

## **PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS**

### **PART – I ACADEMIC UPDATE**

#### **(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)**

#### **Chapter 7: Audit Committee and Corporate Governance**

**As per Stock and Exchange Board of India circular no. CIR/CFD/CMD1/114/2019 dated 18<sup>th</sup> October, 2019 on resignation of statutory auditors from listed entities and their material subsidiaries:**

1. Listed companies are required to make timely disclosures to investors in the securities market for enabling them to take informed investment decisions.
2. Under Sub-clause (2) of Clause A in Part C of Schedule II under Regulation 18(3) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("SEBI LODR Regulations"), the Audit Committee of a listed entity, inter alia, has to make recommendations for the appointment, remuneration and terms of appointment of auditors of a listed entity. Under Sub-clause (7), the Audit Committee is also responsible for reviewing and monitoring the independence and performance of auditors and the effectiveness of the audit process.
3. Further, Sub-clause (7A) inserted under Clause A in Part A of Schedule III under Regulation 30(2) of SEBI LODR Regulations requires detailed reasons to be disclosed by the listed entities to the stock exchanges in case of resignation of the auditor of a listed entity as soon as possible but not later than twenty-four hours of receipt of such reasons from the auditor.
4. Regulation 36(5) of the SEBI LODR Regulations lays down certain disclosures to be made part of the notice to the shareholders for an AGM, where the statutory auditors are proposed to be appointed/re-appointed, including their terms of appointment.
5. Resignation of an auditor of a listed entity / its material subsidiary before completion of the audit of the financial results for the year due to reasons such as pre-occupation may seriously hamper investor confidence and deny them access to reliable information for taking timely investment decisions.
6. In light of the above, the conditions to be complied with upon resignation of the statutory auditor of a listed entity/material subsidiary w.r.t. limited review / audit report as per SEBI LODR Regulations, are as under:
  - A. All listed entities/material subsidiaries shall ensure compliance with the following conditions while appointing/re-appointing an auditor:**
    - (i) 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.

- (ii) If the auditor resigns after 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 as well as the next quarter.
- (iii) Notwithstanding the above, if 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.

**B. Other conditions relating to resignation shall include:**

- (i) Reporting of concerns with respect to the listed entity/its material subsidiary to the Audit Committee:
  - a. In case of any concern with the management of the listed entity/material subsidiary such as non-availability of information or non-cooperation by the management which may hamper the audit process, the auditor shall approach the Chairman of the Audit Committee of the listed entity and the Audit Committee shall receive such concern directly and immediately without specifically waiting for the quarterly Audit Committee meetings.
  - b. In case the auditor proposes to resign, all concerns with respect to the proposed resignation, along with relevant documents shall be brought to the notice of the Audit Committee. In cases where the proposed resignation is due to non-receipt of information or explanation from the company, the auditor shall inform the Audit Committee of the details of information or explanation sought and not provided by the management, as applicable.
  - c. On receipt of such information from the auditor relating to the proposal to resign as mentioned above, the Audit Committee or board of directors, as the case may be, shall deliberate on the matter and communicate its views to the management and the auditor.
- (ii) Disclaimer in case of non-receipt of information: In case the listed entity/ its material subsidiary does not provide information required by the auditor, to that extent, the auditor shall provide an appropriate disclaimer in the audit report, which may be in accordance with the Standards of Auditing as specified by ICAI/ NFRA.

The listed entity/ material subsidiary shall ensure that the conditions as mentioned in 6(A) and 6(B) above are included in the terms of appointment of the statutory auditor at the time of appointing/re-appointing the auditor. In case the auditor has already been appointed, the terms of appointment shall be suitably modified to give effect to 6(A) and 6(B) above.

The practicing company secretary shall certify compliance by a listed entity with 6(A) and 6(B) above in the annual secretarial compliance report issued in terms of SEBI Circular no. CIR/CFD/CMD1/27/2019 dated February 08, 2019.

