For CA FINAL

Group I – PAPER 3

ADVANCE AUDITING ASSURANCE

AND

PROFESSIONAL ETHICS

VOLUME – II | QUESTION BANK

Edition – 10

New Syllabus

KEY FEATURES:

- ✓ **Based on the Institute's New Module**
- ✓ **Updated Outline of the Chapters**
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CA CS Amit Tated

FCA, CS, DISA

For C.A. Final

Advanced Auditing, Assurance & Professional Ethics

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Providing personalized and affordable coaching and support of best possible standard, in shortest possible time.

CA. AMIT TATED

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Preface

It gives me immense pleasure to present the Tenth Revised edition of Advanced Auditing, Assurance & Professional Ethics. This edition has updated syllabus which is applicable from Nov 2024 Exams and onwards.

This book has everything which student may require to understand, remember and reproduce Audit. The book has been developed keeping in mind the technicality of the subject to bring it at a student's grasping level.

This book will suffice to go with institute language as well as understanding the concept.

In recent exam papers we saw that the questions asked are more practical. Thus, students need to understand the concepts and logical reasoning of the Chapter. Only mugging-up shall not suffice to score in this subject.

For Class Work students can refer Amit Tated YouTube Channel.
(Tera Course Mera Guidance)

Every effort has been made to avoid any errors and omissions in this book. Despite all the efforts we believe some errors might have crept in. The students are welcome to point out any errors / suggestions.

Best wishes,

Amit Tated
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August, 2024

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CHAPTER – 1 QUALITY CONTROL

❖ **TEST YOUR UNDERSTANDING**

1. ABC & Associates, Chartered Accountants has a policy to accept the clients wherein the risk evaluation is conducted with respect to the Company and the promoter. XYZ Limited approached ABC & Associates. Promoter of XYZ Limited is a close associate and family friend of Mr. A, Managing Partner of ABC & Associates. XYZ Limited is in news in the previous year for certain inquiries from the regulatory authorities in relation to certain matters. The existing auditor of XYZ Limited has resigned and has created a casual vacancy. XYZ Limited is ready to offer 25% more than the existing fees and has approached ABC & Associates for appointment as Auditor. Mr. A has strong recommendation to the Firm to accept the audit.
What is your understanding of the functioning of the tone at the top of the Firm ABC & Associates, Chartered Accountants? What are the considerations one should exercise to uphold Quality of the Firm?

Ans. The given situation indicates that proposed client is a new one whose promoter is close associate and family friend of managing partner of M/s ABC & Associates. However, previous auditor of proposed client has resigned and company is offering hike in audit fees in comparison to audit fees paid to previous auditor. Besides, there are also regulatory inquires against the company. In spite of all this, managing partner of firm Mr. A has recommended for acceptance of offered audit of the company.
It reflects poorly regarding functioning at top of the firm as regards to quality control. SQC 1 requires that firm should establish a system of quality control designed to provide it with reasonable assurance that firm and its personnel comply with professional standards and legal and regulatory requirements. It further requires that firm's business strategy is subject to overriding requirement of firm to achieve quality in all engagements. However, in the given situation, commercial considerations seem to be overriding factor.
The managing partner of firm is close associate and family friend of promoter. The matter should have been brought to knowledge of firm in accordance with requirements of SQC 1 as it involves issue of independence of managing partner of the firm with

