an expert, you are required to brief Mr. Sharma about the inventory fraud and verification procedure with respect to defalcation of inventory?

Answer

Inventory frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

- (i) Employees may simply remove goods from the premises.
- (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
- (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (a) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (b) availability of sufficient data from which such a record can be constructed.

The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory

Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

4.RTP Nov 2019 Qn no 23

(a) General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose.

In view of the above, you are required to brief out the difference between Audit and Investigation.

Answer

Etymologically, **auditing and investigation** are largely overlapping concepts because auditing is nothing but an investigation used in a broad sense. Both auditing and investigation are fact finding techniques but their basic nature and objectives differ as regards scope, frequency, basis, thrust, depth and conclusiveness. Audit and investigation differ in objectives and in their nature. Auditing is general while investigation is specific.

Basis of Difference	Investigation	Audit
(i) Objective	An investigation aims at establishing a fact or a happening or at assessing a particular situation.	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.

(ii) Scope	The scope of investigation may be governed by statute or it may be non- statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.
(iii) Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either quarterly, half-yearly or yearly.
(iv) Nature	Requires a detailed study and examination of facts and figures.	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion.
(v) Inherent Limitations	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent limitation.
(vi) Evidence	It seeks conclusive evidence.	Audit is mainly concerned with prima- facie evidence.
(vii) Observance of Accounting Principles	It is analytical in nature and requires a thorough mind capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements.
(viii) Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

5.Nov 2019 Qn no 6(C) 4 Marks,MTP Oct 2019 Qn no 6(a) 5 Marks

MF. Ltd., engaged in the manufacturing of various products in its factory, is concerned with shortage in production and there arose suspicion of inventory fraud. You are appointed by MF Ltd. To evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory?

Answer

Inventory frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

- Employees may simply **remove goods** from the premises.
- Theft of goods may be concealed by **writing them off as damaged goods**, etc.
- Inventory records may be manipulated by employees** who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

Verification Procedure for Defalcation of inventory - Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (a) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (b) availability of sufficient data from which such a record can be constructed.

The step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.

Defalcations of inventory, sometimes, also are committed by the management, by **diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production**; similar defalcations of inventories and stores are covered up by **inflating quantities issued for production**. For detecting such shortages, the investigating accountant should take **assistance of an engineer**. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the **shortage in production has been inflated**.

In this regard, guidance can also be taken from **past records showing the extent of wastage in production** in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent.

The **per hour capacity of the machine** and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

Forensic Audit

May 2018 -6 (a) 4 Marks.

1.Explain how a Forensic Audit differs from an Assurance Engagement.

Answer

Difference between Forensic Audit and Assurance Engagement:

Sr. No.	Particulars	Assurance Engagement	Forensic Audit
1.	Objectives	Express an opinion as to 'True & Fair presentation	Whether fraud has taken place in books
2.	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in depth checking
3.	Period	Normally for a particulars accounting period.	No such limitations
4.	Verification of stock, Estimation realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent / verification of suspected/selected items where misappropriation in suspected
5.	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

2.RTP May 2018 Qn no.18

ABC Ltd. is a listed company having turnover of ` 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of ` 20 crore.

Rupees (In crore)	Purpose
10.0	- for Building
8.5	- for Machinery
<u>1.5</u>	- for Working Capital
<u>20 Crore</u>	

Project gets implemented in 2017-18 and one of the accountants points out to Managing Director that something wrong has happened in the purchase of building material.

On hearing this, the management is planning to appoint Forensic Auditor. Advise management that how is a forensic accounting analysis is different from an audit.

- 1. Difference between a forensic accounting analysis and an audit:** The general public believes that a financial auditor would detect a fraud if one were being perpetrated during the financial auditor's audit. The truth, however, is that the procedures for financial audits are designed to detect material misstatements, not immaterial frauds. While it is true that many of the financial statements and frauds could have, perhaps should have, been detected by financial auditors, the vast majority of frauds could not be detected with the use of financial audits. Reasons include the dependence of financial auditors on a sample and the auditors' reliance on examining the audit trail versus examining the events' and activities behind the documents. The latter is simply resource prohibitive in terms of costs and time.
- 2.** There are some basic differences today between the procedures of forensic auditors and those of financial auditors. In comparison, forensic accounting and audit differ in specific ways, as shown below:

Forensic Accounting	Audit
<ul style="list-style-type: none"> *In response to an event *Financial investigation *Finding used as evidence in court or to resolve disputes 	<ul style="list-style-type: none"> *Mandatory *Measures compliance with reporting standards •Obtain reasonable assurance that financial statements are free of material misstatement In practice, there are difference in mind set between forensic accounting and audit: •"Investigative mentality" vs. "professional scepticism". A forensic accountant will often require more extensive corroboration.

A forensic accountant will often look for indications of fraud that are not subject to the scope of a financial statement audit.

Particulars	Other Audits	Forensic Audit
Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has taken place in books
Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in depth

		checking
Period	Normally for a particulars accounting period.	No such limitations
Verification of stock, Estimation realizable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

3.MTP-Aug-18 Qn No 3(b) 5 Marks:

PQR Ltd. is a listed company having turnover of Rs. 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of Rs. 20 crores.

Rupees (In crore)	Purpose
10.0	- for Building
8.5	- for Machinery
1.5	- for Working Capital
<u>20 Crore</u>	

Project gets implemented in 2017-18 and one of the accountants points out to Managing Director that something wrong has happened in the purchase of building material.

On hearing this, the management is planning to appoint Forensic Auditor. Advise the Forensic Auditor about the steps to be undertaken in case of forensic audit process.

Answer:

Each Forensic Accounting assignment is unique. Accordingly, the actual approach adopted, and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps detailed below.

Step 1. Initialization

It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand. A conflict check should be carried out as soon as the relevant parties are established. It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. Develop Plan

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event. In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- calculating economic damages;
- summarizing a large number of transactions;
- performing a tracing of assets;
- performing present value calculations utilizing appropriate discount rates;
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model; and
- utilizing charts and graphics to explain the analysis.

Step 5. Reporting

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence and a conclusion as to the amount of loss suffered as a result of the fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified

4.May 2019 Qn no 5(C)5 Marks

You have been appointed as a forensic accountant in M/s Secure Ltd. to carry out various analysis as a part of your assignment to arrive at a particular result. Specify the various analysis which might have to be carried out by you to arrive at your result.

Answer

Perform the Analysis: The actual analysis performed will be dependent upon the nature of the assignment and may involve:

1. calculating economic damages;
2. summarizing a large number of transactions;
3. performing a tracing of assets;
4. performing present value calculations utilizing appropriate discount rates;
5. performing a regression or sensitivity analysis;

utilizing a computerized application such as a spread sheet, data base or computer model; and

6. utilizing charts and graphics to explain the analysis.

(B) Beta Ltd. is anticipating taking over a manufacturing concern and appoints you for due diligence review. While reviewing, it requests you to look specifically for any hidden liabilities and overvalued assets. State in brief the major areas you would examine for hidden liabilities and overvalued assets.

Major areas to examine in course of Due Diligence Review: 'Due Diligence' is a term that is often heard in the corporate world these days in relation to corporate restructuring. The purpose of due diligence is to assist the purchaser or the investor in finding out all he can, reasonably about the business he is acquiring or investing in prior to completion of the transaction including its critical success factors as well as its strength and weaknesses.

Due diligence is an all pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review of Financial Statements. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does not involve examination from the view point of extraordinary items, analysis of significant deviations, etc.

However, in order to investigate **hidden liabilities**, the auditor should pay his attention to the following areas:

- ◆ The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
- ◆ The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- ◆ The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- ◆ Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
- ◆ Tax liabilities under direct and indirect taxes.
- ◆ Long pending sales tax assessments.
- ◆ Pending final assessments of customs duty where provisional assessment only has been completed.
- ◆ Agreement to buy back shares sold at a stated price.
- ◆ Future lease liabilities.
- ◆ Environmental problems/claims/third party claims.

- ◆ Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
- ◆ Huge labour claims under negotiation when the labour wage agreement has already expired.

Regularly Overvalued Assets:

The auditor shall have to specifically examine the following areas:

- ◆ Uncollected/uncollectable receivables.
- ◆ Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- ◆ Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- ◆ Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- ◆ Litigated assets and property.
- ◆ Investments carried at cost though realizable value is much lower.
- ◆ Investments carrying a very low rate of income / return.
- ◆ Infructuous project expenditure/deferred revenue expenditure etc.
- ◆ Group Company balances under reconciliation etc.
- ◆ Intangibles of no value.

Study Material

5.J Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd., what factors would you consider in assessing the future maintainable turnover?

Answer

In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

- Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
- Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?

Competition: What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

Multiple Choice Question

IMIR Inc is a major technology, engineering, manufacturing and financial services conglomerate, with global operations having its registered office in US. The Company's manufacturing footprint extends across eight countries in addition to US. It has several international offices and a supply chain that extends around the globe.

HIN Private Limited is a medium-sized Fast Moving Electrical Goods (FMEG) company and is also involved in power distribution equipment manufacturing. This company is based in India and enjoys a good market share in a wide spectrum of products like Industrial & Domestic Circuit Protection Devices, Cables & Wires, Fans, Commercial and Industrial Applications.

IMIR Inc (Acquirer) is currently in talks to acquire HIN Pvt Ltd (Target). The initial price has been agreed for the acquisition of business based on net worth and profitability of the target company with an assumption that all contingent liabilities of the target impacting its future business have been considered. The acquirer appointed a firm to carry out the financial due diligence review of the target company and advised that the firm should strictly work as per the scope.

The firm during the course of its review found some showcause notices (which have not matured into demands) being issued against the target company. The firm also found that there could be a potential high value labour claim which may arise out of the negotiation which was ongoing between the target company and the labour union and the labour wage agreement was already expired.

The firm discussed all these matters with the management of the target company. The target company confirmed that these matters are under discussion and was confident that these matters would not result into any liability and hence it did not consider the same in the initial price. The firm after its discussion with the target reported these matters to the acquirer.

In the given situation, please suggest which one of the following should be correct?

- (a) In the given case, the initial price between the target and the acquirer is already set which includes the impact of contingent liabilities. Hence the above mentioned matters relating to showcause notice and labour claim should be ignored by the firm.
- (b) In the given case, the initial price between the target and the acquirer is already set which includes the impact of contingent liabilities. However, since these matters have not been considered by the target company in the initial price, it would be appropriate to consider the impact of matter related to labour claim as that may result in liability in future but the matter related to showcause notice should be ignored by the firm.
- (c) In the given case, the firm has gone beyond its scope of financial due diligence review. Financial due diligence review covers review of trading

results, assets and liabilities and accounting policies and practices of the target company. The management of the target company should talk to acquirer so that the acquirer can ask the firm to limit its work as per the scope agreed.

- (d) In the given case, even though the initial price between the target and the acquirer is already set but still the firm needs to look at any hidden liabilities which may arise in the two cases – show cause notices and labour claim. Accordingly, the firm has done the right thing by reporting these matters to the acquirer.

Answer: (b) In the given case, the initial price between the target and the acquirer is already set which includes the impact of contingent liabilities. However, since these matters have not been considered by the target company in the initial price, it would be appropriate to consider the impact of matter related to labour claim as that may result in liability in future but the matter related to showcause notice should be ignored by the firm

FTA Renewables S.p.A, is based in Europe and has operations in renewable energy. The company's operations are spread out in many countries. The company is also looking for various acquisitions.

VAS Private Limited is a company based in Pune having operations into solar energy. The company's management projected that its operations should increase significantly and it should become one of the largest companies in the sector in the next five years on the basis of the management plan. However, due to some unforeseen circumstances, the promoters of the company are looking to sell their business.

FTA Renewables S.p.A (acquirer) is interested in acquisition of VAS Private Ltd (target) and has started the discussions with the target company for the same.

The due diligence of the target company is in process and the reviewer has come up with following observations so far:

- (i) The target company has certain balances with its related companies which are under reconciliation for long time.
- (ii) The target company had certain demands in respect of taxation matters on which the court has given a stay.
- (iii) The target company has some assets which are carried in its books at more than their current market value due to capitalization of foreign exchange loss as the same was permitted in Indian GAAP.
- (iv) The target company had two properties which were under litigation.
- (v) The target company had given guarantees which were not appearing the financial statements.

Reviewer needs your advise that which of the above mentioned observations should be reported by him to the acquirer?

- (a) i, ii, iv and v.
- (b) ii, iii, iv and v.
- (c) i, ii, iii, iv and v.

(d) i, iii, iv and v.

Answer: (b) ii, iii, iv and v

ARA & Associates is a partnership firm and has been in existence for the last 15 years. The firm is engaged in consultancy business related to various areas and has built a good name for itself over the period.

Some of the clients of the firm are very old who have been continuing since its existence. The business of the firm has gone through various phases some of them were very bad. But currently the business is going very well and the firm is looking to expand its operations into different geographies. For this, the firm's management decided that some of its senior partners will move to new offices and new partners would be inducted.

A team of new partners is in discussion with the senior old partners regarding their joining the firm.

The new partners would be interested to know whether the terms offered to them are reasonable having regard to the nature of the business, profit records, capital distribution, personal capacity of the existing partners, socio-economic setting etc. and whether they would be able to derive continuing benefits in the shape of return of capital to be contributed and remuneration of services to be offered. In addition, they also want to ascertain whether the capital to be contributed by them would be safe and applied usefully or not.

For this purpose, an investigation of the business of the firm was set up on behalf of these new partners.

At the time of scrutiny of the record of profitability of the firm's business, the investigating accountant picked up records of last 4-5 years wherein he observed 2 years which were unusual because the profits during those 2 years were highly erratic and fluctuating. The investigating accountant, therefore, went into the profits of last 7-8 years to iron out the fluctuation. He also examined the provisions of the partnership deed particularly the composition of partners, their capital contribution, drawing rights, retirement benefits and goodwill. He also asked for details of jobs/ contracts in hand and the range of current clientele of the firm for his examination. Some of these procedures of the investigating accountant were not found appropriate by the senior partners of the firm and they advised the investigating accountant not to go beyond his scope.

Please advise which of the above mentioned procedures of investigating accountant is/are not appropriate and what improvements/ changes are required in his approach.

- a) The investigating accountant should not have asked for the records of the profits of last 7-8 years as that would be too much of the information for his review. Also the details of jobs/ contracts in hand and the range of current clientele of the firm are confidential and hence does not get covered in his scope.
- b) After finding 2 years which were unusual because the profits during those 2 years were highly erratic and fluctuating, the investigating accountant should have reported the matter to the new partners instead of asking for more details related to the profits of last 7-8 years. Also he is not required to examine the provisions of the partnership deed as these details would have already been discussed with the new partners and they would have checked that.

- c) The procedures of the investigating accountant looks completely reasonable considering his scope of work. Further, no changes are required in his work approach.
- d) At the outset, it can be said that investigation in the given case was not required. However, even if the new partners decided to carry out the investigation it should have been limited to mainly inquiry procedures by the investigating accountant. The investigating accountant could have also reviewed the manner of computation of goodwill which doesn't seem to have been performed on the basis of the above mentioned facts.