**C. Obligations of the listed entity and its material subsidiary:**

- (i) Format of information to be obtained from the statutory auditor upon resignation: Upon resignation, the listed entity/ its material subsidiary shall obtain information from the Auditor in the format as specified in Annexure A to this Circular. The listed entity shall ensure disclosure of the same under Sub-clause (7A) of Clause A in Part A of Schedule III under Regulation 30(2) of SEBI LODR Regulations.
  - (ii) Co-operation by listed entity and its material subsidiary: During the period from when the auditor proposes to resign till the auditor submits the report for such quarter I financial year as specified above, the listed entity and its material subsidiaries shall continue to provide all such documents/information as may be necessary for the audit I limited review.
  - (iii) Disclosure of Audit Committee's views to the Stock Exchanges: Upon resignation of the auditor, the Audit Committee shall deliberate upon all the concerns raised by the auditor with respect to its resignation as soon as possible, but not later than the date of the next Audit Committee meeting and communicate its views to the management. The listed entity shall ensure the disclosure of the Audit Committee's views to the stock exchanges as soon as possible but not later than twenty-four hours after the date of such Audit Committee meeting.
- 7. In case an entity is not mandated to have an Audit Committee, then the board of directors of the entity shall ensure compliance of this circular.
  - 8. The Stock Exchanges are advised to bring the provisions of this circular to the notice of all listed entities and their material subsidiaries and also disseminate it on their websites.
  - 9. In case the auditor is rendered disqualified due to operation of any condition mentioned in Section 141 of the Companies Act, 2013, then the provisions of this Circular shall not apply.
  - 10. The Circular is issued in exercise of the powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 read with regulations 18(3), 30(2) and 36(5) of the SEBI LODR Regulations and shall be in addition to the provisions of Companies Act, 2013. For more details visit: [https://www.sebi.gov.in/legal/circulars/oct-2019/resignation-of-statutory-auditors-from-listed-entities-and-their-material-subsidaries\\_44703.html](https://www.sebi.gov.in/legal/circulars/oct-2019/resignation-of-statutory-auditors-from-listed-entities-and-their-material-subsidaries_44703.html)

### Chapter 18: Professional Ethics

#### Joining/Association with “Networks” by Members in Practice

It is hereby clarified that associations with “Network” as a medium of referral of professional work is permissible only if the Network is registered with the Institute, comprising only of

Chartered Accountants/ Chartered Accountant Firms, and governed by the Institute' s Network Guidelines, which may be accessed at <https://resource.cdn.icaai.org/24427announ14280.pdf>

Members" attention is also drawn towards following provisions of Chartered Accountants Act, 1949 (hereinafter referred to as the "Act") :

**Clause (2) of Part I of First Schedule to the Act**

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 qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation — In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of item (4) of this Part;

**Clause (3) of Part I of First Schedule to the Act**

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this Part;

**Clause (5) of Part I of First Schedule to the Act**

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he secures, either through the services of a person who is not an employee of such Chartered Accountant or who is not his partner or by means which are not open to a chartered accountant, any professional business.

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this Part;

**Clause (6) of Part I of First Schedule to the Act**

A Chartered Accountant in practice shall be 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:

Provided that nothing herein contained shall be construed as preventing or prohibiting —

- (i) any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or

- (ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

In view of the above provisions, it is not permissible for members in practice to join Networks (by whatever name called) other than the Networks registered with the Institute.

Members may note that joining such Networks as mentioned above may result in noncompliance of the above stated provisions of the Act resulting in disciplinary proceedings in accordance with the provisions of the Act.

#### **A -Meaning of Network & Network Firm –**

**Network** - A larger structure (a) That is aimed at co-operation; and (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

**Network Firm** – “Network Firm” means a firm or Entity that belongs to a Network.

#### **B - Concept of Network**

1. To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is deemed to be a network.
2. The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.
3. Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is deemed to be a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network.  
  
Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.
4. Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is deemed to be a network. This could be achieved by contract or other means.

5. Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is deemed to be a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.
6. Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is deemed to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision.
7. Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a network. A common brand name includes common initials or a common name. A firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.
8. Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms.

Accordingly, if care is not taken in how a firm describes such memberships, a perception may be created that the firm belongs to a network.

9. Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is deemed to be a network. Professional resources include:
  - Common systems that enable firms to exchange information such as client data, billing and time records;
  - Partners and staff;
  - Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;
  - Audit methodology or audit manuals; and
  - Training courses and facilities.
10. The determination of whether the professional resources shared are significant, and therefore the firms are network firms, shall be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical

department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

**C- Forms of the Network:** The different forms of Network can be as under:-

1. A network can be constituted as a mutual entity which will act as a facilitator for the constituents of the Network. In such a case the Network itself will not carry out any professional practice.
2. A network can be constituted as a partnership firm subject to the condition that the total number of partners does not exceed twenty.
3. A network can be constituted as a Limited Liability Partnership subject to the provision of the Chartered Accountant Act and Rules and such other laws as may be applicable.
4. A network can be constituted as company subject to the guidelines prescribed by Institute for corporate form of practice and formation of management consultancy services company.
5. Network Firms shall consist of sole Practitioner/proprietor, partnership or any such entity of professional accountants as may be permitted by the Act
6. A firm is allowed to join only one network.
7. Firms having common partners shall join only one Network.

**D- Approval of Name of Network amongst firms registered with Institute:**

1. The Network may have distinct name which should be approved by the Institute. To distinguish a "Network" from a "firm" of Chartered Accountants, the words "& Affiliates" shall be used after the name of the network and the words "& Co." / "& Associates" shall not be used. The prescribed format of application for approval of Name for Network is at Form 'A' (enclosed). Illustrative examples of names of Network: -
  - (a) If the Network is a Mutual Entity or Partnership Firm: AB & Affiliates
  - (b) If the Network is a LLP: AB Affiliates LLP
  - (c) If the Network is a Limited Company: AB Affiliates P. Ltd/Limited
2. Provisions of Regulation 190 of the Chartered Accountants Regulations, 1988 shall be applicable to the name of Network. However, even if a name is approved and subsequently it is found that the same is undesirable then, the said name may be withdrawn at any time by the Institute. The Institute shall reject any undesirable name and the provisions in respect of names of companies as prescribed in the Companies Act, 1956 shall be applicable in spirit.
3. The Institute shall approve or reject the name of the Network and intimate the same to the Network at its address mentioned in Form 'A' within a period which shall not be later than 30 days from the date of receipt of the said Form.

4. Mere approval of the name of the Network shall not entitle the Network to carry on practice in its own name.

**E- Registration of Network with entities in India**

1. After the name of a Network is approved as per provision under Guideline 5, the Institute same shall reserve such name for a period of three (3) months from the date of approval.
2. The Network shall get itself registered with the Institute by applying in Form B within the period of 3 months, failing which the name assigned shall stand cancelled on the expiry of the said period.
3. Registration of Network with Institute is mandatory.
4. If different Indian firms are networked with a common Multinational Accounting Firm, they shall be considered as a part of network.

**F- Listing of Network with entities outside India**

1. The duly authorized representative(s) of the Indian Member firm (s)/Member constituting the Network with entities outside India shall file a declaration with the Institute in Form 'D' for Listing of such Network within 30 days from the date of entering into the Network arrangement.
2. Proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members as may be permitted by the Act, shall be permitted to join such network with entities outside India provided that the proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members are allowed to join only one network and firms having common partners shall join only one such network.

**G- Change in constitution of registered Network:** In case of change in the constitution of registered Network on account of any entry into or exit from the Network, the network shall communicate the same to the Institute by filing Form 'C' within a period of thirty (30) days from the date of change in the constitution.

**H - Ethical Compliance:** Once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular: -

1. If one firm of the network is the statutory auditor of an entity then the associate [including the networked firm(s)] or the said firm directly/indirectly shall not accept the internal audit or book-keeping or such other professional assignments which are prohibited for the statutory auditor firm.
2. The guidelines of ceiling on Non-audit fees is applicable in relation to a Network as follows:
  - i) For a Network firm who is doing statutory audit (including its associate concern and/or firm(s) having common partnership), it shall be the same as mentioned in the said



notification; and ii) For other firms of the same Network collectively, it shall be 3 times of the fee payable for carrying out the statutory audit of the same undertaking/company.

