

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

Answer any **four** out of remaining five

Question 1

- (a) You are engaged by M/s Active Ltd. to examine and report on prospective financial information which the management of the company has prepared for presentation at an Investor meet program organized by a State Government to attract investment in their state.

The company in its vision document described various plans and proposals of the company with projected financial goals and means to achieve the same and various benefits accruing to the economic development of the State. What important matters will be considered by you while determining the nature, timing and extent of examination procedure to be applied in the review of the same?

(5 Marks)

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

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

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

(5 Marks)

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

(4 Marks)

Answer

- (a) **Examination Procedures:** As per SAE 3400, "The Examination of Prospective Financial Information", when determining the nature, timing and extent of examination procedures, the auditor should consider matters such as:
- (i) the knowledge obtained during any previous engagements;
 - (ii) management's competence regarding the preparation of prospective financial information;
 - (iii) the likelihood of material misstatement;
 - (iv) the extent to which the prospective financial information is affected by the management's judgment;

- (v) the sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;
- (vi) the stability of entity's business; and
- (vii) the engagement team's experience with the business and the industry in which the entity operates and with reporting on prospective financial information.

(b) Responsibility and Co-ordination among Joint Auditors: As per SA 299, "Joint Audit of Financial Statements", where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of the work would usually be in terms of audit identifiable units or specified area. In some cases due to the nature of the business entity under audit, such a division of the work may not be possible. In such situations, the division of the work may be with reference to items of assets or liabilities or income or expenditure or with reference to period of time. The division of the work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

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

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

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

communicated to those charged with governance of the entity.

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

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

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

(c) Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement:

As per SA 705, Modification to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

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

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

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

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

Question 2

- (a) CA Dabu has been appointed as an auditor of M/s MAP Technocraft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take services of Mr. Jay, an engineering consultant. Mr. Jay performed his work and submitted details to CA Dabu. State the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay. **(5 Marks)**
- (b) ALM Associates has been appointed as auditor of M/s Hary Ltd. which acquired 55% shares-in M/s Sam Ltd. on 15th October, 2018. During audit of Harry Ltd., the auditors found that the company has not prepared consolidated financial statements because on the date of acquisition the fair value of certain assets & liabilities has not been ascertained which is significant and are accounted for on estimated basis only. Help ALM Associates in framing opinion paragraph of audit report. **(4 Marks)**
- (c) A professional accountant in public practice is always subject to various threats in compliance with fundamental principles of his profession and you, as a professional accountant, are worried about engagement specific threat in your audit assignment of M/s Soft Ltd. and want to implement some measures to eliminate and reduce the same. Enumerate some engagement specific safeguards which you may introduce in your work environment to ward off such threats. **(5 Marks)**

Answer

- (a) **Evaluating the Adequacy of the Auditor's Expert's Work:** As per SA 620 on "Using the Work of an Auditor's Expert", specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes may include:
- (i) Inquiries of the auditor's expert.
 - (ii) Reviewing the auditor's expert's working papers and reports.
 - (iii) Corroborative procedures, such as:
 - Observing the auditor's expert's work;
 - Examining published data, such as statistical reports from reputable, authoritative sources;
 - Confirming relevant matters with third parties;
 - Performing detailed analytical procedures; and
 - Re-performing calculations.
 - (iv) Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.
 - (v) Discussing the auditor's expert's report with management.

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

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

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

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

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

Adverse Opinion

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

Basis for Adverse Opinion is given below:

As explained in Note X, the M/s Hary Ltd. has not consolidated subsidiary M/s Sam Ltd. that the M/s Hary Ltd acquired during 2018 because it has not yet been able to determine the fair values of certain of the subsidiary’s material assets and liabilities at the acquisition date. This investment is therefore accounted for on an estimate basis. Under the

accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had M/s Sam Ltd. been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

(c) Engagement-specific safeguards in the work environment may include:

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

Question 3

- (a) *You have been appointed as an auditor of M/s Real Ltd. in which total number of directors in the board is 9. As an auditor, state the points to be considered in verification of composition of Board under Regulation 17 of The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.* **(6 Marks)**

- (b) *Banks, because of certain characteristics, are distinguished from other commercial enterprises and hence it needs special audit consideration.*

As an auditor of a bank, specify the various peculiarities which may necessitate special audit consideration to be taken care by you. **(4 Marks)**

- (c) *CA Natraj, in practice, accepted an assignment as advisor and consultant to the public issue of shares by his client M/s Super Ltd.*

Besides helping the company as an advisor, he also underwrote the public issue of the company to the extent of 25% at a commission of 1%. Remaining shares were underwritten by banks and other financial institutions at the same rate of commission. He contends that above assignments are part of management consultancy work permitted by the council of the Institute. Do you agree with the view of CA Natraj? Decide in the light of applicable code of conduct. **(4 Marks)**

Answer

(a) Verification regarding Composition of Board [Regulation 17]

- (i) The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive

directors, with at least one woman director and not less than 50% of the Board of Directors comprising non-executive directors. The minutes of the Board of Directors' meetings should be verified to ascertain whether a director is an executive director or a non-executive director.