Answer: (c) The procedures of the investigating accountant looks completely reasonable considering his scope of work. Further, no changes are required in his work approach.

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Chapter -17 Peer Review and Quality Review

PEER REVIEW

Multiple Choice Questions

Shivam & Co LLP is a large firm of Chartered Accountants based out of Delhi-NCR. During the financial year ended 31 March 2019, the firm Shivam & Co LLP got an intimation for the peer review on 1 July 2018. The process of peer review got started and completed on 15 September 2018 which included the on-site review from 1 August 2018 to 16 August 2018.

Shivam & Co LLP objected to the time taken by the Peer Reviewer on-site, however, as per Peer Reviewer, the entire review process got completed within 90 days from the date of notifying the firm about its selection for review.

- a) The time for complete review should be completed within 120 days.
- e) The time for on-site review should not have extended beyond 10 working days.
- f) The time for complete review should be completed within 60 days.
- g) The time for on-site review should not have extended beyond 7 working days.

Answer: Option D

MTP Mar 2019 Qn no 7 (1 Mark)

An audit firm is the subject of the Peer review, please indicate the maximum number of years in the review cycle:

- (a) 1 year
- (b) 2 years
- (c) 3 years
- (d) 5 years

Answer: c) 3 years

MTP Oct 2019 Qn no 2 (1 Mark)

Rana & Co LLP is a large firm of Chartered Accountants based out of Delhi-NCR. During the financial year ended 31 March 2019, the firm Rana & Co LLP got an intimation for the peer review on 1 July. The entire peer review process including on-site review got completed. The peer reviewer did not share any of his observations with Rana & Co LLP as draft and final report was submitted to the firm.

- (e) Peer reviewer need not share any draft report with the firm if there are no observations.
- (f) Even the final report is not required to be submitted to the firm.
- (g) Peer reviewer needs to share draft report with the firm before finalisation.
- (h) There are no reports in case of peer review. On completion, a certificate to that effect is issued.

Answer: Option (c) Peer reviewer needs to share draft report with the firm before finalisation.

Descriptive Questions

RTP May 2018 Qn no.20 (a), RTP May 2019 Qn no 25(a)

Technical, ethical and professional standards as per statement on peer review

Answer

Technical, Ethical and Professional Standards as per Statement on Peer Review:

As per the Statement, Technical, Professional and Ethical Standards means-

1. Accounting Standards issued by ICAI and /or prescribed and notified by the Central Government of India;
2. Standards issued by the Institute of Chartered Accountants of India including-
 - (i) Engagement standards
 - (ii) Statements
 - (iii) Guidance notes
 - (iv) Standards on Internal Audit
 - (v) Statements on Quality Control
 - (vi) Notifications / Directions / Announcements / Guidelines / Pronouncements/ Professional standards issued from time to time by the Council or any of its committees.
3. Framework for the Preparation and presentation of financial statements, framework of statements and Standard on Auditing, Standard on Assurance Engagements, Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the Institute of Chartered Accountants of India and framework for assurance engagements;
4. Provisions of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.

May 2018 -4(e) 4 Marks

The elements of skill, experience and independence of reviewers are ensured before initiating them in Peer Review process. In the above light, state few eligibility criteria fixed for a person to be empanelled and also for being appointed as a Peer Reviewer.

ANSWER:

Eligibility to be a Reviewer :

- (i) A Peer Reviewer shall: -
 - (a) Be a member with at least 10 years of experience in practice.
 - (b) Is in Practice as per the Chartered Accountants Act, 1949.
 - (c) Should have undergone the requisite training as prescribed by the Board.
 - (d) Should furnish a declaration as prescribed by the Board, at the time of acceptance of Peer Review appointment.
 - (e) Should have signed the Declaration of Confidentiality as prescribed by the Board.
 - (f) Should have conducted audit of Level I Entities for at least 7 years to be eligible for conducting Peer Review of Level I Entities as referred to in Para II of this Statement.
- (ii) For being a Reviewer a member should not have: -
 - (a) Disciplinary action / proceedings pending against him
 - (b) been found guilty by the Council or the Disciplinary Board or Committee at any time.
 - (c) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with transportation or imprisonment.
 - (d) any Obligation or conflict of interest in the Practice Unit or its Partners / Personnel.
- (iii) A Reviewer shall not accept any professional assignment from the Practice Unit for a period two years from the date of appointment.

MTP-Mar 2019 Qn No 4(c) 5 Marks:

Ayush, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What are the areas excluded from the scope of peer reviewer?

Answer:

Areas excluded from scope of Peer Reviewer are:

- (i) Management Consultancy Engagements;
- (ii) Representation before various Authorities;
- (iii) Engagements to prepare tax returns or advising clients in taxation matters;
- (iv) Engagements for the compilation of financial statements;
- (v) Engagements solely to assist the client in preparing, compiling or collating information other than financial statements;
- (vi) Testifying as an expert witness;

- (vii) Providing expert opinion on points of principle, such as Accounting Standards or the applicability of certain laws, on the basis of facts provided by the client; and
- (viii) Engagement for Due diligence.

RTP Nov 18 Qn no 20(C)

Write short note on the stepwise approach of the peer reviewer.

Answer

Stepwise Approach of the Peer Reviewer: The stepwise approach which may be adopted by the reviewer is discussed below-

- (iii) The reviewer should gain an understanding of the engagement letter since an assurance engagement or for that matter any other kind of engagement should begin with an engagement letter. This understanding would help him in planning the review of documentation.
- (iv) The number of assurance engagements to be selected requires the exercise of judgement by the reviewer based on the evaluation of replies given in the questionnaire and the size of the practice unit.
- (v) The practice unit may have policies and procedures for accepting a particular engagement. The reviewer should, wherever possible, examine that the policies and procedures for acceptance of audit have been complied with and necessary documentation with regard to the same exists.
- (vi) The reviewer may follow a combination of compliance procedures and substantive procedures throughout the peer review process.
- (vii) Finally, the reviewer while evaluating records may consider the following:
 - determine that any significant issues, matters, problems that arose during the course of the engagement have been appropriately considered, resolved and documented;
 - determine that adequate audit evidence or other relevant evidence in relation to the engagement is obtained to support the reasonableness of the conclusions drawn; and
 - determine that significant decisions relating to the engagement, use of professional judgement, resolution of significant matters have been properly documented.

Nov 2018 Qn no 6(e) 4 Marks

What are the objectives of Peer Review?

Answer

Objectives of Peer Review: The main objective of Peer Review is to ensure that in carrying out the assurance service assignments, the members of the Institute-

- (1) comply with Technical, Professional and Ethical Standards as applicable including other regulatory requirements thereto and
- (2) have in place proper systems including documentation thereof, to amply demonstrate the quality of the assurance services.

Thus, the primary objective of peer review is not to find out deficiencies but to improve the quality of services rendered by members of the profession. The Statement of Peer Review also makes it clear that the peer review, "does not seek to redefine the scope and authority of the Technical Standards specified by the Council but seeks to enforce them within the parameters prescribed by the Technical Standards".

The peer review is directed towards maintenance as well as enhancement of quality of assurance services and to provide guidance to members to improve their performance and adherence to various statutory and other regulatory requirements. Such an objective of the peer review process makes it amply clear that the reviewer is not going to sit on the judgment of the practice unit while rendering assurance services but to evaluate the procedure followed by the practice unit in rendering such a service. Accordingly, where a practice unit is not following technical standards, the reviewers are expected to recommend measures to improve the procedures. To elaborate further, the key objective of peer review exercise is not to identify isolated cases of engagement failure, but to identify weaknesses that are pervasive and chronic in nature. The conclusion, therefore, is that the peer review seeks to identify and address patterns of non-compliance with quality control standards.

Nov 18 Qn no 6(e) 4 Marks

What are the inherent limitations of Peer Review?

Answer

Inherent Limitations of Peer Review: The reviewer conducts the review in accordance with the Statement on Peer Review. The review would not necessarily disclose all weaknesses in compliance of technical standards and maintenance of quality of assurance services since it would be based on selective tests. As there are inherent limitations in the effectiveness of any system of quality control which happens to be subject-matter of review, departure from the system may occur and may not be detected.

MTP-OCT-18 Qn No 6(E) 4 Marks:

Arpit, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas Arpit should review in the assessment of independence of the practicing unit?

MTP-OCT-19 Qn No 6(c)(2) 4 Marks:

Aarav, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas A should review in the assessment of independence of the practicing unit?

Answer:

Review in the Assessment of Independence of the Practicing Unit – The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration and evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation service engagements to be reviewed.

Aarav, a practicing Chartered Accountant should review following controls in respect of assessment of independence of the practicing unit:

- (i) Does the practice unit have a policy to ensure independence, objectivity and integrity, on the part of partners and staff? Who is responsible for this policy?
- (ii) Does the practice unit communicate these policies and the expected standards of professional behaviour to all staff?
- (iii) Does the practice unit monitor compliance with policies and procedures relating to independence?
- (iv) Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?

RTP May 2020 Qn no 20

(a) Scope of peer review.

Answer:

Scope of Peer Review: The Statement on Peer Review lays down the scope of review to be conducted as under:

The Peer Review process shall apply to all the assurance services provided by a Practice Unit.

1. Once a Practice Unit is selected for Review, its assurance engagement records pertaining to the Peer Review Period shall be subjected to Review.
2. The Review shall cover:
 - (i) Compliance with Technical, Professional and Ethical Standards:
 - (ii) Quality of reporting.
 - (iii) Systems and procedures for carrying out assurance services.

(iv) Training programmes for staff (including articled and audit assistants) concerned with assurance functions, including availability of appropriate infrastructure.

(v) Compliance with directions and/or guidelines issued by the Council to the

Members, including Fees to be charged, Number of audits undertaken, register for Assurance Engagements conducted during the year and such other related records.

(vi) Compliance with directions and/or guidelines issued by the Council in relation to article assistants and/or audit assistants, including attendance register, work diaries, stipend payments, and such other related records.

QUALITY REVIEW

RTP May 2018 Qn no.20(b)

Write short note on the Various Stages involved in the Conduct of the Quality Review Assignments

Answer

Various Stages involved in the Conduct of the Quality Review Assignments are:

- Selection of Audit Firm and Technical Reviewer to conduct Quality Review and sending Offer Letter of Engagement to the Technical Reviewer.
- Technical Reviewer to convey his acceptance of Letter of Engagement by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by the Technical Reviewer and his assistant/s, if any.
- Intimation to the Audit Firm about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. Also marking a copy of the intimation to the Technical Reviewer.
- Technical Reviewer to send the specified Quality Review Program General Questionnaire to the Audit firm for filling-up and call for additional information from the Audit Firm, if required.
- Technical Reviewer to carry out the Quality Review by visiting the office of the Audit Firm by fixing the date as per mutual consent.
- Technical Reviewer to send the preliminary report to Audit firm.
- Audit firm to submit representation on the preliminary report to the Technical Reviewer.
- Technical Reviewer to submit final report alongwith a copy of Annual report of the company/entity for the year, to the Board in the specified format, on their (individual) letterhead, duly signed and dated within 45 days from the date of acceptance of the assignment.

- Technical Reviewer should also send a copy of their final report to the Statutory Auditor/Audit firm, requesting the firm to send their submissions thereon to the
- Board within 7 days of receipt of the final report with a copy to Technical Reviewer. Upon receipt of their final submission, Technical Reviewer shall submit within next 7 days a summary of their findings, reply of the audit firm thereon alongwith their final comments in the specified format.
- Quality Review Group to consider the report of the Technical Reviewer and responses of the Audit firm and make recommendations to Quality Review Board.
- Quality Review Board to consider the report of the Quality Review Group and decide the final course of action.

MTP Mar 18 Qn no.6(e) 5 Marks

List out the consequences if the Quality review board notices major non-compliances with the requirements of the Standards on quality control or standards on auditing or accounting standards?

Answer

Consequence in case QRB notices non-compliance of Standards:

- Referring the case to the Director (Discipline) of the Institute for necessary action under the Chartered Accountants Act, 1949;
- Informing the details of the non-compliance to the regulatory bod(y)/ies relevant to the enterprise;
- Intimating the concerned auditor as to the findings of the Report as well as action initiated under (a) and/or (b) above;
- Consider the matter complete and inform the audit firm/auditor accordingly.

MTP Apr 18 Qn no.6(d) 4 Marks

Reviewers, based on the conclusions drawn from the quality review, shall issue a preliminary report and subsequently the final report. As a quality reviewer briefly discuss the basic elements of Quality Review Report.

Basic Elements of the Reviewer's Report in case of Quality Review: The quality review report should contain elements relating to audit quality of companies and elements relating to quality control framework adopted by the audit firm in conducting audit which are given below:

A. Elements relating to audit quality of companies:

- A reference to the description of the scope of the review and the period of review of audit firm conducted alongwith existence of limitation(s), if any, on the review conducted with reference to the scope as envisaged.
- A statement indicating the instances of lack of compliance with technical standards and other professional and ethical standards.

- A statement indicating the instances of lack of compliance with relevant laws and regulations.
- B. Elements relating to quality control framework adopted by the audit firm in conducting audit:**
- An indication of whether the firm has implemented a system of quality control with reference to the quality control standards.
 - A statement indicating that the system of quality control is the responsibility of the reviewed firm.
 - An opinion on whether the reviewed firm's system of quality control has been designed to meet the requirements of the quality control standards for attestation services and whether it was complied with during the period reviewed to provide the reviewer with reasonable assurance of complying with technical standards in all material respects.
 - Where the reviewer concludes that a modification in the report is necessary, a description of the reasons for modification. The report of the reviewer should also contain the suggestions.
 - A reference to the preliminary report.
 - An attachment which describes the quality review conducted including an overview and information on planning and performing the review.

Further, the Quality Review Report should be issued on the reviewer's (individual) letterhead and signed by the reviewer. The report should be addressed to the Board and should be dated as of the date of the conclusion of the review.

MTP-Aug-18 Qn No 6(e) 4 Marks:

Reviewers, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a reviewer may qualify the report due to one or more reasons. In view of above Give example of some of the situations when Reviewer of Quality Review Board may qualify the report.

Answer:

Reviewers, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a reviewer may qualify the report due to one or more of the following:

- ◆ non-compliance with technical standards;
- ◆ non-compliance with relevant laws and regulations;

- ◆ quality control system design deficiency;
- ◆ non-compliance with quality control policies and procedures; or
- ◆ non-existence of adequate training programmes for staff.

RTP Nov 18 Qn no 20(b)

Write short note on Objective of Quality Review

Answer

Objectives of Quality Review: Quality review is directed towards evaluation of audit quality and adherence to various statutory and other regulatory requirements. They are designed to identify and address weaknesses and deficiencies related to how the audits were performed by the audit firms. To achieve that goal, quality reviews included reviews of certain aspects of selected statutory audits performed by the firm and reviews of other matters related to the firm's quality control system.