	respect to proposed audit engagement. Further, matters of inquiries from regulators and resignation of previous auditor raise question about integrity of the proposed client. SQC 1 further requires firm to consider before acceptance of an engagement that client does not lack integrity. All these factors need to be taken into consideration before accepting engagement.
	Overall, such a situation reflects lack of proper establishment of quality control framework at top of the firm. Following considerations should be taken into account while upholding quality of firm: -
(i)	The firm assigns its management responsibilities so that commercial considerations do not override quality of work performed
(ii)	The firm's policies and procedures in relation to its personnel are designed to demonstrate its overriding commitment to quality.
(iii)	The firm devotes sufficient resources for development and documentation of its quality control policies and procedures
(iv)	A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about integrity of Client, promoters and key managerial personnel, competence (including capabilities, time and resources) to perform engagement and compliance with ethical requirements.
2.	MNP & Co., a firm of auditors, is appointed by a bank to conduct stock audit of a borrower. It deputes one of its paid Chartered accountant employees, Sudhanshu, to conduct above said stock audit. He leverages it as an opportunity to prevail upon the client to get the accounts audited from their firm. He also assures the client of a clean stock audit report without adverse comments as a *quid pro quo*. Is approach of Sudhanshu proper? How does it reflect upon quality control system of firm?
Ans.	Approach of Sudhanshu is not proper. Such practices blatantly violate code of ethics and its spirit. It reflects poorly upon quality control system of firm envisaged in SQC 1 which requires that quality control policies and procedures should be documented and communicated to the firm's personnel. It shows that firm's personnel are not properly sensitized regarding requirements of SQC 1.

3.	CA M is introduced to a prospective client in a social function. He assures to visit office of CA M very soon in relation to professional work. During discussions over a cup of coffee next week, it transpires that there was a search by Enforcement Directorate in his premises about a month back resulting in recovery of huge sum of cash. The income tax department had also searched his premises in relation to bogus capital gains on penny stocks. Lamenting poor quality of services provided by his present auditor, he offers appointment as tax auditor of his five family-owned firms to CA M in lieu of handsome fees. What are the factors to be evaluated by CA M if he wants to take up the engagement?
Ans.	As per SQC 1, before accepting a new engagement, integrity of client should be considered including matters that indicate involvement in money laundering or criminal activities. There has been search of ED on the said party leading to recovery of huge amount of cash. The above coupled with actions of income tax department relating to bogus capital gains on penny stocks indicates that client might be involved in money laundering activities. Therefore, offer should not be accepted.
4.	GVN & Associates are auditors of a listed company involved in "fin-tech" sector. The engagement team is stuck up with some issue pertaining to a particular Ind-AS applicable to the company. They have framed a query and sent to ICAI for expert opinion on the matter. The issue was resolved upon receipt of expert opinion. Since expert opinion was provided by ICAI, engagement team was of the view that appointment of engagement quality control reviewer has lost its relevance. Do you agree?
Ans.	Engagement quality control review in listed entities is a mandatory requirement. Expert opinion of ICAI pertains to issue of interpretation. The appointment of reviewer is a separate and mandatory requirement in audits of listed companies.
5.	RST & Co., a firm of Chartered accountants, are auditors of a listed company engaged in manufacturing of heavy machinery components. The audit report for year 2021-22 also included report on matters listed in CARO, 2020. While reporting under clause vii(a) of the said order relating to regularity of undisputed statutory dues by the company, the auditors have commented that company is "generally regular" in

depositing statutory dues to appropriate authorities. Is above reporting qualitative and in line with requirements of SA-220?

Ans. Such type of reporting is not qualitative. It is not in accordance with SA 220. One of the objectives of the auditor, as per SA 220, is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that the audit complies with professional standards and regulatory and legal requirements. The reporting under CARO, 2020 is not proper. Hence, the audit does not comply with regulatory and legal requirements.

❖ **THEORY QUESTIONS**

1. PQR & Associates are statutory auditors of a listed company. There arose an issue during the course of audit relating to related party transactions. The engagement partner wants to consult engagement quality control reviewer on this matter during the course of audit process itself. Can he consult with engagement quality control reviewer? Discuss.

Ans. It is necessary to maintain objectivity of reviewer. Therefore, participation in engagement or making decisions for engagement team is to be avoided at all costs. However, engagement partner may consult engagement quality control reviewer during the engagement so as not to compromise his objectivity and eligibility to perform the role.

2. Beta Private Limited has approached a firm of Chartered accountants to assist them in preparation of financial statements and issue a compilation report in this regard. Does CA firm have responsibility in relation to quality control for above said engagement? Discuss with reasons.