- (ii) The auditor should also verify that where the Chairperson of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case the listed entity does not have a regular non-executive Chairperson, at least half of the Board of Directors should comprise independent directors. Further, if the regular non-executive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors.

In determining the number of requisite independent directors and/or non-executive directors, the fraction, if any, in the number of one-half or one-third as the case may be, should be rounded off. Since the terms in this clause refer to 'not less than' and 'at least', it would be appropriate to compute the number by rounding off any fraction to the next integer. For example, in a Board headed by a non-executive Chairman and comprising of six other directors (i.e., seven directors), the independent directors should be three or more.

- (iii) Annual disclosure submitted by the directors to the Board of Directors may be examined for this purpose. If the Board of Directors has followed any particular procedure(s) to ascertain the independence of directors, the auditor should examine the same. Effect of changes in the composition of the Board and/or its Chairman and its impact on compliance throughout the reporting period should also be examined.
- (iv) An independent non-executive director, apart from receiving remuneration, should not have any material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year. Also, such independent director, either by himself or with any of his relatives should not be a material supplier, service provider or customer or a lessor or lessee of the listed entity and should not also be a substantial shareholder of the listed entity. In determining 'not a substantial shareholder', he (together with his relatives) should not own 2% or more of total voting power of the listed entity.

(b) Special audit considerations arise in the audit of banks because of:

- (i) the particular nature of risks associated with the transactions undertaken;
- (ii) the scale of banking operations and the resultant significant exposures which can arise within short period of time;
- (iii) the extensive dependence on IT to process transactions;
- (iv) the effect of the statutory and regulatory requirements;

- (v) the continuing development of new products and services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices;
- (vi) Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk.

The auditor should consider the effect of the above factors in designing his audit approach. It is imperative for Branch Auditor and SCAs to have detailed knowledge of the products offered and risks associated with them, and appropriately address them in their audit plan to the extent they give rise to the risk of material misstatements in the financial statements.

In today's environment, the banks use different applications to carry out different transactions which may include data flow from one application to other application; the auditor while designing his plans should also understand interface controls between the various applications.

- (c) **Assignment as Advisor and Consultant:** The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

In the instant case, CA Natraj accepted an assignment as advisor and consultant to the public issue of shares by his client M/s Super Ltd. In addition, he also underwrote the public issue of the company to the extent of 25% at a commission of 1%. Contention of CA. Natraj that advisor, consultant and underwriting work is part of management consultancy work and permitted by the council is not correct as Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

Conclusion: In view of this, CA. Natraj would be guilty of misconduct under the Chartered Accountants Act, 1949.

Question 4

- (a) *A newly qualified professional has received his first appointment as auditor of a large company and is very much concerned about the effectiveness of internal control and wants to assess and evaluate the control environment as part of his audit program. Towards achieving his objective, he seeks your help in knowing the Standard Operating Procedures (SOPs) of assessment and evaluation of control. (5 Marks)*
- (b) *PQ & Co. is an audit firm with P and Q as partners. For the financial year 2018-19, the firm has been appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. The audit firm*

is a regular customer of the hotel and the partners usually stay in the same hotel at various locations in the course of travelling for their various professional assignments. Normally, payments for such stay are settled against quarterly bills raised by the company. Give your comment with respect to the Companies Act, 2013. **(4 Marks)**

- (c) *On receipt of statutory audit report on 30-03-2018 of M/s Sunlight Ltd., a government company, C&AG on 25-05-2018 appointed M/s Veeru & Associates to conduct supplementary audit u/s 143(6)(a) of the Companies Act, 2013. They submitted their report to C&AG as per their scope of work. The Company held its AGM on 01-09-2018 but directors did not think it necessary to discuss supplementary auditor's report and comment of the C&AG. Is the approach of the directors of Sunlight Ltd. correct? Guide the company with the provisions related to supplementary audit.* **(5 Marks)**

Answer

- (a) **Standard Operating Procedures (SOPs):** A well-defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover.
- (i) **Enterprise Risk Management:** An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.
- (ii) **Segregation of Job Responsibilities:** A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person.
- (iii) **Job Rotation in Sensitive Areas:** Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example, if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.
- (iv) **Delegation of Financial Powers Document:** As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.
- (v) **Information Technology based Controls:** With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier

to monitor. For example, at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

- (b) Indebtedness to the Company:** According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding ₹ 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

Further a person or a firm who directly or indirectly has business relationship with a company or its subsidiary or its holding or associate company, is also not qualified to be appointed as auditor of the company. But here business relationship does not include commercial transactions which are in the ordinary course of the business of the company at arm's length price.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, PQ & Co., an audit firm with P & Q as partners is appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. and the audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations. They also settle the payments for such stay against quarterly bills raised by the company.