In the course of reviewing aspects of selected audits, a review may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, aspects in which an entity's financial statements do not present fairly the financial position or the results of operations in conformity with the applicable Generally Accepted Accounting Principles (GAAP) and other technical standards. **It is not the purpose of a review, however, to review all of a firm's audits or to identify every aspect in which a reviewed audit is deficient.** Accordingly, a review should not be understood to provide any assurance that the firm's audits, or its clients' financial statements or reporting thereon, are free of any deficiencies.

RTP Nov 2019 Qn no 25(e)

Scope of the Quality review.

Answer

The scope of the quality review includes:

- ❑ Examining whether the Engagement Partner has ensured compliance with the applicable technical standards in India and other applicable professional and ethical standards and requirements.
- ❑ Examining whether the Engagement Partner has ensured compliance with the relevant laws and regulations.
- ❑ Examining whether the Audit firm has implemented a system of quality control as envisaged in line with the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

Study Material

1.A, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas A should review in the assessment of independence of the practicing unit?

Answer

Review in the Assessment of Independence of the Practicing Unit – The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration and evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation service engagements to be reviewed.

A, a practicing Chartered Accountant should review following controls in respect of assessment of independence of the practicing unit:

- (i) Does the practice unit have a policy to ensure independence, objectivity and integrity, on the part of partners and staff? Who is responsible for this policy?
- (ii) Does the practice unit communicate these policies and the expected standards of professional behaviour to all staff?
- (iii) Does the practice unit monitor compliance with policies and procedures relating to independence?
- (iv) Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?

2.What are the reporting responsibilities of the technical reviewer while carrying out a Quality review assignment?

The Technical Reviewers expresses an opinion on whether the system of quality control for the attestation services of the firm under review has been designed so as to carry out professional attestation services assignments in a manner that ensures compliance with the applicable Technical standards and maintenance of the quality of attestation service work they perform. The Technical Reviewer's review would not necessarily disclose all weaknesses in the quality of attestation work or all instances of lack of compliance with applicable Technical Standards. As there are inherent limitations in the effectiveness of any system of quality control, departure from the system may occur and not be detected. Also, projection of any evaluation of system of quality control to future periods is subject to the risk that the system of quality controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate. In the process, the Technical Reviewers also identified what they considered to be deficiencies and any defects in, or criticisms of the firm's quality control system.

3.Give examples of areas on which the reviewer may qualify the report?

ANSWER:

The reviewer, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. The final report shall be issued in the format as may be specified by the Board from time to time. A clean report indicates that the TR is of the opinion that the statutory audit is being conducted in a manner that ensures the quality of audit services rendered. However, a reviewer may qualify the report due to one or more of the following:

- ☒ non-compliance with technical standards and other relevant guidance;
- ☒ non-compliance with relevant laws and regulations as required under applicable auditing standard;
- ☒ quality control system design deficiency; or
- ☒ non-compliance with quality control policies and procedures.

4. What are the consequences if the Quality review board notices major non-compliances with the requirements of the Standards on quality control or standards on auditing or accounting standards?

ANSWER:

- (a) Make recommendations to the Council of ICAI u/s 28B(a) of Chartered Accountants Act, 1949 for referring the case to the Director (Discipline) of the Institute for consideration and necessary action under the Chartered Accountants Act, 1949.
- (b) Issue advisory and guidance to the AFUR u/s 28B(c) of Chartered Accountants Act, 1949 for improvement in the quality of services and adherence to various statutory and other regulatory requirements. A copy of such advisory may also be sent to the ICAI for information.
- (c) Inform the details of the non-compliance to the regulatory bod(y)/ies relevant to the entity as may be decided by the Board.
- (d) Intimate the AFUR as to the findings of the Report as well as action initiated as above.
- (e) In case of review arising out of a reference received from a regulatory body, inform the results of review and the details of action taken to the concerned regulatory body.
- (f) Consider the matter complete and inform the AFUR accordingly.

5. Briefly discuss the various stages involved in the conduct of the quality review assignments.

ANSWER:

The following table describes the various stages generally involved in the conduct of the quality review assignments:

QRB selects Audit Firm and the audit file for review and identifies TR to conduct Quality Review.
QRB sends Offer Letter of Engagement to TR.
TR conveys his acceptance of Letter of Engagement to QRB by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by himself and his assistant/s, if any.
QRB intimates AFUR about the proposed Quality Review. QRB also sends a copy of this intimation letter to TR and provides them contact details of each other for further

communication.

TR sends the specified Quality Review Questionnaire to the AFUR for filling-up. He also calls for additional information from the AFUR, if required

TR & his team carry out the Quality Review by starting their off-site review by making proper planning for the review and then on-site visiting the office of the AFUR by fixing the date as per mutual consent ensuring that review exercise gets completed within specified time frame.

On completion of on-site review, TR to send the preliminary report to AFUR. TR shall send a copy of preliminary report to QRB as well.

AFUR to submit representation on the preliminary report to the TR and TR to immediately send the reply of the AFUR to QRB.

TR to submit final report along with a copy of Annual report of the entity for the year under review, to the QRB in the specified format, on his (individual) letterhead, duly signed and dated within specified time frame or as extended by the QRB. In addition, he shall also send a copy of the final report to the AFUR, requesting them to send their final reply thereon to the QRB within 7 days of receipt of the final report. AFUR shall also send a copy of their final reply to TR.

AFUR to submit to QRB their reply on the final report and feedback, in prescribed format, regarding their experience of the quality review.

Upon receipt of the final reply from the AFUR, TR shall submit to QRB within next 7 days a summary of his findings, in the specified format, containing his findings, technical requirements, final reply of the AFUR and his final comments thereon.

QRB to consider the report of the TR and responses of AFUR and make recommendations to QRB. QRB may also call for additional details/information/explanations, if required, from TR/AFUR or issue such directions to TR, as it may deem appropriate, enabling it to assess the quality of audit and reporting by the AFUR.

QRB to consider report and recommendations of QRB and decide further course of action.

6.What are the important areas for evaluation while conducting quality reviews in terms of SQC -1 Standard on Quality Control?

ANSWER:

- (1) Whether the audit firm establishes and implements policies and procedure on all the element of system of quality control
- (2) Whether the engagement quality control reviewer review at an appropriate time for the planning of an audit, significant audit judgement, and expressions of an audit opinion.
- (3) Whether the audit firm assigns as the person responsible for the

monitoring of the system of quality control a person with appropriate experience for the role, vest the assigned person with sufficient and appropriate authority.

(4) Whether the audit firm obtain, at least annually, a confirmation letter concerning compliance with policies and procedure for the maintenance of independence from all person required to maintain independence. (5) Whether the audit firm perform the independence confirmation procedure set forth in its internal rules before acceptance and continuance of an audit engagement, and when issuing the auditor's report appropriately confirms that there was no change in the status of independence.

(6) Whether the audit firm develop and provides education/ training program that fully take into account the knowledge, experience, competence and capabilities of the professional staff.

7. Evaluating the professional judgment exercised by the auditor is one of the important aspects under Quality review, please explain the situation with reference to applicable SA.

ANSWER:

As per the QRB, the term "Technical Standards" in the context of the Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006 includes:

Preface to the Statements of Accounting Standards;

Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services;

The Accounting Standards notified under section 133 of the Companies Act, 2013;

The Accounting Standards issued by the Institute of Chartered Accountants of India;

The Framework for the Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India;

The applicable Quality Control and Standards on Auditing issued by the Institute of Chartered Accountants of India and those notified under the relevant statute;

The Statements on Auditing issued by the Institute of Chartered Accountants of India;

The Notifications/Directions/Guidelines issued by the Institute of Chartered Accountants of India including those of a self-regulatory nature;

Other relevant legal and regulatory requirements.

"Other Relevant Guidance" include:-

- *The Guidance Notes on accounting and auditing matters issued by the Institute of Chartered Accountants of India;*

- *The Code of Ethics issued by the Institute of Chartered Accountants of*

India.

8. What are the objectives of the Quality review?

ANSWER:

Quality review is directed towards evaluation of audit quality and adherence to various statutory and other regulatory requirements. They are designed to identify and address weaknesses and deficiencies related to how the audits were performed by the audit firms. To achieve that goal, quality reviews included reviews of certain aspects of selected statutory audits performed by the firm and reviews of other matters related to the firm's quality control system.

In the course of reviewing aspects of selected audits, a review may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, aspects in which an entity's financial statements do not present fairly the financial position or the results of operations in conformity with the applicable Generally Accepted Accounting Principles (GAAP) and other technical standards. **It is not the purpose of a review, however, to review all of a firm's audits or to identify every aspect in which a reviewed audit is deficient.** Accordingly, a review should not be understood to provide any assurance that the firm's audits, or its clients' financial statements or reporting thereon, are free of any deficiencies.

2.1 The scope & objective of the quality review includes:

- (a) Examining whether the Statutory Auditor has ensured compliance with the applicable technical standards in India and other applicable professional and ethical standards and **other relevant guidance.**
- (b) Examining whether the Statutory Auditor has ensured compliance with the relevant laws and regulations **as required under applicable auditing standard.**
- (c) Examining whether the Audit firm under review (AFUR) has implemented a system of quality control with reference to the applicable quality control standards.
- (d) Examining whether there is no material misstatement of assets and liabilities as at the reporting date in respect to the selected entity.

Multiple Choice Question

ICAI is responsible for monitoring the quality of the work of its members for performing audits of financial statements?

- (a) Yes - for all audits of financial statements
- (b) Yes - for all audits except those of listed entities
- (c) No, responsibility for quality assurance for all audits rests with another body
- (d) Yes - for all audits except those of unlisted entities

Answer: (a) Yes - for all audits of financial statements

What types of engagements are not included in the scope of the quality assurance review program?

- a) Financial statement audit - listed entities (minimum requirement)
- b) Financial statement audit - audit of other than listed entities
- c) Other services (e.g., review, compilation)
- d) Insolvency

Answer: d) Insolvency

RTP Nov 2020 Q no 20

Write a short note on the following:

(a) Selection of sample by the reviewer in case of peer review.

(b) Classification of frauds by NBFC.

(c) General steps in the conduct of risk based audit.

(d) Contents of an audit plan.

Answer

(a) Selection of Sample by the Reviewer in case of Peer Review:

(i) The Reviewer shall within 15 days of receiving the information from the Practice Unit select a sample of the assurance services that he would like to Review and intimate the same to the Practice Unit.

(ii) The Reviewer may also seek further / additional clarification from the Practice Unit on the information furnished / not furnished.

(iii) The Reviewer shall plan for an on-site Review visit or initial meeting in consultation with the Practice Unit. The Reviewer shall give the Practice Unit at least fifteen days' time to keep ready the necessary records of the selected assurance services.

(iv) The Reviewer and Practice Unit shall mutually cooperate and ensure that the entire Review process is completed within 90 days from the date of notifying the Practice Unit about its selection for Review.

(b) Classification of Frauds by NBFC: In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

(i) Misappropriation and criminal breach of trust.

(ii) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.

(iii) Unauthorised credit facilities extended for reward or for illegal gratification.

(iv) Negligence and cash shortages.

(v) Cheating and forgery.

(vi) Irregularities in foreign exchange transactions.

(vii) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

(I) cases of cash shortages more than ` 10,000/- and

(II) cases of cash shortages more than ` 5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

(c) General Steps in the Conduct of Risk Base Audit: RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable level and the reporting to auditee of audit results. These are achieved through the following:

Step 1 Understand auditee operations to identify and prioritize risks: Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

Step 2 Assess auditee management strategies and controls to determine residual audit risk: Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.

Step 3 Manage residual risk to reduce it to acceptable level: Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.

Step 4 Inform auditee of audit results through appropriate report: The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of internal controls that affect the organization's ability to record, process, summarize and report financial data

(d) Contents of an Audit Plan: The auditor shall develop an audit plan that shall include a description of-

- i. The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- ii. The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".
- iii. Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

CHAPTER- 18 Professional Ethics

Multiple Choice questions

MTP Mar 2019 QN no 16

BVM & Associates is an audit firm that employs large number of audit assistants. CA Mahesh, a partner pays extreme attention to briefing the audit assistants every day while the audit is continuing. All audit assistants are required to document their notes in the daily briefing and accordingly conduct the audit. CA Mahesh has made it very clear that any assistant who does not document the notes taken and the steps taken accordingly will be reprimanded as it will mean that the assistants are not creating their audit programmes on the job. The practice deployed by CA Mahesh can be termed as?

- (a) Unacceptable as CA Mahesh being the auditor should be providing the audit programme and he cannot expect the team to take daily notes instead of performing the audit.
- (b) Appropriate and in line with SA 230 as the audit programme must be prepared on the basis of documentation of auditor's briefing notes.
- (c) Acceptable but incomplete as CA Mahesh has not given any audit programme to the audit assistants to follow.
- (d) Inappropriate as CA Mahesh should not only provide the audit programme but also make sure that audit programme is formally approved by all partners of the firm.

Answer(c) Acceptable but incomplete as CA Mahesh has not given any audit programme to the audit assistants to follow.

MTP Apr 2019 Qn no 6 (1 Mark)

Prabhakar & Associates were the statutory auditors of Inverto & Co for last 2 years. In the current year, one of the partners Mr. Anant Prabhakar, a qualified chartered accountant from ICAI also got qualified as a chartered management accountant from a foreign accountancy body CIMA. The management of Inverto & Co were glad to hear this and offered Mr. Anant to handle the management services of the company from this year. Is he allowed take up this assignment for Inverto & Co as per the Chartered Accountants Act 1949 and Schedules thereunder?

- (a) Yes, being a qualified management accountant within their group, Prabhakar & Associates should take this assignment.
- (b) Yes, Mr. Anant can cover the management services and another auditor from the firm can cover the statutory audit of Inverto & Co.
- (c) No, the management services cannot be provided by the firm, who currently is the statutory auditor of Inverto & Co.
- (d) No, Mr. Anant is newly qualified management accountant who does not

have enough experience, hence should not take up the management services assignment.

Answer: (c) No, the management services cannot be provided by the firm, who currently is the statutory auditor of Inverto & Co.

MTP Oct 2019 Qn no 1 (1 Mark)

CA Ram is practicing in the field of financial management planning for over 12 years. He has gained expertise in this domain over others. Mr. Ratan, a student of Chartered Accountancy course, is very much impressed with the knowledge of CA. Ram. He approached CA. Ram to take guidance on some topics of financial management subject related to his course. CA. Ram, on request, decided to spare some time and started providing private tutorship to Mr. Ratan along with some other aspirants for 4 days in a week and for 3 hours in a day. However, he forgot to take specific permission for such private tutorship from the Council. Later on, he came to know that the Council has passed a Resolution under Regulation 190A granting general permission (for private tutorship, and part-time tutorship under Coaching organization of the Institute) and specific permission (for part-time or full time tutorship under any educational institution other than Coaching organization of the Institute). Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should _____ in order to be able to undertake attest functions.