Ans. Such kind of services fall in category of "related services". SQC 1 is applicable to all type of engagements including engagement pertaining to "related services".

3. Ramanujan, a CA final student, feels that engagement file in audit engagement should be ready prior to issue of audit report. Discuss whether Ramanujan's view is in order.

Ans. The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports

	have been finalized. Engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements. Thus, view of Ramanujam is not in order.
4.	BNE & Co. are in midst of audit process of a listed company. During the course of audit, an issue arose relating to revenues from contracts with customers in terms of Ind AS 115. The engagement partner took a certain stand. However, engagement quality control reviewer recommended otherwise after review. The engagement partner is not willing to accept recommendations of reviewer. How can the stalemate be ended?
Ans.	In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body. The audit report should be issued only after resolution of matter.
5.	MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also, been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1.
Ans.	As per SQC 1, the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.
	With regard to the integrity of a client, matters that the firm considers include, for example:

(i)	The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
(ii)	The nature of the client's operations, including its business practices.
(iii)	Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
(iv)	Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
(v)	Indications of an inappropriate limitation in the scope of work.
(vi)	Indications that the client might be involved in money laundering or other criminal activities.
(vii)	The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
	The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.
❖	**INTEGRATED CASE SCENARIO**
	CA Mritunjay is statutory auditor of a listed company engaged in providing services relating to "tourism sector". He is practicing in sole-proprietorship capacity. The audit of above said listed company was conducted by his proprietary firm and report was issued for year 2021-22. Subsequently, audit report was selected by NFRA to oversee quality of service and compliance with Standards. Necessary information was called from auditor towards above objective.
	It was required of him to produce audit working papers to show that audit was carried out in accordance with Standards on auditing. Details of the audit plan and details of risk assessment procedures carried out to identify and assess risk of material misstatement in financial statements were called. It was also required to show how response to assessed risks was designed and implemented and communicated with those charged with governance.
	Audit working papers sent by him through email included procedures on how some

	balances in financial statements were verified. Also included in working papers were procedures performed by him relating to verification of inventories, trade receivables and trade payables.
	The working papers sent by him to the authority did not include details on audit plan and manner of identifying and assessing risks of material misstatement. On being asked to respond, it was reasoned by him that audit was properly planned and required procedures were carried out in relation to material items on test check basis.
	It has been further clarified by him to the authority that audit was carried out in accordance with Standards and it was practically not feasible for a firm of small size to make a detailed audit plan. It was also put on record with authority that he had assessed risk of material misstatement to be low based upon his understanding of the company. He has further reasoned that assessing risks is a matter of professional judgment. Representation has also been made by him stating that communications as necessary were made orally with those charged with governance.
	It was also pointed out to him that engagement quality control review was not carried out. He has answered that no contentious matter arose during the course of audit and therefore, no need was felt to carry out this exercise.
	Attention was also drawn to the fact that financial statements of company were required to be prepared on basis of Ind-AS. However, at some places in notes to accounts, reference is made to accounting standards which are not applicable to the company. These errors have been attributed to data feeding entry errors by junior staff.
	Based upon above, answer the following questions:
(1)	**It has been contended by auditor that audit was properly planned. He has further stated that it was practically not feasible for firm of small size to prepare a detailed audit plan.**
	Which of the following views is most appropriate in this regard?
(a)	Audit was, in fact, planned as evidenced by auditor's submissions.
(b)	Although auditor has no record of audit plan, it does not affect compliance with SA 220.
(c)	Since auditor has no record of audit plan, it goes on to show non-compliance with SA 220.