3. In those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.
4. The Network may advertise the Network to the extent permitted by the Advertisement Guidelines issued by Institute. The firms constituting the network are permitted to use the words "Network Firms" on their professional stationery.
5. The constituent member firms of a Network and the Network shall comply with all the Ethical Standards prescribed by the Council from time to time.

**I - Consent of Client:** The effect of registration of network with Institute will be deemed to be a public notice of the network and therefore consent of client will be deemed to be obtained.

**J - Framework of Internal Byelaws of Network:** To streamline the networking, a network shall formulate operational bye-laws. Bye-laws may contain the following clauses on which the affiliates of the network may enter into a written agreement among themselves:

- (i) Appointment of a Managing Committee, from among the managing partners of the member firms of the network and the terms and conditions under which it should function. The minimum and maximum number of members of the Managing Committee shall also be agreed upon.
- (ii) Administration of the network
- (iii) Contribution of membership fees to meet the cost of the administration of the network.
- (iv) Identifying a partner of any of the member firms of the network to be responsible for the assignment (engagement partner)
- (v) Dispute settlement procedures through arbitration and conciliation
- (vi) Development of training materials for members of the network
- (vii) Issue of News-letters for staff and clients
- (viii) Development of softwares for different types of assignments
- (ix) Development and maintenance of data bases relevant for different types of assignments
- (x) Library
- (xi) Appointment of a technical director to whom references can be made
- (xii) Determining the methodology for drawing resources from each member firm
- (xiii) Determining compensation to member firms for resources to be drawn from them
- (xiv) Peer review of the member firms These clauses are illustrative.

**K - Repeal and Saving:** The erstwhile “Rules/Guidelines of Network” issued by the Institute stands repealed from the date of commencement of these Guidelines.

Provided that notwithstanding such repeal, anything done or any action taken or purported to have been done or taken in respect of the erstwhile Rules/Guidelines prior to the date of applicability of these Guidelines shall be deemed to have been done or taken under the corresponding provisions of these Guidelines.

**Note:** Students are also advised to refer RTP of Paper 1 Financial Reporting (for AS, Ind AS and other updates) and Paper 4 Part A -Corporate Laws (for academic updates relating to Company Law).

## PART – II : QUESTIONS AND ANSWERS

### QUESTIONS

#### PART A: MULTIPLE CHOICE QUESTIONS

##### Integrated Case Scenario 1.

PQR Ltd., is one of the leading companies in the cement manufacturing industry. Right from its incorporation, it has been a subsidiary of GDP Ltd. The total shareholding of GDP Ltd includes the following:

- The Government of Puducherry and Government of Delhi each hold 19% of the paid-up share capital,
- The Government of Gujarat's share is 13.5%.

On 27<sup>th</sup> August 2019, Mr. JJ, the auditor of PQR Ltd. had resigned from his post, citing personal reasons. He had forgotten to inform about his resignation to the concerned authorities. The casual vacancy which was created by the outgoing auditor was filled up with the appointment of FDI & Co. Chartered Accountants as statutory auditors of PQR Ltd. However, few shareholders of the company raised certain objections, which was later settled without any problems. As a part of the terms and conditions of appointment as auditors, FDI & Co. agreed to do the following:

- Charge fees at 5% of the paid-up capital plus 0.1% of net profit of the company (however Mr. JJ had agreed to charge only ₹ 45,000/-),
- Select and recruit personnel, conduct training programmes for and on behalf of PQR Ltd.

The company was having an annual turnover of ₹ 200 crores, and hence it was also liable to tax audit under section 44 AB of Income Tax Act, 1961.

During the current financial year 2019-20, PQR Ltd. had changed its method of accounting compared to the previous financial year (2018-19) and had reported a closing stock of raw material amounting to ₹ 2 lakhs only as on 31<sup>st</sup> March 2020. Also, the company had borrowed

a sum of ₹ 10 crores equally from two public sector banks and two Non-Banking Financial Companies. It had also repaid few deposits amounting to ₹ 75 lakhs to the deposit holders.