- (i) not exceed 25 hours a week
- (j) not exceed 21 hours a week
- (k) not exceed 25 hours a month
- (l) not exceed 21 hours a month

Answer: (a) not exceed 25 hours a week

Clause 1 of Part 1 First Schedule

Descriptive Questions

1.May 2019 Qn no 6(C)5 Marks

CA Sant, a newly qualified professional with certificate of practice, approached CA Pant, the auditor of his father's company M/s Max Ltd., to allow him to have some practical and professional knowledge and experience in his firm before he can set up his own professional practice. CA Pant allowed him to sit in his office for 6 month and allotted a small chamber with other office infrastructure facility. In the course of his association with CA Pant's office, he used to provide tax consultancy independently to the client of the firm and also filed few IT and GST return and represented himself before various tax authorities on behalf of the firm although no documents were signed by him. During his association in CA Pant's office, he did not get any salary or share of profit or commission but only re-imburement of usual expenses like conveyance, telephone etc. was made to him. After the end of the agreed period, he was given a lump sum amount of ` 3,00,000 by CA Pant for his association out of gratitude.

Examine the case in the light of code of professional misconduct.

Answer

Clause (1) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner, or his employee and would work under his control and supervision.

In the instant case, CA Pant allowed CA Sant (who is a newly qualified CA professional with COP) to sit in his office for 6 months, and allowed him to provide tax consultancy independently to his firm's clients, filing of some IT and GST Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA Sant was only reimbursed with his usual expenses and was not paid any salary or share of profit for the same. However, after the end of agreed period he was given a lump-sums of rupees 3,00,000 for his association out of gratitude.

Thus, in the present case CA. Pant will be held guilty of professional misconduct as per Clause (1) of Part I of First Schedule to the Chartered Accountants Act, 1949 as he allowed CA Sant to practice in his name as Chartered accountant and CA Sant is neither in partnership nor in employment with CA. Pant.

Clause 2 of Part 1 First Schedule

MTP-OCT-19 Qn No 4(c) 4 Marks:

2.Mr. Avin, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non- Chartered Accountant, Mr. Lucky, under the nomenclature of office allowance and such an arrangement continued for a number of years. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Or

Study Material

Mr. K, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years.

Answer:

Sharing of Audit Fees with Non-Member: As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant in practice pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons

having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

In the instant case, Mr. Avin, a practising Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. Lucky, under the nomenclature of office allowance and such an arrangement continued for a number of years. In this case, it is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into.

The Chartered Accountant had shared his profits and, therefore, Mr. Avin will be held guilty of professional misconduct under the Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949.

3.MTP Mar 2018 2(a) 5 Marks

Ms. Preeti is a practicing Chartered Accountant. Mr. Preet is a practicing Advocate representing matters in the court of law. Ms. Preeti and Mr. Preet decided to help each other in the matters involving their professional expertise. Accordingly, Ms. Preeti recommends Mr. Preet in all tax litigation matters in the court of law and Mr. Preet consults Ms. Preeti in all matters related to finance and other related matters, which comes to him in arguing various cases in the court of law. Consequently, they started sharing some part in the profits of their professional work. Comment on above with reference to the Chartered Accountants Act, 1949, and Schedules thereto

Answer

Sharing and Accepting of Part of Profits with an Advocate: According to Clause(2) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute, for the purpose of rendering such professional services from time to time in or outside India.

Furthermore, Clause (3) of Part I of the First Schedule to the said Act states that a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts any part of the profits of the professional work of a person who is not a member of the Institute.

However, a practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as prescribed by the Council under Regulation 53-A of the Chartered Accountants Regulations, 1988. Under the said regulation, the member of "Bar Council of India" is included.

Therefore, Mr. Preet, an advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Ms. Preeti. Hence, Ms. Preeti, a practicing Chartered Accountant, will not be held guilty under any of the abovementioned clauses for paying and accepting part of profits from Mr. Preet.

4.Mr. X who passed his CA examination of ICAI on 18th July, 2020 and started his practice from August 15, 2017. On 16th August 2017, one female candidate approached him for articleship. In addition to monthly stipend, Mr. X also offered her 1 % profits of his CA firm. She agreed to take both 1 % profits of the CA firm and stipend as per the rate prescribed by the ICAI. The Institute of Chartered Accountants of India sent a letter to Mr. X objecting the payment of 1 % profits. Mr. X replies to the ICAI stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the financial position of the articled clerk is very weak. Is Mr. X Liable to professional misconduct?

Answer

Sharing Fees with an Articled Clerk: As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India. In view of the above, the objections of the Institute of Chartered Accountants of India, as given in the case, are correct and reply of Mr. X, stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the position of the articled clerk is weak is not tenable.

Hence, Mr. X is guilty of professional misconduct in terms of Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949

5.Mr. Qureshi, Chartered Accountant, in practice died in a road accident. His widow proposes to sell the practice of her husband to Mr. Pardeshi, Chartered Accountant, for ` 5 lakhs. The price also includes right to use the firm name - Qureshi and Associates. Can widow of Qureshi sell the practice and can Mr. Pardeshi continue to practice in that name as a proprietor?

Solution

Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

It lays down that the sale is permitted subject to certain conditions discussed in the above flowchart. It further resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.

Conclusion: Thus, in a given case, the widow of Mr. Qureshi, who has proposed to sell the practice for ` 5 lakhs is in effect proposing the sale of goodwill. Thus, the act of Mrs. Qureshi is permissible and Mr. Pardeshi can continue to practice in that name as a proprietor.

Clause 4 of Part 1 First Schedule

6.Mr. P, a Chartered Accountant in practice entered into a partnership with Mr. L, an advocate for sharing of fees for work sent by one to the other. However, due to some disputes, the partnership was dissolved after 1 month without any fees having been received.

Partnership with an Advocate: As per Clause (4) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant will be guilty of professional misconduct if he enters into partnership with any person other than a chartered accountant in practice or a person resident without India who but for his residence abroad would be entitled to be registered as a member under Clause (v) of Sub-section (1) of Section 4 or whose qualification are recognized by the Central Government or the Council for the purpose of permitting such partnership.

However, Regulation 53B of the Chartered Accountants Regulations, 1988 permits a Chartered Accountant in practice to enter into partnership with other prescribed Professionals which includes an Advocate, a member of Bar Council of India. In the instant case, Mr. P, a chartered accountant, has entered into partnership with Mr. L, an advocate.

Thus, he would not be guilty of professional misconduct as per Clause (4) of Part I of First Schedule read with Regulation 53B

Clause 6 of Part 1 First Schedule

7.Mr. S, a Chartered Accountant published a book and gave his personal details as the author. These details also mentioned his professional experience and his present association as partner with M/s RST, a firm.

Soliciting Professional Work: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means. Therefore, members should not adopt any indirect methods to advertise their professional practice with a view to gain publicity and thereby solicit clients or professional work. Such a restraint must be practiced so that members may maintain their independence of judgement and may be able to command the respect of their prospective clients. While elaborating forms of soliciting work, the Council has specified that a member is not permitted to indicate in a book or an article, published by him, his association with any firm of chartered accountants. In this case, Mr. S, a Chartered Accountant published the book and mentioned his professional experience and his association as a partner with M/s RST, a firm of chartered accountants.

Conclusion: Mr. S being a chartered accountant in practice has committed the professional misconduct by mentioning that at present he is a partner in M/s. RST, a chartered accountants firm.

MTP-Aug-18 Qn No 4(a) 4 Marks:

8.M/s LMN, a firm of Chartered Accountants responded to a tender from a State Government for computerization of land revenue records. For this purpose, the firm also paid Rs. 50,000 as earnest deposit as part of the terms of the tender. Comment with reference to the Chartered Accountants Act, 1949.

Answer:

Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. As per the guidelines if a matter relates to any services other than audit, members can respond to any tender. Further, in respect of a non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits.

In the instance case, since computerization of land revenue records does not fall within exclusive areas for chartered accountants, M/s LMN can respond to tender as well as deposit Rs. 50,000 as earnest deposit and shall not have committed any professional misconduct.

MTP-OCT-19 Qn No 2(c) 5 Marks:

9.Mr. Rival, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While addressing the audience, he informed that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

Using Designation Other Than a CA and Providing Details of Services Offered:

Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients. Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the

notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write must not be promotional of his or his firm but must be an objective professional view of the topic under consideration. Thus, it is improper to use designation "Management Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Management Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6).

MTP Mar 2018 3(a) 5 Marks

10.A special notice has been issued for a resolution at 3rd annual general meeting of Fiddle Ltd. providing expressly that CA. Smart shall not be re-appointed as an auditor of the company. Consequently, CA. Smart submitted a representation in writing to the company as provided under section 140(4)(iii) of the Companies Act, 2013. In the representation, CA. Smart incorporated his independent working as a professional throughout the term of office and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the Company. Advise on above with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer

Soliciting Clients: As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so

chooses, his willingness to continue as auditor, if re- appointed by the shareholders. Thus, the incorporation as an independent professional, made by CA. Smart, while submitting representation under section 140(4)(iii) of the Companies Act, 2013 and indication of willingness to continue as an auditor if reappointed by shareholders, does not leads to solicitation.

Therefore, CA. Smart will not be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

RTP May 2018 Qn no 19(a)

11.Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

Mr. Brilliant, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in blue colour. He also circulated the information contained in the website through E-mail to acknowledge public at large about his expertise. However, due to shortage of time, he could not intimate his website address to the Institute.

Answer:

Circulating Information Contained in Own Website: As per clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the guidelines approved by the Council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request.

Further, members are not required to intimate the Website address to the Institute. Members are only required to comply with the Website Guidelines issued by the Institute in this regard.

In the given case, Mr. Brilliant has circulated the information contained in the website through E-mail to public at large. Therefore, he is guilty of professional misconduct under clause (6) of Part I of the First Schedule to the said Act. However, there is no such misconduct for not intimating website address to the Institute.

CA. Raj is a leading income tax practitioner and consultant for derivative products. He resides in Bangalore near to the XYZ commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 50% of his time to settle the commodity transactions, though he has not taken any permission for this. Is CA. Raj liable for professional misconduct

Nov 18 Qn no 3(a) 5 Marks

12. During the opening ceremony of a new branch office of CA. Young, his friend CA. Old introduced to CA. Young, his friend and client Mr. Rich, the owner of an Export House whose accounts had been audited by CA. Old for more than 15 Years. After few days, Mr. Rich approached CA. Young and offered a certification work which hitherto had been done by CA. Old. CA. Young undertook the work for a fee which was not less than fee charged by CA. Old in earlier period. Comment whether CA. Young had done any professional misconduct.

Answer

Acceptance of original professional work by a member emanating from the client Introduced to him by another member: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.

Further, some forms of the soliciting work which the Council has prohibited include that a member should not accept the original professional work emanating from a client introduced to him by another member. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.

In the given case, CA Old introduced his friend CA. Young to his friend and client Mr. Rich, the owner of an Export House whose accounts has been audited by CA. Old for more than 15 years. After a few day Mr. Rich approached CA. Young and offered a certification work which hitherto had been done by CA. Old. Fees charged by CA. Young is also not less than fee charged by CA. Old.

In view of above decision CA Young should ask the client to come through CA Old. However, CA Young undertook the work without informing CA. Old. Thus, CA. Young is held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

MTP-Apr-19 Qn No 3(a) 5 Marks:

13. A special notice has been issued for a resolution at 2nd annual general meeting of Fiddle Ltd. providing expressly that CA. Smart shall not be re-appointed as an auditor of the company. Consequently, CA. Smart submitted a representation in writing to the company as provided under section 140(4)(iii) of the Companies Act, 2013. In the representation, CA. Smart incorporated his independent working as a professional throughout the term of office and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the Company. Comment with reference to the Chartered Accountants Act, 1949 and Regulations there to.

Answer:

Soliciting Clients: As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re-appointed by the shareholders.

Thus, the incorporation as an independent professional, made by CA. Smart, while submitting representation under section 140(4)(iii) of the Companies Act, 2013 and indication of willingness to continue as an auditor if reappointed by shareholders, does not leads to solicitation.

Therefore, CA. Smart will not be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

RTP May 2019 Qn no 24

14.Mr Bold, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in blue colour. He also circulated the information contained in the website through E-mail to acknowledge public at large about his expertise. However, due to shortage of time, he could not intimate his website address to the Institute.

(a) Circulating Information Contained in Own Website: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the guidelines approved by the Council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request.

Further, members are not required to intimate the Website address to the Institute. Members are only required to comply with the Website Guidelines issued by the Institute in this regard.

In the given case, Mr. Bold has circulated the information contained in the website through E-mail to public at large. Therefore, he is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the said Act. However, there is no such misconduct for not intimating website address to the Institute.

Nov 2019 Qn no 2(C) 4 Marks

15. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: A special notice has been issued for a resolution at 3rd annual general meeting of LED Ltd., providing expressly that CA. Anoop shall not be re-appointed as an auditor of the company. Consequently, CA. Anoop submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Anoop included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company.

Answer

Soliciting Clients: As per **Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949**, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, **section 140(4)(iii) of the Companies Act, 2013**, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re-appointed by the shareholders.

The proposition of the auditor to highlight contributions made by him in strengthening the control procedures in the representation should not be included in such representations because the representation letter should not be prepared in a manner so as to seek publicity.

Thus, highlighting contributions made by him in strengthening the control procedures, while submitting representation U/S 140(4)(iii) of the Companies Act 2013, would amount to canvassing or soliciting for his continuance as auditor.

Therefore, **CA. Anoop will be held guilty for professional misconduct** under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

RTP May 2020

16.OPAQ & Associates, a firm of Chartered Accountants responded to a tender issued exclusively for Chartered Accountants by an organisation in the area of tax audit. However no minimum fee was prescribed in the tender document.

Answer:

Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. It states that a member may respond to tenders or enquiries issued by various users of professional services or organizations from time to time and secure professional work as a consequence.

However, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for Chartered Accountants, such as audit and attestation services. Though, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the instant case, OPAQ & Associates responded to a tender of tax audit which is exclusively reserved for Chartered Accountants even though no minimum fee was prescribed in the tender document.

Therefore, OPAQ & Associates shall be held guilty of professional conduct for responding to such tender in view of above-mentioned guideline.

17.ABZ & Co., a firm of Chartered Accountants, develops a website “abz.com”. The colour chosen for the website was a very bright green and the web-site was to run on a “push” technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator.

Posting of Particulars on Website: The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by ABZ & Co. are:

- ◆ No restriction on the colours used in the website;
- ◆ The websites are run on a “pull” technology and not a “push” technology
- ◆ Names of clients and fees charged not to be given.

However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that “This disclosure is in terms of the requirement of [name of the regulator] having

jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].

In view of the above, ABZ & Co. would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

Study Material

18.M/s XYZ, a firm in practice, develops a website “xyz.com”. The colour chosen for the website was a very bright green and the web-site was to run on a “push” technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator.