(d)	Audit was, in fact, planned as evidenced by auditor's submissions. However there is an exemption for small CA firms doing away with cumbersome documentation in relation to audit plan.
(2)	**The auditor has reasoned that risk of material misstatement has been assessed to be low based upon his understanding of the company and it is a matter of professional judgment. Identify the most appropriate statement from below in this regard.**
(a)	Assessing risks of material statement is a matter of professional judgment. It cannot be demanded from him how his judgment was arrived at.
(b)	Although auditor has not submitted record of how risk of material misstatement was arrived at, it does not affect compliance with SA 220.
(c)	Since auditor has no record of how risk of material misstatement was arrived at, it goes on to show non-compliance with SA 220.
(d)	Such a query, itself, is outside the mandate of authority.
(3)	**Considering auditor's point of view regarding engagement quality control review, identify the most appropriate statement from below: -**
(a)	Engagement quality control review is mandatory in such type of engagement. It was not proper for auditor to bypass such review. He has violated mandatory requirement of SA 220.
(b)	Engagement quality control review is optional in such type of engagement. Therefore, question of not following SA 220 does not arise.
(c)	No contentious matter arose during the course of engagement. Therefore, question of not following SA 220 does not arise in respect of engagement quality control review.
(d)	Engagement quality control review is dependent upon benchmarks established under SQC 1. If those bench marks are satisfied, such a review is necessary.
(4)	**Considering auditor's reply regarding errors in data feeding entry by junior staff in relation to accounting standards, which of the following statements is proper?**
(a)	Such are examples of clerical errors encountered during preparation of reports. There is no question of non-compliance with SA 220.

(b)	Such are examples of clerical errors encountered during preparation of reports. There is no effect on auditor's opinion and consequently question of non-compliance with SA 220 does not arise.
(c)	Such are examples of serious lapses on part of auditor showing non-compliance with SA 220.
(d)	Such are examples of serious lapses on part of auditor. However, these are not related to compliance with SA 220.
(5)	**On your overall reading of the case study, which of the following statements appears to be true?**
(a)	The firm has an effective system of quality control described in SQC 1. Audit engagement has also been performed in accordance with SA-220.
(b)	The firm does not have effective system of quality control described in SQC 1. Audit engagement has also not been performed in accordance with SA 220.
(c)	SQC 1 is not applicable in the case. Audit engagement has not been performed in accordance with SA 220.
(d)	SQC 1 is not applicable in the case. Audit engagement has been performed in accordance with SA 220.
	ANSWERS
1.	**(c) 2. (c) 3. (a) 4. (c) 5. (b)**

CHAPTER - 2

GENERAL AUDITING PRINCIPLES & AUDITORS RESPONSIBILITIES

❖ TEST YOUR UNDERSTANDING

1. My Décor Limited, presently engaged in manufacturing of fabrics, wants to set up a new plant for manufacturing of special kind of fabric providing an altogether different texture and feel. This kind of fabric has become a hit with retail customers. The company needs to set up plant for manufacturing the above kind of fabric involving huge capital outlays to stay competitive in the market.

You are auditor of the company and find that company's revenue has increased in financial year 2022-23 to ₹ 1000 crore from ₹ 750 crore in last year. By the time, you started the audit, there was no change in plant capacity and information regarding need to set up new plant has become known to you during inquiry of company's personnel.

Discuss, how you should proceed to deal with above situation, as auditor of the company, paying special attention to risk of material misstatement due to fraudulent financial reporting?

Ans. The given situation highlights need for the company to set up new plant for manufacturing of special kind of fabric to stay competitive in the market. Setting up of such plant involves huge capital outlays which could entail financing arrangements. Therefore, excessive pressure exists for management to be involved in fraudulent financial reporting. In such a situation, management may be tempted to inflate its revenues to show rosy picture. It is a fraud risk factor and needs to be evaluated by the auditor.

The revenues of company have jumped from ₹ 750 crore in last year to ₹ 1000 crore in year 2022-23 without any change in plant capacity. The auditor may consider abovesaid fraud risk factor for assessing risk of material misstatement due to fraud.