Assuming the balance amount at any time during the year due to the hotel does not exceed the prescribed limits of rupees 5,00,000, PQ & Co., is not disqualified to be appointed as statutory auditor of M/s Mango Orchards Hotel Ltd as per section 141(3)(d)(ii), in the absence of the same the auditor shall be disqualified to act as an auditor and shall vacate his office of auditor when he incurs this disqualification subsequent to the appointment.

Since in term of section 141(3)(e) of Companies Act, 2013 PQ & Co. is not a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, the auditor shall not be disqualified to act as an auditor and shall not required to vacate his office of auditor.

- (c) The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,**

- (i) conduct a supplementary audit under section 143(6)(a),** of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
- (ii) comment upon or supplement such audit report under section 143(6)(b):** It may be noted that any comments given by the Comptroller and Auditor-General of India

upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

In view of above provisions, the approach of directors of Sunlight Ltd. is not correct. They are required to mandatorily send the Supplementary Audit Report and comments of C&AG to every member of the company etc. as prescribed and also be placed before the annual general meeting of the company in the same manner as in case of audit report. Since in the given case neither the report has been distributed nor discussed in the Annual General Meeting, the directors of the company will be liable for contravention of aforesaid sections.

Question 5

- (a) *The volatility, unpredictability and pace of fast changes that exists in the automated environment today is far greater than in the past and consequently it throws more risk to business which requires them to have a need to continuously manage such risks. State various risks which an enterprise may have to face and manage.*

Or

A professional accountant is often required to give certificates or report for special purposes required by various authorities and statute and he needs to take careful evaluation of such engagement. However, issuing such special purpose certificates or reports has some inherent limitations which could limit his review and evaluation. Enumerate some of the limitations associated with such special purpose report or certificates.

(5 Marks)

- (b) *In the course of your tax audit assignment u/s 44AB of the Income Tax Act, 1961 of Dream Bank Ltd., you have instructed your assistant to find out receipt of capital nature which might not have been credited to Profit & Loss Account and needs to be reported in Para 16(e) of Form 3CD. Your audit assistant seeks your guidance in reporting the same. Specify any four illustrative examples of such receipt.*
- (4 Marks)**
- (c) *You have been appointed as a forensic accountant in M/s Secure Ltd. to carry out various analysis as a part of your assignment to arrive at a particular result. Specify the various analysis which might have to be carried out by you to arrive at your result.*
- (5 Marks)**

Answer

- (a) **Various Risk:** Businesses today operate in a dynamic environment. The volatility, unpredictability and pace of changes that exist in the business environment today is far greater than in the past. Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because of this dynamic environment the associated risks to business have also increased and companies

have a need to continuously manage risks.

Examples of risks include:

- Market Risks;
- Regulatory & Compliance Risks;
- Technology & Security Risks;
- Financial Reporting Risks;
- Operational Risks;
- Credit Risk;
- Business Partner Risk;
- Product or Project Risk;
- Environmental Risks.

OR

(a) Inherent Limitations: A practitioner is expected to provide either a reasonable assurance (about whether the subject matter of examination is materially misstated) or a limited assurance (stating that nothing has come to the practitioner's attention that causes the practitioner to believe that the subject matter is materially misstated) since it is difficult to reduce engagement risk to zero due to inherent limitations of the audit. The inherent limitations could arise from:

- (i) the nature of financial reporting;
- (ii) the use of selective testing;
- (iii) the inherent limitations of internal controls;
- (iv) the fact that much of the evidence available to the practitioner is persuasive rather than conclusive;
- (v) the nature of procedures to be performed in a specific situation;
- (vi) the use of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence;
- (vii) in some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria; and
- (viii) the need for the engagement to be conducted within a reasonable period of time and at a reasonable cost.

Therefore, whenever a practitioner is required to give a "certificate" or a "report" for special purpose, the practitioner needs to undertake a careful evaluation of the scope of the engagement, i.e., whether the practitioner would be able to provide reasonable assurance or limited assurance on the subject matter.