Answer

Posting of Particulars on Website: The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s XYZ are:

- ◆ No restriction on the colours used in the website;
- ◆ The websites are run on a “pull” technology and not a “push” technology;
- ◆ Names of clients and fees charged not to be given.

However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that “This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].

In view of the above, M/s XYZ would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

19.A partner of a firm of chartered accountants during a T.V. interview handed over a bio-data of his firm to the chairperson. Such bio-data detailed the standing of the international firm with which the firm was associated. It also detailed the achievements of the concerned partner and his recognition as an expert in the field of taxation in the country. The chairperson read out the said bio-data during the interview. Discuss whether this action by the Chartered Accountant would amount to misconduct or not.

Answer

Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means since it shall constitute professional misconduct. The bio-data was handed over to the chairperson during the T.V. interview by the Chartered Accountant which included details about the firm and the achievements of the partner as an expert in the field of taxation. The chairperson simply read out the same in detail about association with the international firm as also the achievements of the partner and his recognition as an expert in the field of taxation. Such an act would definitely lead to the promotion of the firms' name and publicity thereof as well as of the partner and as such the handing over of bio-data cannot be approved. The partner would be held guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949

20. An advertisement was published in a Newspaper containing the photograph of Mr. X, a member of the institute wherein he was congratulated on the occasion of the opening ceremony of his office.

Answer

Publishing an Advertisement Containing Photograph: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means

In the given case, Mr. X published an advertisement in a Newspaper containing his photograph on the occasion of the opening ceremony of his office. On this context, it may be noted that the advertisement which had been put in by the member is quite prominent. If soliciting of work is allowed, the independence and forthrightness of a Chartered Accountant in the discharge of duties cannot be maintained.

The above therefore amounts to soliciting professional work by advertisement directly or indirectly. Mr. X would be therefore held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949

21. Mr. X, a Chartered Accountant and the proprietor of X & Co., wrote several letters to the Assistant Registrar of Co-operative Societies stating that though his firm was on the panel of auditors, no audit work was allotted to the firm and further requested him to look into the matter.

Answer

Soliciting Professional Work: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. In the given case, Mr. X, a Chartered Accountant and proprietor of M/s X and Co., wrote several letters to the Assistant Registrar of Co-operative Societies, requesting for allotment of audit work. In similar cases, it was held that the Chartered Accountant would be guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The writing of continuous letter to ascertain the

reasons for not getting the work is quite alright but in case such either amount to request for allowing the work then Mr. X will be liable for professional misconduct.

Consequently, Mr. X would therefore be held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

22.Mr. Nigal, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While delivering the speech, he told to the audience that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment

Answer

Using Designation Other Than a CA and Providing Details of Services Offered: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write must not be promotional of his or his firm but must be an objective professional view of the topic under consideration.

Thus, it is improper to use designation "Management Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Management Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6).

RTP Nov'2020 Q No 1 Part A

Integrated Case Scenario

1. YS & Associates, a firm of Chartered Accountants, having CA. Y and CA. S as partners, is based at Mumbai. YS & Associates get their website developed as www.ysassociates.com from KPY Ltd. The colour of their website was very bright and attractive to run on a “push” technology. Names of the partners of the firm and the major clients were also displayed on the web-site without any disclosure obligation from any regulator.

CA. Y, accepted his appointment as tax auditor of a firm under Section 44AB, of the Income-tax Act, and commenced the tax audit within two days of appointment since the client was in a hurry to file Return of Income before the due date. After commencing the audit, CA. Y realised his mistake of accepting this tax audit without sending any communication to the previous tax auditor. In order to rectify his mistake, before signing the tax audit report, he sent a registered post to the previous auditor and obtained the postal acknowledgement.

CA. S, provides management consultancy and other services to his clients. During 2019, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Looking at his expertise in financial management, Mr. Tarak, a student of Chartered Accountancy course, is very much impressed with his knowledge. He approached CA. S to take guidance on some topics of financial management subject related to his course. CA. S, on request, decided to spare some time and started providing classes to Mr. Tarak along with some other aspirants for 3 days in a week and for 1 hour in a day. However, he has not taken any specific permission for such private tutorship from the Council.

YS & Associates is appointed to conduct statutory audit of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed CA. IA as its internal auditor. YS & Associates asked Mr. IA to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements. He also seeks his direct assistance in assembling the information necessary to resolve exceptions in confirmation responses with respect to external confirmation requests and evaluation of the results of external confirmation procedures.

XYZ Ltd is seeking advice of YS & Associates to appoint CA. IA for conducting GST Audit.

Question No.: (1-5)

1. YS & Associates sought direct assistance from CA. IA, internal auditor as stated in the above scenario. Advise as to whether he is permitted to do so in accordance with relevant Standards on Auditing.

(a) YS & Associates cannot ask CA. IA for direct assistance regarding evaluating significant accounting estimates and assessing the risk of material misstatements. However, CA. IA may assist YS & Associates in assembling information necessary to resolve exceptions in confirmation responses as per SA 610.

(b) CA. IA cannot assist YS & Associates in assembling information necessary to resolve exceptions in confirmation responses. However, YS & Associates can ask Mr. IA for direct assistance regarding evaluating significant accounting estimates and assessing the risk of material misstatements as per SA 610.

(c) YS & Associates cannot ask CA. IA for direct assistance regarding evaluating significant accounting estimates and assessing the risk of material misstatements and in assembling the information necessary to resolve exceptions in confirmation responses as per SA 610.

(d) YS & Associates can ask CA. IA for direct assistance regarding evaluating significant accounting estimates and assessing the risk of material misstatements and in assembling the information necessary to resolve exceptions in confirmation responses as per SA 610.

Answer: (a) YS & Associates cannot ask CA. IA for direct assistance regarding evaluating significant accounting estimates and assessing the risk of material misstatements. However, CA. IA may assist

YS & Associates in assembling information necessary to resolve exceptions in confirmation responses as per SA 610.

2. Whether CA S is guilty of professional misconduct in providing private tutorship to Mr. Tarak along with some other aspirants for 3 days in a week and for 1 hours in a day in the absence of specific approval.

(a) CA. S is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a month as per Regulation 192A

(b) CA. S is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a month as per Regulation 190A

(c) CA. S is guilty of professional misconduct as he has not obtained specific permission for the same.

(d) CA. S is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a week as per Regulation 190A

Answer: d) CA. S is not guilty of professional misconduct as he is teaching within prescribed hours i.e. not exceeding 25 hours a week as per Regulation 190A

3. Before signing the tax audit report, CA. Y sent a registered post to the previous auditor and obtained the postal acknowledgement. Will CA. Y be held guilty of professional misconduct under the Chartered Accountants Act, 1949?

(a) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949 CA. Y will not be held guilty of professional misconduct as he communicated with the previous tax auditor before signing the audit report.

(b) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, CA. Y will not be held guilty of professional misconduct since the requirement for communicating with the previous auditor being a chartered accountant in practice would apply to statutory audit only.

(c) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, CA. Y will be held guilty of professional misconduct since he has accepted the tax audit, without first communicating with the previous auditor in writing.

(d) As per Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949, CA. Y will be held guilty of professional misconduct since he has accepted the tax audit, without first communicating with the previous auditor in writing.

Answer: c) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, CA. Y will be held guilty of professional misconduct since he has accepted the tax audit, without 540 first communicating with the previous auditor in writing.

4. In view of YS & Associates, whether CA. IA is eligible to undertake Goods and Service Tax (GST) Audit of XYZ Ltd simultaneously?

- (a) CA. IA is internal auditor of XYZ Ltd and therefore, is eligible to undertake Goods and Service Tax (GST) Audit of XYZ Ltd simultaneously
- (b) CA. IA is internal auditor of XYZ Ltd and therefore, not eligible to undertake Goods and Service Tax (GST) Audit of XYZ Ltd simultaneously
- (c) Being Internal Auditor CA. IA is appropriate person to carry out Goods and Service Tax (GST) Audit of XYZ Ltd
- (d) None of the above

Answer: b) CA. IA is internal auditor of XYZ Ltd and therefore, not eligible to undertake Goods and Service Tax (GST) Audit of XYZ Ltd simultaneously

5. Whether, website designed for www.ysassociates.com is in compliance with the guidelines given in Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949:

- (a) Yes, website can have names of partners and major clients along with its fess.
- (b) Yes, as the websites can be designed on a “push” technology.
- (c) Yes, as there is no restriction on the colours used in the website.
- (d) No, as names of the partners of the firm and the major clients were displayed without any

Answer: d) No, as names of the partners of the firm and the major clients were displayed without any

Clause 7 of Part 1 First Schedule

RTP Nov 2019 Qn no 19

23.A Chartered Accountant in practice, empanelled as IP (Insolvency Professional) has mentioned the same on his visiting cards, letter heads and other communications also. Mr. A, who is residing in his neighbourhood has filed a complaint for professional misconduct against the said member for such mention of insolvency professional on circulations.

Answer

As per the Clause 7 of Part 1 of the First Schedule, if any Chartered Accountant advertises his professional attainments or services, or uses any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the ICAI of any other institution that has been recognized by the Central Government or may be recognized by the council, will be guilty of professional misconduct.

Here A Chartered Accountant empanelled as IP (Insolvency Professional) can mention 'Insolvency Professional' on his visiting cards, Letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause-7 of Part-1 of First Schedule to the Chartered Accountants Act, 1949. Thus, complaint of neighbour is not enforceable/valid.

RTP May 2019 Qn no 24

24.Mr. M, a Chartered Accountant in practice, has printed visiting cards which besides other details also carries a Quick Response (QR) code. The visiting card as well the QR code contains his name, office and residential address, contact details, e-mail id and name of the firm's website.

MTP-Aug-18 Qn No 5(a) 4 Marks:

Mr. M, a Chartered Accountant in practice, has printed visiting cards which besides other details also carries a Quick Response (QR) code. The visiting card as well the QR code contains his name, office and residential address, contact details, e-mail id and name of the firm's website. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer

Printing of QR Code on Visiting Cards: As per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he advertises his professional attainments or services.

Ethical Standards Board has also clarified that a member in practice is allowed to print Quick Response Code (QR Code) on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card.

In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice.

Thus, Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

25.MTP-Aug-18 Qn No 3(a) 5 Marks:

A practicing Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, as

- (i) Tax Consultant
- (ii) Cost Accountant.

Advise on above with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

1. **Tax Consultant:** Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognized by the Central Government or the Council. Thus, it is improper to use designation "Tax Consultant" since neither it is a degree of a University established by law in India or recognized by the Central Government nor it is a recognized professional membership by the Central Government or the Council.

(ii) **Cost Accountant:** As stated in the preceding paragraph, this would also constitute misconduct under section 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. A chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". However as per the Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant".

Study Material

26.A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant.

Answer

Cost Accountant: As stated in the case study given in clause 7 with reference to tax consultant, this would also constitute misconduct under section 7 of the Act read with Clause(7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. A chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". However as per the

Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant".

Clause 8 of Part 1 First Schedule

27.MTP-Mar 2019 Qn No 3(a) 5 Marks:

CA. T, in practice, was appointed to carry out internal audit of a stock broker, listed with BSE. However, he failed to intimate his appointment to the statutory auditors of the company. The statutory auditor feels this is violation of professional ethics. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been Issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

This clause is applicable in situation of replacing of one auditor by another auditor. Internal auditor and statutory audition are parallel positions and not replacement positions. The management generally appoints the internal auditor whereas the statutory auditor will be appointed by the shareholders in the AGM. In this situation, there is no need for communication by one to other.

In view of above the contention of the statutory auditor is unacceptable and there is no question of communicating in writing by Mr. T.

28.CA Raja was appointed as the Auditor of Castle Ltd. for the year 2019-20. Since he declined to accept the appointment, the Board of Directors appointed CA Rani as the auditor in the place of CA Raja, which was also accepted by CA Rani. Board can appoint the auditor in the case of casual vacancy under section 139(8) of the Companies Act, 2013. The non-acceptance of appointment by CA. Raja does not constitute a casual vacancy to be filled by the Board. In this case, it will be deemed that no auditor was appointed in the AGM.

Further, as per Section 139(10) of the Companies Act, 2013 when at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. The appointment of the auditor by the Board is defective in law.

Clause (9) of Part I of First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant is deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956 (now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013), in respect of such appointment have been fully complied with.

Conclusion: Hence, CA. Rani is guilty of professional misconduct since she accepted the appointment without verification of statutory requirements.

29. Mrs. X is a Director of ABC Pvt. Ltd. During the year 2020-21, the company appointed CA Mr. Y, Mrs. X's spouse, as its statutory auditor. Mr. Y used to deliver audit report without any comments or disclosures, thereupon.

As per Section 141(3)(f) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a director or is in the employment of the company as a director or key managerial personnel. The definition of 'Relative' includes husband and wife.

Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013), in respect of such appointment have been duly complied with.

In this case Mrs. X is a Director of ABC Pvt. Ltd. and the company has appointed Mr. Y, Chartered Accountant, Mrs. X's spouse, as its statutory auditor. Mr. Y should not accept the appointment as statutory auditor of the company, where his wife Mrs. X is a director. This is contravention of section 141 of the Companies Act, 2013.

Conclusion: Therefore, Mr. Y is liable for misconduct under the said clause since he accepted the appointment without first verifying the compliance of statutory requirements.

Clause 10 of Part 1 First Schedule

30.MTP Mar 2018 Qn no.4(a) 4 Marks

Alora Pvt. Ltd. approached CA. Neha, a practicing Chartered Accountant since 1998, for recovery of debts amounting ` 20 crore. CA Neha accepted the work and requested to charge fees @ 1.5% of the debt recovered. Later on, she raised a bill for debts recovered and charged ` 27 lacs for recovering 90% of the debts. Comment with reference to the Chartered Accountants Act, 1949.

Answer

Charging of Fees based on Percentage: Clause (10) of Part I to First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.

However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed Regulation 192 which exempts debt recovery services where fees may be based on a percentage of the debt recovered.

In the given case, CA. Neha has charged fees based on percentage of the debt recovered (which is exempted under Regulation 192). Hence, CA. Neha will not be held guilty for professional misconduct.

31.RTP May 2020 Qn no 19 (b)

Agarwal Pvt Ltd. approached CA. Prem, a Chartered Accountant in practice, for debt recovery services. CA Prem accepted the work and insisted for fees to be based on 2% of the debt recovered.

Answer:

Charging of Fees based on Percentage: Clause (10) of Part I to First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.

However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed Regulation 192 which exempts debt recovery services where fees may be based on a percentage of the debt recovered.

In the given case, CA. Prem has insisted for fees to be based on percentage of the debt recovered (which is exempted under Regulation 192). Hence, CA. Prem will not be held guilty for professional misconduct.