As far as FDI & Co. Chartered accountants are concerned, Mr. F, who is one of the partners of the firm (*NOTE-* Mr. F does not sign the financials of PQR Ltd.) had borrowed a sum of ₹ 3.89 lakhs from GDP Ltd. He had also purchased goods worth ₹ 1.09 lakhs from the company. Both the sum borrowed and the cost of the goods bought are not yet paid by Mr. F. Another partner of the firm, Mr. I, who is also responsible for signing the financials statements of PQR Ltd. was also engaged in the teaching profession during his free time.

Upon hearing about the efficient services provided by FDI & Co. Chartered accountants, they were approached by XYZ Cooperative Society to act as their statutory auditor for the upcoming financial years. The firm agreed to the offer and had the following options in mind with respect to the fees to be charged from them:

- (i) To charge fees as percentage of Net Profits, or
- (ii) To charge fees of ₹ 101/-.

**Question No.: (1-5)**

1. To whom should have Mr. JJ informed about his resignation? What could be the possible consequence for his non-compliance?
  - (a) He should have informed the registrar and PQR Ltd. As a consequence of his failure, he is liable to a penalty not exceeding ₹ 5 lakhs.
  - (b) He should have informed the registrar alone. As a consequence of his failure, he is liable to a penalty not less than ₹ 50,000/-.
  - (c) He should have informed the registrar and FDI & Co. As a consequence of his failure, he is liable to a fine of ₹ 500 per day for each day of failure.
  - (d) He should have informed the registrar & comptroller and auditor general. As a consequence of his failure, he is liable to a fine of ₹ 45,000/-.
2. With respect to the acts carried out by Mr. F, the partner of the audit firm, what can you infer about the appointment of FDI & Co. as auditors of PQR Ltd.?
  - (a) It is valid since the indebtedness is within prescribed limits.
  - (b) It is not valid since the indebtedness exceeds prescribed limit of ₹ 1 lakhs.
  - (c) It is valid since Mr. F is not signing the financials of PQR Ltd.
  - (d) It is valid since the indebtedness is not with PQR Ltd.
3. Which among the below are permitted as per Chartered Accounts Act, 1949?
  - (i) Charge fees at 5% of the paid-up capital plus 0.1% of net profit of the company.
  - (ii) Select and recruit personnel, conduct training programmes for and on behalf of PQR Ltd.

- (iii) Mr. I, one of the partners who is responsible to sign the financials of PQR Ltd. was into teaching profession.
- (a) (i) & (ii)
- (b) (iii) only
- (c) (ii) & (iii)
- (d) (i), (ii) & (iii)
4. With respect to the fees to be charged for its new assignment, which option can be opted by FDI & Co.?
- (i) To charge fees as percentage of Net Profits, or
- (ii) To charge fees of ₹ 101/-.
- (a) (i) Only.
- (b) (ii) Only.
- (c) Either (i) or (ii).
- (d) Neither (i) nor (ii).
5. Among the below transactions which were undertaken by PQR Ltd., which needs to be reported by the auditors under fiscal laws?
- (i) ₹ 10 crores loan taken, which is exceeding the limit specified u/s 269 SS of Income Tax Act.
- (ii) Changed its method of accounting from the previous financial year.
- (iii) Repayment of deposits of ₹ 75 lakhs, which is exceeding limit specified u/s 269 T of Income Tax Act.
- (iv) Reporting of Closing stock of raw material worth ₹ 2 lakhs only.
- (a) (i), (iii) & (iv).
- (b) (ii) & (iv).
- (c) (i) & (iii).
- (d) (i), (ii), (iii) & (iv).

**Integrated Case Scenario 2.**

CA & Co. Chartered Accountants have been appointed as the auditors of ZXC company. The company has obtained a license from the Central Government for itself to promote the sport of hockey in the rural areas of India. The company's average annual profit was estimated to be around ₹ 50 lakhs. This profit would not be distributed as dividend to the shareholders, however, it would be applied towards its objective of promoting sports in the country. During the course of audit for the financial year 2019-20, the following observations with respect to the company were made by the auditors:

- The company was not maintaining proper records with respect to the fixed assets maintained by it. The value of fixed assets of the company amounts to ₹ 1.50 crores approximately.
- Physical verification for the same was not carried out at regular intervals. The last physical verification was conducted on 31<sup>st</sup> July 2018.