(b) Capital Receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD:

(a) Guidance for reporting capital receipts: Capital receipts are not generally credited to profit and loss account hence the auditor should take enough care to check out any transaction generating the capital receipts by –

- Enquiring whether the assessee is in receipt of any amount of capital nature during the previous year.
- Going through the financial statements, in particular reserve account, to ascertain whether the assessee has received any such receipts and credited them directly to reserve account.
- Enquiring whether the assessee has credited such receipts to profit and loss account.
- Checking that any such receipts is accounted for in terms of method of accounting followed by the assessee.

(b) Illustrative examples of capital receipts: The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD-

- (i) Capital subsidy received in the form of Government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.
- (ii) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.
- (iii) Compensation for surrendering certain rights.
- (iv) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

(c) Perform the Analysis: The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- (i) calculating economic damages;
- (ii) summarizing a large number of transactions;
- (iii) performing a tracing of assets;
- (iv) performing present value calculations utilizing appropriate discount rates;
- (v) performing a regression or sensitivity analysis;
- (vi) utilizing a computerized application such as a spread sheet, data base or computer model; and

(vii) utilizing charts and graphics to explain the analysis.

Question 6

- (a) *Pearl Ltd. is an exporter of precious and semi-precious stones. The turnover of the company is ₹ 150 crore, out of which ₹ 105 crore is from export business and remaining ₹ 45 crore from domestic sales. Amount received from export business is all in foreign currency. Directors of Pearl Ltd. are of the opinion that cost audit is not applicable to their company as maximum revenue has been generated from export business. Give your opinion.* **(4 Marks)**
- (b) *You have been appointed as an auditor of ABC Insurance Co. Ltd. and found that M/s PQR Ltd. got their Plant & Machinery insured on 01-10-2018 but the amount of premium has been paid by them on 15-10-2018. In the meanwhile, on 10-10-2018 a fire has broken out in the factory and the company filed a claim for damages of plant & machinery with the Insurance company. Advise the insurance company in this regard.* **(5 Marks)**
- (c) *CA Sant, a newly qualified professional with certificate of practice, approached CA Pant, the auditor of his father's company M/s Max Ltd., to allow him to have some practical and professional knowledge and experience in his firm before he can set up his own professional practice. CA Pant allowed him to sit in his office for 6 month and allotted a small chamber with other office infrastructure facility. In the course of his association with CA Pant's office, he used to provide tax consultancy independently to the client of the firm and also filed few IT and GST return and represented himself before various tax authorities on behalf of the firm although no documents were signed by him. During his association in CA Pant's office, he did not get any salary or share of profit or commission but only re-imbursement of usual expenses like conveyance, telephone etc. was made to him. After the end of the agreed period, he was given a lump sum amount of ₹ 3,00,000 by CA Pant for his association out of gratitude.*

Examine the case in the light of code of professional misconduct.

(5 Marks)

Answer

- (a) **Cost Audit Rules not to apply in certain cases:** The requirement for cost audit shall not be applicable to a company whose revenue from exports, in foreign exchange, exceeds seventy-five per cent of its total revenue, which is operating from SEZ and which is engaged in the generation of electricity for captive consumption through captive generating plant. (as per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014).

In the instant case, Pearl Ltd. is an exporter of precious and semi-precious stones and the turnover of the company is rupees 150 crore out of which rupees 105 crore i.e. 70% is from export business and remaining rupees 45 crore i.e. 30% from domestic sales. It is neither operating from SEZ nor involved in captive power generation.

Thus, opinion of director is not tenable as revenue from exports in foreign exchanges is below prescribed limit. Therefore, cost audit is applicable on Pearl Ltd. as per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014. Pearl Ltd. has to appoint cost

auditor to get the cost accounts of the company audited.

- (b) **No Risk Assumption without Premium:** No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

Therefore, in the instant case, PQR Ltd. signed the insurance documents on 01.10.2018 but did not paid the premium. In case of non-payment of insurance premium if any accidental incident occurs insurance company will have no liability to pay claim. In the given case, fire is occurred on 10th October, 2018 in factory and premium has been paid on 15 October 2018, the ABC Insurance Company Ltd. will not be liable for claim for damages of plant and machinery.

- (c) Clause (1) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner, or his employee and would work under his control and supervision.

In the instant case, CA Pant allowed CA Sant (who is a newly qualified CA professional with COP) to sit in his office for 6 months, and allowed him to provide tax consultancy independently to his firm's clients, filing of some IT and GST Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA Sant was only reimbursed with his usual expenses and was not paid any salary or share of profit for the same. However, after the end of agreed period he was given a lump-sums of rupees 3,00,000 for his association out of gratitude.

Thus, in the present case CA. Pant will be held guilty of professional misconduct as per Clause (1) of Part I of First Schedule to the Chartered Accountants Act, 1949 as he allowed CA Sant to practice in his name as Chartered accountant and CA Sant is neither in partnership nor in employment with CA. Pant.