Clause 11 of Part 1 First Schedule

32.RTP May 2018 Qn no 19(b)

CA. Raj is a leading income tax practitioner and consultant for derivative products. He resides in Bangalore near to the XYZ commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 50% of his time to settle the commodity transactions, though he has not taken any permission for this. Is CA. Raj liable for professional misconduct?

Answer

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

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, CA. Raj is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.

33.MTP Mar 18 Qn no.5(a) 4 Marks

CA. Aman, a practicing Chartered Accountant, took over as the executive chairman of Signora IT Ltd. on 01.04.2016. However, realizing about obtaining prior approval from the Council of the ICAI for engaging into other business, he applied to the Council for permission within 10 days. Comment with reference to the Chartered Accountants Act, 1949.

Answer

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

In the instant case, CA. Aman took over as the executive chairman on 01.04.2016 and applied for permission later. Based on the given facts, he was engaged in other occupation, after 01.04.2016 and before the application for approval, without the permission of the Council. Therefore, CA. Aman is guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

34.MTP Apr 18 Qn no 3(A) 5 Marks

CA Raman is practicing in the field of financial management planning for over 12 years. He has gained expertise in this domain over others.

Mr. Ratan, a student of Chartered Accountancy course, is very much impressed with the knowledge of CA. Raman. He approached CA. Raman to take guidance on some topics of financial management subject related to his course. CA. Raman, on request, decided to spare some time and started providing private tutorship to Mr. Ratan along with some other aspirants for 3 hours in a week. However, he forgot to take specific permission for such private tutorship from the Council. Comment on above with reference to the Chartered Accountants Act, 1949, and Schedule thereto.

ANSWER

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

Further, regulation 190A of the Chartered Accountants Regulation, 1988 provides that a Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should not exceed 25 hours a week in order to be able to undertake attest functions. According to the same there is no specific permission from the council would be necessary in the case of private tutorship.

In the given case, CA. Raman has started providing private tutorship to Mr. Ratan along

with some other aspirants 3 hours in a week, without obtaining specific or prior approval of the Council.

On this context, it may be noted that the Council has provided general permission for providing such private tutorship subject to the condition that the direct teaching hours devoted to such activities taken together should not exceed 25 hours a week. Therefore, CA. Raman would not be held guilty of professional misconduct under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

35.A chartered accountant holding certificate of practice and having four articled clerks registered under him accepts appointment as a full-time lecturer in a college. Also, he becomes a partner with his brother in a business. Examine his conduct in the light of Chartered Accountants Act, 1949 and the regulations thereunder.

Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. This clause, in effect, has empowered the Council of the Institute to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper. Accordingly, the Council had formulated Regulations 190A and 191 to the Chartered Accountants Regulations, 1988 to provide a basis for considering applications of chartered accountants seeking permission to engage in other business or occupation. A member can accept full-time lecturer-ship in a college only after obtaining the specific and prior approval of the Council as also becoming a partner in a business with his brother would require specific permission.

Conclusion: Thus, the chartered accountant is liable for professional misconduct since he failed to obtain specific and prior approval of the Council in each case.

36.Mr. A, a practicing Chartered Accountant, took over as the executive chairman of Software Company on 1.4.2019. On 10.4.2019 he applied to the Council for permission.

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

In the instant case, Mr. A took over as the executive chairman on 01.04.2019 and applied for permission on 10.04.2019. On the basis of these facts, he was engaged in other occupation between the period 01.04.2019 and 10.04.2019, without the permission of the Council.

Conclusion: Therefore, Mr. A is guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Clause 12 of Part 1 First Schedule

MTP Apr 18 QN no.2(a) 5 Marks

1.Mr. 'A' is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Y' a Chartered Accountant his employee for taking care of routine matters of his office. During his absence Mr. 'Y' has conducted the under mentioned jobs in the name of M/s A & Co.

- (i) He issued the audit queries to client which were raised during the course of audit.
- (ii) He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.

Comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s A & Co. and liability of Mr. 'A' under the Chartered Accountants Act, 1949.

Answer

Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA. 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is a member of the Institute of Chartered Accountants but not his partner.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause 12 for example issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- (i) In the given case, Mr. 'Y', a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here "Y" is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
- (ii) In this instance, Mr. "Y", CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act.

Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

2.Nov 2019 Qn no 5(A) 5 Marks

Mr. 'K', a practicing Chartered Accountant is the proprietor of M/s K & Co. since 1995. He went abroad in the month of December 2018. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee for taking care of the important matters of his office. During his absence Mr. 'Y' has conducted the undermentioned jobs in the name of M/s K & Co.

- (i) He issued Net worth certificate to a client for furnishing to a Bank.
- (ii) He attended the GST proceedings for a client as authorized representative before GST Authorities.

Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s K & Co. and liability of Mr. 'K' under the Chartered Accountants Act, 1949

Answer

Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA. 'K' proprietor of M/s K & Co., went abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of the important matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

In the given case, Mr. 'Y', a chartered accountant being employee of M/s K & Co. has **issued net worth certificate for furnishing to a bank**. Since the issuance of net worth certificate to a client by Mr. "Y" being an employee of M/s K& Co. (an audit firm), is **not a routine work and it is outside his authorities**. Thus, **CA. 'K' is guilty of professional misconduct** under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.

Further, Mr. "Y", CA employee of the audit firm M/s K& Co. has **attended the GST proceedings** for a client as authorized representative before GST Authorities. Since the **council has allowed the delegation of such work**, the chartered accountant employee can attend to routine matter in tax practice as decided by the council.

Therefore, there is **no misconduct in this case** as per Clause (12) of Part I of First schedule to the Act.

Study Material

1.Mr. 'A' is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Y' a Chartered Accountant his employee for taking care of routine matters of his office. During his absence Mr. 'Y' has conducted the under mentioned jobs in the name of M/s A & Co.

- (i) **He issued the audit queries to client which were raised during the course of audit.**
- (ii) **He issued production certificate to a client under GST Act, 1944.**
- (iii) **He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.**

Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s A & Co. and liability of Mr. 'A' under the Chartered Accountants Act, 1949

Answer

Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct “if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements”.

In this case CA. 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- (i) In the given case, Mr. 'Y', a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here “Y” is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

- (ii) Further, issuance of production certificate to a client under GST Act, 1944 by Mr. "Y" being an employee of M/s A & Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA. 'A' is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.
- (iii) In this instance, Mr. "Y", CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

CA. Smart, a practicing Chartered Accountant was on Europe tour between 15-9-20 and 25-9-20. On 18-9-20 a message was received from one of his clients requesting for a stock certificate to be produced to the bank on or before 20-9-20. Due to urgency, CA. Smart directed his assistant, who is also a Chartered Accountant, to sign and issue the stock certificate after due verification, on his behalf.

Allowing a Member Not Being a Partner to Sign Certificate: As per Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case, CA. Smart allowed his assistant who is not a partner but a member of the Institute of Chartered Accountants of India to sign stock certificate on his behalf and thereby commits misconduct.

Conclusion: Thus, CA. Smart is guilty of professional misconduct under Clause (12) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Clause 2 of Part II First Schedule

2.Nov 2019 Qn no 6(B) 5 Marks

Mr. 'C', a Chartered Accountant employed as Senior executive in charge of Tax in a company, and not holding certificate of practice recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from the employer of Mr. 'C' paid a particular sum as referral fee to Mr. 'C'. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. (5 Marks)

Answer

Referral Fee from Lawyer: According to **Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949**, a member of the Institute (other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or

person or agent or customer of such company, firm or person by way of commission or gratification.

In the present case, Mr. C who **beside holding a certificate of practice, is also an employee** and by referring a lawyer to the company in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.

Conclusion: Therefore, **Mr. C is guilty of professional misconduct** by virtue of Clause (2) of Part II of First schedule

3.Mr. 'C', a Chartered Accountant holds a certificate of practice while in employment also, recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from employer paid a particular sum as referral fee to Mr. 'C'.

Referral Fee from Lawyer: According to Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949, a member of the Institute (other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

In the present case, Mr. C who beside holding a certificate of practice, is also an employee and by referring a lawyer to the company in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.

Conclusion: Therefore, Mr. C is guilty of professional misconduct by virtue of Clause (2) of Part II of First schedule.

Clause 2 of Part III First Schedule

Nov 18 Qn no 5(a) 4 Marks

1.XYZ Associates, a Chartered Accountants Firm is having a relationship with a multi- national accounting firm in India. The ICAI required that all firms having networking relationship with any other entity need to furnish information online within the stipulated time. XYZ Associates failed to respond. Comment on this with reference to Professional misconduct, if any.

Answer

Failed to Supply Information Called For: As per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Thus, in the given case, Mr. XYZ Associates, a chartered accountant firm is failed to furnish the information of its relationship with multi-national accounting firm in India. The ICAI required this information to be submitted online within the stipulated time. XYZ Associates failed to respond and submit the required information. Therefore, XYZ

Associates is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

Mr. 'G', while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business.

Disclosure of Information: As per Clause (2) of Part III of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant, in practice or not, does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

In the given case, Mr. "G", a Chartered Accountant while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business. Details of engagement in business need to be disclosed while applying for the certificate of practice as it was the information called for in the application, by the Institute.

Conclusion: Thus, Mr. G will be held guilty for professional misconduct under the Clause (2) of Part III of First Schedule of the Chartered Accountants Act, 1949.

Mr. X, a Chartered Accountant, employed as a paid Assistant with a Chartered Accountant firm, leaves the services of the firm on 31st December, 2019. Despite many reminders from ICAI he fails to reply regarding the date of leaving the services of the firm.

Failed to Supply Information Called For: As per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Conclusion: Thus, in the given case, Mr. X has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant. Therefore, he is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

Clause 2 of Part IV First Schedule

2.MTP-Mar2019 Qn No 2(a) 4 Marks:

YKS & Co., a proprietary firm of Chartered Accountants was appointed as concurrent auditor of a bank. YKS used his influence for getting some cheques purchased and thereafter failed to repay the loan/overdraft. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

This is a case which is covered under the expression in other misconduct of the Chartered Accountants Act, 1949. As per Clause (2) of Part IV of First Schedule to the

Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work. Here the Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards calls for disciplinary action.

In the present case, YKS & Co, being a concurrent auditor used his position to obtain the funds and failed to repay the same to the bank. This brings disrepute to the profession of a Chartered Accountant. This act of YKS & Co is not pardonable.

Conclusion: Therefore, YKS & Co will be held guilty of other misconduct under Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949.

3.MTP-OCT-18 Qn No 4(a) 5 Marks:

CA. X, a practicing Chartered Accountant, failed to return the books of account and other documents of ABC Ltd. despite many reminders from the company. The company had settled his entire fees dues also. Comment with reference to the Chartered Accountants Act, 1949.

Answer:

Bringing Disrepute to the Profession: A member is liable to disciplinary action under section 21 of the Chartered Accountants Act, 1949, if he is found guilty of any professional or "Other Misconduct". As per Clause (2) of Part IV of the First Schedule to the said Act, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

A member may be found guilty of "Other Misconduct" as per Clause (2) under the aforesaid provisions rendering himself unfit to be member if he retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.

In the given case, CA. X failed to return the books of accounts and other documents of his client without any reasonable cause, therefore, he would be guilty of other misconduct under the aforesaid provisions.

Clause 1 of Part I of Second schedule

4.May 2018 4(a) 4 Marks

Mr. B, a Chartered Accountant in practice was invited to deliver a seminar on GST which was attended by professionals as well as by representatives of various Industries. One section of audience raised a particular issue unique to the industry to which it pertains. Mr. B enthusiastically explained the issue and elaborated how

he actually solved this, for his client facing the same issue with worked out examples from the computer storage device using the actual data of one of his clients with full identification of client details being displayed to the group for the sake giving clarity on a topic in a real life situation. Comment his acts in the light of Code of Conduct

ANSWER

Disclosure of Information to third Party: Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force.

SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired during his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

In the instant case, Mr. B is a Chartered Accountant in practice and he was invited to deliver a seminar on GST which was attended by professional as well as by representatives of various industries. During his session, a query was raised on particular issue and Mr. B used the actual data of one of his clients with full identification of client details displayed to explain and elaborate such query. Applying the above provision, the auditor cannot disclose the information in his possession without specific permission of the client. Thus, CA. B will be liable for professional misconduct under clause 1 of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Study Material

5.XYZ Co. Ltd. has applied to a bank for loan facilities. The bank on studying the financial statements of the company notices that you are the auditor and requests you to call at the bank for a discussion. In the course of discussions, the bank asks for your opinion regarding the company and also asks for detailed information regarding a few items in the financial statements. The information is available in your working paper file. What should be your response and why?

Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force. SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired in the course of his work and

should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose". In the instant case, the bank has asked the auditor for detailed information regarding few items in the financial statements available in his working papers. Having regard to the position stated earlier, the auditor cannot disclose the information in his possession without specific permission of the client. As far as working papers are concerned, working papers are the property of the auditor. The auditor may at his discretion, make portions of or extracts from his working papers available to his client". Thus, there is no requirement compelling the auditor to divulge information obtained in the course of audit and included in the working papers to any outside agency except as and when required by any law

Clause 2 of Part I of Second schedule

6.Mr. Mohan is a practising Chartered Accountant. He issued a certificate of consumption which did not reflect the correct factual position of the consumption of raw material by the concerned entity. It is found that the certificate is given on the basis of data appearing in the minutes of meeting of the Board of Directors. Comment on above with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

According to Clause (2) of Part I of Second Schedule to the Chartered Accountants Act, 1949 a chartered accountant is held guilty of professional misconduct if he certifies or submits a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or employee in his firm or any other chartered accountant in practice.

Mr. Mohan has issued a certificate of consumption which does not reflect the correct factual position of the consumption of raw material by the concerned entity. He has failed in his duty of examining the record. He has relied on the minutes of Board of director's meeting which is not proper evidence to show the consumption of raw material. The relevant record of production and stock register should have been scrutinized thoroughly and properly.

Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 also applies to this case which states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

Mr. Mohan will be held guilty of Professional Misconduct under Clause (2) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

7.Mr. Parekh, a Chartered Accountant was invited by the Chamber of Commerce to present a paper in a symposium on the issues facing Indian Leather Industry. During the course of his presentation he shared some of the vital information of his client's business under the impression that it will help the Nation to compete with other countries at international level.

Disclosure of Client's Information: Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 deals with the professional misconduct relating to the disclosure of information by a chartered accountant in practice relating to the business of his clients to any person other than his client without the consent of his client or otherwise than as required by any law for the time being in force would amount to breach of conduct. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. The Chartered Accountant may however, disclose the information in case it is required as a part of performance of his professional duties. In the given case, Mr. Parekh has disclosed vital information of his client's business without the consent of the client under the impression that it will help the nation to compete with other countries at International level.

Conclusion: Thus, it is a professional misconduct covered by Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

8.Mr. A, a Chartered Accountant was the auditor of 'A Limited'. During the financial year 2019-20, the investment appeared in the Balance Sheet of the company of ` 10 lakhs and was the same amount as in the last year. Later on, it was found that the company's investments were only ` 25,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan.