As a result of the above observations, the auditors decided to report the same in the Companies (Auditors Report) Order 2016. However, the management of the company was against the decision of the auditors and insisted that the observations need not be reported. After several discussions between the auditors and the management, CA & Co. decided not to report the issues.

CA & Co. Chartered Accountants, were also acting as auditors for another company, LS Ltd. and KD Bank Ltd. During the course of audit of LS Ltd, there was a difference of opinion between the management 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 financial year.
- (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

During the audit of KD Bank Ltd., the auditors and the management had a certain difference of opinion as to the amount and the items which needs to be disclosed under the head of contingent liabilities. However, apart from that, the auditors had observed the following:

- 59 agricultural loan accounts (guaranteed by Government of Delhi) amounting to ₹ 29 lakhs were overdue for more than two years.
- 73 (guaranteed by Government of India) agricultural loan accounts amounting to ₹ 25 lakhs were overdue for more than two years.
- 6 corporate loans accounts (guaranteed three each by Government of India and Government of Delhi) amounting to ₹ 25 lakhs for each company were overdue for more than three and a half months.

On hearing about the efficient services provided by CA & Co. Chartered Accountants, they were offered the following new assignments:

- A GST assessing officer approached for conduct of special audit under section 66 of CGST Act for a company named MD Ltd. which was having an annual turnover of ₹ 1 crore. He had requested for the special audit as per the opinion that the company had not availed input tax credit within normal limits.

- Offer to provide incorporation services to RS General Insurance Ltd. which was proposed to be set up with a paid-up share capital of ₹ 113 crores, of which preliminary expenses of ₹ 17 crores were included.

The audit firm after taking into consideration all the facts and figures with respect to its new assignments, decided not to undertake both of them.

**Question No: (6-10)**

6. Is the decision of CA & Co. of not reporting the issues of ZXC in CARO 2016 justified? If so, under what reason?
  - (a) No. CARO 2016 is applicable to ZXC and hence the same has to be reported under clause (i) of CARO.
  - (b) Yes. CARO 2016 is not applicable to ZXC and hence the same need not to be reported.
  - (c) No. As per SA 240, the auditor has to maintain professional skepticism when it comes to issues in the area of fixed assets and hence the same has to be reported.
  - (d) Yes. As per SA 320, the auditor after taking into account the materiality of the issue, he may either choose to report or not report about the same.
7. What is the total amount of loans that should be classified as NPA by KD Bank?
  - (a) ₹ 79 lakhs.
  - (b) ₹ 100 lakhs.
  - (c) ₹ 204 lakhs.
  - (d) ₹ 104 lakhs.
8. Which among the following has to be reported by the auditor as contingent liability of KD Bank Ltd.?
  - (a) Guarantee given by KD Bank on behalf of constituent located in Myanmar.
  - (b) A percentage of the total bills purchased by KD Bank.
  - (c) Claims against the bank acknowledged as debt.
  - (d) Unpaid salary of ₹ 5 lakhs to five staffs of KD Bank Ltd., who are currently undergoing a court trail.
9. What could be the possible reason for not accepting the special audit under section 66 of CGST Act?
  - (a) Such audit is applicable only if the turnover of the company exceeds ₹ 2 crores.
  - (b) Such audits need to be conducted by cost accountants.
  - (c) Such audit has to be called upon by assistant commissioner.

- (d) Such audit has to be called upon by the central government.
10. Whether CA & Co. are justified for not accepting the incorporation services for RS General Insurance Ltd.? If so, as to what is the reason?
- (a) Yes. The incorporation services for an insurance company should be done by the auditor appointed by the comptroller and auditor general of India.
- (b) Yes. The insurance company should have a minimum paid up share capital of ₹ 100 crores which shall exclude the preliminary expenses.
- (c) No. The insurance company should have a minimum paid up share capital of ₹ 100 crores which also includes the preliminary expenses.
- (d) Yes. The incorporation services for an insurance company should be done by the auditor appointed by the Insurance Regulatory and Development Authority.

**PART B : DESCRIPTIVE QUESTIONS****Standards on Auditing, Statements and Guidance Notes**

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 31<sup>st</sup> 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?
- (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 ₹ 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?
- (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?