Grossly Negligent in Conduct of Duties: As per Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice, under Clause (2); does not exercise due diligence, or is grossly negligent in the conduct of his professional duties, under Clause (7); or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, under Clause (8).

The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation.

In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty.

Conclusion: Accordingly, Mr. A, will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Clause 3 of Part I of Second schedule

9.Lily, a chartered accountant prepares and certifies projected financial statements of his client Amazon Ltd. Amazon Ltd. forwarded the same to their banks to secure some loans and bank, on that basis sanctioned a loan. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

Certification of Projected Financial Forecast: Under Clause (3) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

Further, SAE 3400 “The Examination of Prospective Financial Information”, provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.

In the instant case, Mr. Lily, a chartered accountant, has **prepared** and certified a projected financial forecast of his client Amazon Ltd. which was forwarded to the client’s bank to secure some loans and based on which the bank sanctioned a loan to the client is not in order.

Thus, Mr. Lily will be held guilty of misconduct in view of above.

Clause 5 of Part I of Second schedule

10.Nov 2018 Qn no 4(a) 4 Marks

D, a Chartered Accountant in practice was appointed by Realty Limited to represent its cases before GST Authorities under a duly executed power of representation. In the course of proceedings he submitted certain statements-written as well as oral-which later found to be false and materially misleading. Comment this in the light of Professional Code.

Answer

Submitting Information as Authorized Representative: As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, if a member in practice fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional capacity, he will be held guilty under Clause (5). As per Clause (6) of Part I of Second Schedule if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity, he will be held guilty under Clause (6).

In given case, the Chartered Accountant had submitted the statements before the GST authorities. These statements are based on the data provided by the management of the company. Although the statements prepared were based on incorrect facts and misleading, the Chartered Accountant had only submitted them acting on the instructions of his client as his authorized representative.

Hence Mr. D would not be held liable for professional misconduct.

MTP-Apr-19 Qn No 2(a) 4 Marks:

11. In the course of his audit assignment in M/s Bailey Ltd., CA Soft came to know that the company, due to financial crunch and unable to meet employees salary, has taken a loan of Rs. 50 lacs from Employees Gratuity Fund. The said loan was not reflected in the books of account of the company and the auditor ignored this transaction in his report. Comment with reference to the Chartered Accountants Act, 1949 and Regulations there to.

Answer:

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

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

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

12. Mr. Joe, a Chartered Accountant during the course of audit of M/s XYZ Ltd. came to know that the company has taken a loan of ` 10 lakhs from Employees Provident Fund. The said loan was not reflected in the books of account. However, the auditor ignored this information in his report.

Failure to Disclose Material Facts: As per Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading. In this case, Mr. Joe has come across information that a loan of ` 10 lakhs has been taken by the company from Employees Provident Fund. This is contravention of Rules and the said loan has not been reflected in the books of accounts. Further, this material fact has also to be disclosed in the financial statements. The very fact that Mr. Joe has failed to disclose this fact in his report, he is attracted by the provisions of professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

13.A practicing Chartered Accountant was appointed to represent a company before the tax authorities. He submitted on behalf of his clients certain information and explanations to the authorities, which were found to be false and misleading.

Submitting Information as Authorised Representative: As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, if a member in practice fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional capacity, he will be held guilty under Clause (5). As per Clause (6) of Part I of Second Schedule if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity, he will be held guilty under Clause (6).

In given case, the Chartered Accountant had submitted the statements before the taxation authorities. These statements are based on the data provided by the management of the company. Although the statements prepared were based on incorrect facts and misleading, the Chartered Accountant had only submitted them acting on the instructions of his client as his authorized representative.

Conclusion: Hence the Chartered Accountant would not be held liable for professional misconduct .

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Clause 7 of Part I Second Schedule

MTP-OCT-18 Qn No 2(a) 5 Marks:

14. Mr. Anil, a Chartered Accountant was the auditor of 'A Limited'. During the financial year 2015-16, the investment appeared in the Balance Sheet of the company of Rs. 10 lakhs and was the same amount as in the last year. Later on, it was found that the company's investments were only Rs. 25,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan.

Answer:

Grossly Negligent in Conduct of Duties: As per Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice, under Clause (2); does not exercise due diligence, or is gross negligent in the conduct of his professional duties, under Clause (7); or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, under Clause (8).

The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation.

In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty.

Accordingly, Mr. Anil, will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

15. RTP Nov 2018 Qn no.19

Mr. D, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.

ANSWER

Not Exercising Due Diligence: According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard. He was guilty of professional misconduct under Clause (7).

Since Mr. D has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, therefore, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949

16.CA Chiranjiv who conducted ABC audit of a Haryana daily 'New Era' certified the circulation figures based on Management Information System Report (M.I.S Report) without examining the books of Account.

According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties".

In the instant case, CA Chiranjiv did not exercise due diligence and is grossly negligent in the conduct of his professional duties since he certified the circulation figures without examining the books of accounts.

To ascertain the number of paid copies verification of remittances from the agents, credit allowed to the agents for unsold copies returned, examination of books of account is essential. Further certification of circulation figures based on statistical information without cross verification with financial records amounts to gross negligence and failure to exercise due diligence.

Conclusion: Hence, CA Chiranjiv is guilty of professional misconduct as per Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949.

17.Z, a practicing Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e. by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printer's bills and by not caring to ascertain how many copies were sold and paid for.

Failure to Obtain Information: Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that if a Chartered Accountant in practice fails to obtain sufficient information to warrant the expression of an opinion or his exceptions are sufficient material to negate the expression of an opinion, the chartered accountant shall be deemed to be guilty of a professional misconduct.

In the instant case Mr. Z, a practicing Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e., by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printer's bills and by not caring to ascertain how many copies were sold and paid for.

The chartered accountant should not express his opinion before obtaining the required data and information. As an auditor, Mr. Z ought to have verified the basic records to ensure the correctness of circulation figures.

Conclusion: Thus, in the present case Mr. Z will be held guilty of professional misconduct as per Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Clause 10 of Part I Second Schedule

MAY 2018 3(c) -5 Marks

18.A film artist who was going abroad for long shooting, deposited a sum of ` 20 lakhs with his tax consultant Mr. G, a practising Chartered Accountant for payment of Goods and Service Tax monthly when they were due, Mr. G duly remitted all but one instalments. He utilised the amount of instalment which he did not pay, to remit his own advance income tax. However, while filing return of GST of the film artist, he duly remitted on her behalf the tax payable with interest due for late payment of GST out of money lying with him. He also bore for himself the interest due to short fall in remittance of tax of his client. Comment on the above in the light of Code of Conduct.

ANSWER

Money of Clients to be Deposited in Separate Bank Account: Clause (10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if “he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended”.

In the instant case, CA. G received sum of rupees 20 lakh from his client who is a film artist for monthly installment payment of Goods and Service Tax. This money should have been deposited in a separate bank account. CA. G utilized the amount of last installment for his own advance tax payment, though he paid the same along with interest and bore the interest due to short fall in remittance of tax of his client.

As per fact of the case CA. G has failed to keep the sum of rupees 20 lakh received on behalf of his client in a separate Bank Account and utilized the same for his own advance tax payment amounts to professional misconduct under Clause (10) of Part I of Second Schedule.

19.A charitable institution entrusted ` 10 lakhs with its auditors M/s Ram and Co., a Chartered Accountant firm, to invest in a specified securities. The auditors pending investment of the money, deposited it in their Savings bank account and no investment was made in the next three months

Failure to Keep Money in Separate Bank Account: If a Chartered Accountant in practice fails to keep moneys of his clients in a separate bank account or fails to use such moneys for purposes for which they are intended then his action would amount to professional misconduct under Clause (10) of Part I of Second Schedule to the Chartered Accountants Act, 1949. In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilise such funds only in accordance with the instructions of the client or for the purposes intended by the client.

Conclusion: In the given case by depositing the client's money by M/s Ram and Co., a firm of Chartered Accountants, in their own savings bank account, the auditors have committed a professional misconduct. Hence in the given case, M/s Ram & Co. will be held guilty of professional misconduct.

Clause 1 of Part II Second Schedule

20.MTP-OCT-19 Qn No 3(c) 4 Marks:

A Chartered Accountant in practice certified in requisite Form that an articled assistant was undergoing training with him, whereas, he was also employed in a company between 9:30 a.m. and 5:30 p.m. on a monthly salary of Rs. 18,000 and attended the office of the Chartered Accountant thereafter until 7 p.m. The Chartered Accountant pleaded that the articled assistant was on audit of the company. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

Failure to Observe Regulations: As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member shall be held guilty of professional misconduct if he contravenes any of the provisions of the Act or the regulations made thereunder or any guidelines issued by the Council. The chartered accountant, as per Regulations also, is expected to impart proper practical training.

In the instant case, the articled assistant is not attending office on timely basis and the explanation of the Chartered Accountant that the articled assistant was on audit of the company cannot be accepted particularly in view of the fact that articled assistant is getting monthly salary from that company. Under the circumstances, the Chartered Accountant would be held guilty of professional misconduct in regard to the discharge of his professional duties as per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949.

21.MTP-OCT-18 Qn No 5(a) 4 Marks:

A Chartered Accountant in practice certified in requisite Form that an articled assistant was undergoing training with him, whereas, he was also employed in a company between 10 a.m. and 6 p.m. on a monthly salary of Rs. 17,000 and attended the office of the Chartered Accountant thereafter until 7 p.m. The Chartered Accountant pleaded that the articled assistant was on audit of the company. Comment with reference to the Chartered Accountants Act, 1949.

Answer:

Failure to Observe Regulations: As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member shall be held guilty of professional misconduct if he contravenes any of the provisions of the Act or the regulations made thereunder or any guidelines issued by the Council. The chartered accountant, as per Regulations also, is expected to impart proper practical training.

In the instant case, the articled assistant is not attending office on timely basis and the explanation of the Chartered Accountant that the articled assistant was on audit of the company cannot be accepted particularly in view of the fact that articled assistant is getting monthly salary from that company. Under the circumstances, the Chartered Accountant would be held guilty of professional misconduct in regard to the discharge of his professional duties.

22.RTP May 2019 Qn no 24 (b)

The manager of ZedEx (P) Ltd. approached CA. Vineet in the need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA. Vineet issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute.

Answer

Issuing Certificate without having Certificate of Practice: As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, CA. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, CA. Vineet will be held guilty of professional misconduct in terms of clause(1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

Clause 3 of Part II Second Schedule

23.MTP Apr 18 Qn no 4(a) 4 Marks,RTP May 2020 Qn no 19(d)

Mr. P and Mr. Q are running a firm of Chartered Accountants in the name of M/s PQ & Co. On 23.05.2017, they included the name of Mr. R, a practicing Chartered Accountant, without his knowledge, as a partner while submitting an application for empanelment as auditor for Public Sector Bank branches to the Institute. However, they added Mr. R as a partner to their firm offering a share of 21% of the profits, on 25.05.2017. Comment with reference to the Chartered Accountants Act, 1949.

Answer

Submitting Wrong Information to the Institute: As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

In the instant case, Mr. P and Mr. Q, partners of M/s PQ & Co., included the name of Mr. R, another Chartered Accountant, as partner in their firm, without his knowledge, in their application for empanelment as auditor of branches of Public Sector Banks submitted to the Institute. However, such a member was not a partner of the said firm as on the date of application submitted. Here, Mr. P and Mr. Q have submitted wrong information to the Institute.

Therefore, Mr. P and Mr. Q, both, would be held guilty of professional misconduct under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

Miscellaneous

24.MAY 2018-2(d) 5 Marks

M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city, had great difficulty in regularly attending to the consultancy needs of his clients who are mostly located in an industrial cluster in a nearby outskirts which is situated at a distance of 26 kms from the office of the firm. To mitigate the difficulty and to have ease of business, a facilitation centre was opened in the industrial cluster. The proprietor managed, both the office and the facilitation centre, by himself. No intimation was made to the Institute of Chartered Accountants of India. Examine whether there, is any professional misconduct in this respect

Answer

Maintenance of Branch Office in the Same City: As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in charge of two offices if the second office is

located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 Kilometres from the municipal limits of a city, in which the first office is located. Further a member having two offices of the type referred to above, shall have to declare which of the two offices is his main office, which would constitute his professional address.

In the given case, M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city and had great difficulty in regularly attending to the consultancy needs of his clients. Therefore, a facilitation centre was opened in the industrial cluster and the proprietor is managing both the office and facilitation centre. Though distance between his office and facilitation centre i.e. sort of second office is within prescribed range i.e. 50 kilometres but M& Co., will be liable for misconduct as prescribed intimation about facilitation centre and main office should be sent to the Institute of Chartered Accountants of India.

25. Write a short note on Other Misconduct.

ANSWER:

Other misconduct has been defined in part IV of the First Schedule and part III of the Second Schedule. These provisions empower the Council to inquire into any misconduct of a member even it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action. Other misconduct would also relate to conviction by a competent court for an offence involving moral turpitude punishable with transportation or imprisonment to an offence not of a technical nature committed by the member in his professional capacity. [See section 8(v) of the Act].

26. May 2018 5(a) 4 Marks

Mr. Dice, a practising Chartered Accountant was ordered to surrender his Certificate of Practice and he was suspended for one year on certain professional misconduct against him. During the period of suspension, Mr. Dice, designating himself as GST Consultant, did the work of filing GST returns and made appearance as a consultant before various related authorities. He contended that there is nothing wrong in it as he, like any other GST consultant, could take such work and his engagement as such in no way violates the order of suspension inflicted on him. Is he right in his contention?

Answer

Filing of GST Returns and Appearance as GST Consultant: A chartered accountant not holding certificate of practice cannot take up any other work in the capacity of Chartered Accountant in practice because it would amount to violation of the relevant provisions of the Chartered Accountants Act, 1949.

In case a member is suspended and is not holding Certificate of Practice, he cannot in any

other capacity take up any practice separable from his capacity to practices as a member of the Institute. This is because once a member becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations.

In case he files GST returns and appears as a consultant before various related authorities in his capacity as a chartered accountant and a member of the Institute, having bound himself by the said Act and its Regulations made thereunder, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity. But if he is doing so in any other capacity such as GST Consultant wherein his capacity is not chartered accountant in practice, he will not be held guilty for misconduct.

In the instant case, Mr. Dice was a practicing chartered accountant and he was ordered to surrender his certificate of practice and was suspended for one year. Mr. Dice is doing the work of filing GST returns and has appeared as a consultant before various related authorities as GST Consultant which is not in capacity of a practicing chartered accountant rather in capacity of authorized representative. Any person who has been authorized to act as a GST Practitioner on behalf of the concerned registered person can become authorized representative. Thus, Mr. Dice would not be allowed to represent as a Chartered Accountant before various related authorities for the period he remains suspended. Accordingly, in the present case he is guilty of professional misconduct.