**Risk Assessment and Internal Control**

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.

- (b) 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.

### The Company Audit & Audit Report

13. (a) The Balance Sheet of G Ltd. as at 31<sup>st</sup> March, 19 is as under. Comment on the presentation in terms of Schedule III.

Heading	Note No.	31 <sup>st</sup> March, 19	31 <sup>st</sup> March, 18
<b>Equity &amp; Liabilities</b>			
Share Capital	1	XXX	XXX
Reserves & Surplus	2	0	0
Employee stock option outstanding	3	XXX	XXX
Share application money refundable	4	XXX	XXX
<b>Non-Current Liabilities</b>		XXX	XXX
Deferred tax liability (Arising from Indian Income Tax)	5	XXX	XXX
<b>Current Liabilities</b>			
Trade Payables	6	<u>XXX</u>	<u>XXX</u>
<b>Total</b>		<u>XXXX</u>	<u>XXXX</u>
<b>Assets</b>			
<b>Non-Current Assets</b>			
Fixed Assets-Tangible	7	XXX	XXX
CWIP (including capital advances)	8	XXX	XXX
<b>Current Assets</b>			
Trade Receivables	9	XXX	XXX
Deferred Tax Asset (Arising from Indian Income Tax)	10	XXX	XXX
Debit balance of Statement of Profit and Loss		<u>XXX</u>	<u>XXX</u>
<b>Total</b>		<u>XXXX</u>	<u>XXXX</u>

- (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:

- (i) Qualified Opinion;
  - (ii) Adverse Opinion and
  - (iii) Disclaimer of Opinion.
- (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) Limitations imposed by management.

Explain with the help of examples.

#### **Audit of Banks & Insurance Company**

- 14 (a) In course of audit of Good Samaritan Bank as at 31st March, 2019 you observed the following:
- (1) 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?
  - (2) The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.
- (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".

#### **Audit under Fiscal Laws**

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.

- (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.

#### **Audit of Public Sector Undertakings**

16. (a) 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.
- (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.

#### **Internal Audit, Management and Operational Audit**

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?

#### **Due Diligence, Investigation and Forensic Audit**

18. ABC 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.

**Professional Ethics**

19. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:
- (a) 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.
  - (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.
  - (c) 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.
  - (d) Mr. P and Mr. Q are running a firm of Chartered Accountants in the name of PQ & Co. On 23.05.2019, 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 branches of a public sector bank, to the Institute. However, they added Mr. R as a partner to their firm offering a share of 25% of the profits, on 25.05.2019.
20. Write a short note on the following:
- (a) Scope of peer review.
  - (b) "Mandatory Review" areas of the audit committee.
  - (c) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III
  - (d) Understanding and documenting automated environment

**SUGGESTED ANSWERS/HINTS****PART A : ANSWERS TO MULTIPLE QUESTIONS**

- 1. (d)
- 2. (a)
- 3. (c)
- 4. (c)
- 5. (b)

- 6. (b)
- 7. (d)
- 8. (a)
- 9. (c)
- 10. (b)

**PART B**

11. (a) **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.

- (b) 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.

By following the above procedure, it will be ensured that the physical verification conducted by the management was in order.

- (c) **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.

12. (a) **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.
- (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.
- (b) **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.

**13. (a) 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.”
- (b) (i) **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:
  - (1) 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
  - (2) 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.
- (ii) **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:
  - (1) 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
  - (2) 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].
- (iii) **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:



- (1) State that the auditor does not express an opinion on the accompanying financial statements;
- (2) 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
- (3) 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.

- (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) 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.

14. (a) (1) **Government Guaranteed Advance:** If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not 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.

- (2) **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.

**(b) 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.

15. (a) **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.
- (b) 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.

**16 (a) 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?

**(b) 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.

17. (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. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

- (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.

18. **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.
- (10) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

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.

19. (a) **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.

- (b) **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.

- (c) **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.

- (d) **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 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.

20. (a) **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.

**(b) Mandatory Review Areas of the Audit Committee:** 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.

**(c) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III** –The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

- (i) 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.
- (ii) 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.
- (iii) 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.

(d) **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.