27.RTP May 2018 Qn No.19(D)

CA. Elegant is in practice for two years and runs his proprietorship firm in the name of "Elegant & Co.". He maintains notes in his mobile in which he writes the fees received from various clients. Based on his record, he prepares and files his income tax return.

Answer

Maintenance of Books of Account by a CA in Practice: Chapter V of the Council General Guidelines, 2008 specifies that a member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his/its professional practice, proper books of accounts including the following-

- (i) a Cash Book
- (ii) a Ledger

Thus, a Chartered Accountant in practice is required to maintain proper books of accounts.

In the instant case, CA. Elegant does not maintain proper books of accounts and writes the fees received from various clients in notes in his mobile. Notes maintained by him in mobile cannot be treated as books of accounts.

Hence, CA. Elegant, being a practicing Chartered Accountant will be held guilty of misconduct for violation of Council General Guidelines, 2008.

MTP Apr 18 Qn no.5(a) 4 Marks

28.MNC Pvt. Ltd. appointed CA. Moksh for some professional assignments like company's ROC work, preparation of minutes, statutory register etc. For this, CA. Moksh charged his fees depending on the complexity and the time spent by him on each assignment.

Later on, MNC Pvt. Ltd. filed a complaint against CA. Moksh to the Institute of Chartered Accountants of India (ICAI) that he has charged excessive fees for the assignments comparative to the scale of fees recommended by the Board as well as duly considered by the Council of ICAI. Comment with reference to the Chartered Accountants Act, 1949.

ANSWER

Charging Excess Fees: The prescribed scale of fees for the professional assignments done by the chartered accountants is recommendatory in nature. Charging an excessive fee for a professional assignment does not constitute any misconduct in the context of the provisions of the Chartered Accountants Act, 1949 and regulation made thereunder since the matter of fixation of actual fee charged in individual cases depends upon the mutual agreement and understanding between the member and the client.

In the given case, CA. Moksh has charged excess fees compared to the scale of fees recommended by the Board as well as duly considered by the Council of ICAI. In this context, it may be noted that the scale of fees is the minimum prescribed scale of fees.

From the above facts and provisions, it may be concluded that CA. Moksh is not liable for any misconduct under the Chartered Accountants Act, 1949. Therefore, the contention of MNC Pvt. Ltd. is not tenable.

29.Nov 18 Qn no 2(a) 5 Marks

Mr. X, a Chartered Accountant in Practice filed his income tax return for the Assessment Year 2018-19 under section 44ADA of the Income Tax Act, 1961, declaring his income on presumptive basis. In a disciplinary proceeding against him for an alleged misuse of funds of his clients, it was asked that he should submit his books of accounts for the financial year ended on 31/03/2018. Mr. X refused to submit books of accounts on the ground that he had not maintained any books and even for income tax purposes, he submitted his Return of Income on a presumptive basis. Is he right in putting such a defence? Analyse the issues in the light of Professional Code, if any

Answer

Maintenance of Books of Account: As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct.

Accordingly, it does not matter that as per section 44ADA of the Income Tax Act Mr. X declared his income on presumptive basis. Here, it may be noted that though 44ADA of the Income Tax Act exempt the requirement of books and accounts but as per Council General Guidelines a chartered accountant in practice is required to maintain and keep

proper books of accounts including cash book and ledger. Hence, Mr. X is guilty of professional misconduct.

30.MTP-OCT-18 Qn No 6(a) 3 Marks:

M/s LMN, a firm of Chartered Accountants having 5 partners accepts an audit assignment of a newly formed private limited company for audit fees of Rs. 5,000. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

Minimum Audit Fee: Prescribed minimum audit fee is recommendatory, not mandatory in nature. Therefore, acceptance of audit assignment by M/s LMN, a firm of Chartered Accountants having 5 partners of a newly formed private limited company for audit fees of Rs. 5,000 is not violation of any provisions.

Therefore, M/s LMN will not be held liable for guilty of misconduct.

31.May 2019 Qn no 3(C) 4 Marks

CA Natraj, in practice, accepted an assignment as advisor and consultant to the public issue of shares by his client M/s Super Ltd.

Besides helping the company as an advisor, he also underwrote the public issue of the company to the extent of 25% at a commission of 1%. Remaining shares were underwritten by banks and other financial institutions at the same rate of commission. He contends that above assignments are part of management consultancy work permitted by the council of the Institute. Do you agree with the view of CA Natraj? Decide in the light of applicable code of conduct.

Answer

Assignment as Advisor and Consultant: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

In the instant case, CA Natraj accepted an assignment as advisor and consultant to the public issue of shares by his client M/s Super Ltd. In addition, he also underwrote the public issue of the company to the extent of 25% at a commission of 1%. Contention of CA. Natraj that advisor, consultant and underwriting work is part of management consultancy work and permitted by the council is not correct as Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and

portfolio management services.

Conclusion: In view of this, CA. Natraj would be guilty of misconduct under the Chartered Accountants Act, 1949

32.P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2020, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Is P guilty of professional misconduct?

ANSWER:

Advising on Portfolio Management Services: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients.

33.RTP Nov 2018 Qn no.19

CA Kumar who is contesting Central Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period

Answer:

Other Misconduct: CA Kumar has engaged his Articled Assistant for his own election campaigning for the central Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'.

Hence, CA Kumar is guilty of 'Other Misconduct'.

34.RTP May 2019 Qn no 24

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) **WCP & Co LLP are the internal auditors of DEF Ltd. WCP & Co LLP also agreed to undertake Goods and Service Tax (GST) Audit of DEF Ltd simultaneously.**

Answer:

The Council of the Institute, while considering the issue whether an internal auditor of an entity can also undertake GST Audit of the same entity as required under the Central Goods and Service Act, 2017, decided, that internal auditor of an assessee, whether working with the organization or independently practising Chartered Accountant being an individual chartered accountant or a firm of chartered accountants, cannot be appointed as his Tax auditor (under the Income Tax Act, 1961). Upon consideration, the Council decided that based on the conflict in roles as statutory and internal auditor simultaneously, the bar on internal auditor of an entity to accept tax audit (under Income Tax Act, 1961) will also be applicable to GST Audit (under the Central Goods and Service Act, 2017). Accordingly, an Internal Auditor of an entity cannot undertake GST Audit of the same entity.

In the instant case, WCP & Co LLP are the internal auditors of DEF Ltd. and it also agreed to undertake Goods and Service Tax (GST) Audit of DEF Ltd simultaneously. WCP & Co LLP will be held guilty for misconduct.

35.RTP Nov 2019 Qn no 24

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) **Mr. 'A' is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee, for taking care of routine matters of his office. During his absence, Mr. 'Y' has conducted the under mentioned jobs in the name of M/s A & Co.:**
- (i) **He issued the audit queries to client which were raised during the course of audit.**
- (ii) **He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.**

Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s A & Co. and liability of Mr. 'A' under the Chartered Accountants Act, 1949.

- (b) **M/s Amudhan & Co., a firm of Chartered Accountants, received ` 2.8 lakhs in January, 2019 on behalf of one of their clients, who has gone abroad and deposited the amount in their Bank account, so that they can return the money to the client in July, 2019, when he is due to return to**

India.

- (c) CA Raman who is contesting Regional Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period.
- (d) Mr. Anil, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.

Answer

(a) Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct “if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements”.

In this case CA. ‘A’ proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- In the given case, Mr. ‘Y’, a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here “Y” is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
 - In this instance, Mr. “Y”, CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
- (b) **Money of Clients to be Deposited in Separate Bank Account:** Clause (10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if “he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended”.

In the given case, M/s Amudhan & Co. received the money in January, 2019 which is to be paid only in July 2019, hence, it should be deposited in a separate bank account. Since in this case M/s Amudhan & Co. has failed to keep the sum of ` 2.8 lakhs received on behalf of their client in a separate Bank Account, it amounts to professional misconduct under Clause (10) of Part I of Second Schedule.

(c) **Other Misconduct:** CA Raman has engaged his Articled Assistant for his own election campaigning for the Regional Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work. This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'.

Hence, CA Raman is guilty of 'Other Misconduct'.

(d) **Not Exercising Due Diligence:** According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard, he was guilty of professional misconduct under Clause (7).

Since, Mr. Anil has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, the auditor is guilty of professional misconduct under Clause(7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

36.Mr. A, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. X gave him an idea to start online services and give stock certifications to traders with Cash Credit Limits in Banks. Mr. A started a website with colorful catchy designs and shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services". Besides, Mr. A entered in an agreement with a Digital Marketer to give him 5% commission on each service procured through him.

Discuss if the actions of Mr. A are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.

ANSWER:

As per Clause (6) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Mr. A is wrong in seeking clients through family and friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines.

In the given situation, Mr. A shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on website issued by the ICAI. Thus, CA, A would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

37. Mr. D, a practicing CA, is appointed as a Director Simplicator in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. Is Mr. D right in accepting the auditor position?

ANSWER:

As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicator in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. In view of above provisions Mr. D cannot accept the Directorship of the company until the completion of two years after his resignation.

Thus, CA, D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949. As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest. Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. In view of above provisions Mr. D cannot accept the Directorship of the company until the completion of two years after his resignation.

Thus, CA, D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.

38.Mr. F, a Chartered Accountant, gave advisory services to PQR Pvt. Ltd. Further, he gave them GST consultancy and helped in ERP set up. Later, the company turned out to be a part of a group of companies involved in money laundering. Mr. F was asked to provide details of the companies. Mr. F refused on the grounds that he gave only consultancy services to the company and wasn't supposed to keep any information about the company. Is Mr. F right as per the guidelines issued by the ICAI?

ANSWER:

The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice. In the given situation, CA. F, gave GST consultancy and helped in ERP set up along with advisory services to PQR Pvt. Ltd. Mr. F was asked to provide details of the companies as the company, turned out to be a part of a group of companies, involved in money laundering. Contention of Mr. F that he gave only consultancy services to the company and wasn't supposed to keep any information about the company is not valid as Mr. F should have kept following information in compliance with KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestation functions. In the given case of PQR Pvt. Ltd., a Corporate Entity, Mr. F should have kept following information:

A. General Information

Name and Address of the Entity
Business Description
Name of the Parent Company in case of Subsidiary
Copy of last Audited Financial Statement

B. Engagement Information

Type of Engagement

C. Regulatory Information

Company PAN No.
Company Identification No.
Directors' Names & Addresses
Directors' Identification No.

39.Mr. S, the auditor of ABC Pvt. Ltd. has delegated following works to his articles and staff:

i Issue of audit queries during the course of audit.

- ii Issue of memorandum of cash verification and other physical verification.
- iii Letter forwarding draft observations/financial statements.
- iv Issuing acknowledgements for records produced.
- v Signing financial statements of the company.

Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

ANSWER:

As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements. The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause: (i) Issue of audit queries during the course of audit. (ii) Asking for information or issue of questionnaire. (iii) Letter forwarding draft observations/financial statements. (iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit. (v) Acknowledging and carrying on routine correspondence with clients.

(vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.

(vii) Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.

(ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.

(x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

In the instant case, Mr. S, the auditor of ABC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company.

Therefore, Mr. S is correct in allowing first four tasks i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles.

However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, Mr. S is wrong in delegating signing of financial statements to his staff.

Conclusion: In view of this, S would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

Study Material

Multiple Choice Question

AJ & Co LLP is a firm of Chartered Accountants. The firm has 10 Partners. The firm has a good portfolio of clients for statutory audits, but the same clients had some other firms as their tax auditors. In the current year (FY 2019-20), many existing clients for whom AJ & Co LLP happens to be the statutory auditor have requested the firm to carry out their tax audits as well. The firm is expecting the no of tax audits to increase significantly this year. One of the partners of the firm has also raised a point that the firm can accept tax audits upto a maximum limit. However, other partners are of the strong view that limits on audits is applicable in case of statutory audits and not for tax audits. This needs to be decided as soon as possible so that the appointment formalities can also be completed. You are requested to advise the firm in this matter.

- (a) There is no limit on no of tax audits in case of LLP.
- (b) All the partners of the firm can collectively sign 450 tax audit reports.
- (c) All the partners of the firm can collectively sign 600 tax audit reports.
- (d) All the partners of the firm can collectively sign 450 tax audit reports. However, one partner can individually sign maximum 60 tax audit reports.

Answer: (c) All the partners of the firm can collectively sign 600 tax audit reports

CA. D, a chartered accountant in practice availed of a loan against his personal investments from a bank. He issued 2 cheques towards repayment of the said loan as per the instalments due. However, both the cheques were returned back by the bank with the remarks "Insufficient funds". As per Chartered Accountants Act, 1949, under which clause CA D is liable for misconduct .

- a) Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- b) Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- c) Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- d) Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949

Answer: d) Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949

CA. Intelligent, a Chartered Accountant in practice, provides part-time tutorship under the coaching organization of the Institute. On 30th June, 2019, he was awarded 'Best Faculty of the year' as gratitude from the Institute. Later on, CA. Intelligent posted his framed photograph on his website wherein he was receiving the said award from the Institute. As per Chartered Accountants Act, 1949, under which clause Intelligent is liable for

misconduct .

- a) Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- b) Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- c) Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- d) Clause (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949

Answer : a) Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Mr. Hopeful, an aspiring student of ICAI, approached Mr. Witty, a practicing Chartered Accountant, for the purpose of articleship. Mr. Witty, the principal, offered him stipend at the rate of ` 2,000 per month to be paid every sixth month along with interest at the rate of 10% per annum compounded monthly to compensate such late payment on plea that cycle of professional receipts from clients is six months. Mr. Hopeful agreed for such late payment in the hope of getting extra stipend in the form of interest. Mr. Witty, however, used to disburse salary to all of his employees on time. As per Chartered Accountants Act, 1949, under which clause Mr. Witty is liable for misconduct.

- a) Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949
- b) Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- c) Mr. Witty is paying interest thus he is not liable for misconduct
- d) Clause (10) of Part I of the Second Schedule to the Chartered Accountants Act, 1949

Answer: a) Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949

CA Ram is practicing in the field of financial management planning for over 12 years. He has gained expertise in this domain over others. Mr. Ratan, a student of Chartered Accountancy course, is very much impressed with the knowledge of CA. Ram. He approached CA. Ram to take guidance on some topics of financial management subject related to his course. CA. Ram, on request, decided to spare some time and started providing private tutorship to Mr. Ratan along with some other aspirants for 3 days in a week and for 2 hours in a day. However, he forgot to take specific permission for such private tutorship from the Council. Later on, he came to know that the Council has passed a Resolution under Regulation 190A granting general permission (for private tutorship, and part-time tutorship under Coaching organization of the Institute) and

specific permission (for part-time or full time tutorship under any educational institution other than Coaching organization of the Institute). Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should _____ in order to be able to undertake attest functions.

- a) not exceed 25 hours a week
- b) not exceed 21 hours a week
- c) not exceed 25 hours a month
- d) not exceed 21 hours a month

Answer: a) not exceed 25 hours a week