In case of auditor assessing risk of material misstatement due to fraudulent financial reporting, audit procedures to address such risk like performing substantive analytical

	procedures relating to revenue, use of computer assisted audit techniques to identify unusual revenue transactions and testing controls pertaining to revenue transactions need to be performed.
2.	CA. Ridhima, internal auditor of Track Store Limited, has pointed out following deficiencies in internal control of the company, in her reports: -
(i)	Receivables are not reconciled at stipulated intervals.
(ii)	Customers are provided a credit limit based upon their track record. However, no review of customer credit limits is undertaken at required intervals.
	The statutory auditor of the company finds that no action has been taken by the company on the said deficiencies pointed out in reports of internal auditor.
	What does above situation allude to statutory auditor of company?
Ans.	Management failing to remedy known significant deficiencies in internal control on a timely basis is a fraud risk factor for misstatements arising from fraudulent financial reporting.
	When management does not correct significant deficiencies in internal control on a timely basis, it reflects an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act.
	Failure to rectify known control deficiencies pertaining to reconciliation of receivables and review of customer credit limits has the potential to fraud. Lack of timely reconciliation of receivables may lead to intentional misstatements. Further, non-reviewing customer limit may lead to grant of credit beyond creditworthiness of customers. It may result in intentional tying up of company's funds with risky customers due to collusion.
	The above situation is a fraud risk factor for fraudulent financial reporting.
3.	FAS Insurance Brokers Limited is a leading online insurance intermediary. During the year, Director General of GST Intelligence (DGGI) has issued notice to the company for allegedly creating fictitious invoices for "marketing and sales services" amounting to ₹ 50 crores in favour of non-life insurance companies. The premises of company were also searched during the year by DGGI officials. The matter was also informed

	to IRDAI by DGGI for violation of norms and regulations in this regard.
	Does above situation has any bearing on your responsibilities as statutory auditor of the company? Outline briefly in context of possible non-compliance with laws by the company.
Ans.	When the auditor becomes aware of the existence of or has information about investigations by government departments and regulatory organizations, it may be an indication of non- compliance with laws and regulations.
	In the instant case, notice has been served upon the company by DGGI for allegedly creating fictitious invoices in guise of providing "marketing and sales servicesfo"r ` 50 crores. Issuing an invoice without supply of services is a serious offence under GST laws and it could involve penalties and imprisonment. Such suspected non-compliance may have a direct effect on financial statements.
	The matter has also been informed to regulator i.e. IRDAI. Violation of IRDAI regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.
	If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain: -
(a)	An understanding of the nature of the act and the circumstances in which it has occurred and
(b)	Further information to evaluate the possible effect on the financial statements.
	If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.
	If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

4.	CA. Vallabh Sundar is auditor of a leading private sector bank. "IT Systems and controls" is under his consideration to be reported as "Key audit matter" in audit report of the bank due to high level of automation and complexity of the IT architecture and its impact on the financial reporting system. At what time he should communicate such identified "Key audit matter"? What are relevant considerations in this regard and their usefulness?
Ans.	SA 260 requires the auditor to communicate with those charged with governance on a timely basis. SA 701 states that the appropriate timing for communications about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit, and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two- way dialogue about key audit matters at the time the financial statements are being finalized for issuance. Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report, and provides them with an opportunity to obtain further clarification where necessary. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion. Communication with those charged with governance recognizes their important role in overseeing the financial reporting process, and provides the opportunity for those charged with governance to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.
5.	Four audit firms viz. GPR & Co., MKS & Co., CY & Associates and DES & Associates have been appointed for conducting statutory audit of KNB Bank, a public sector bank in accordance with regulatory guidelines. The professional work was divided by

	audit firms on the basis of zones of bank. However, work relating to "IT Systems and controls" was not allocated by them due to its very nature.
	While planning for the above common work area, it was decided to test IT general controls, application controls and IT dependent manual controls. Planned key audit procedures relating to this common area also included testing design and operating effectiveness of controls over "computer operations including back-up, batch-processing and data centre security".
	The actual audit procedures pertaining to "testing controls over batch processing" were performed by team of DES & Associates. In case work in relation to above audit procedures is not performed professionally by DES & Associates, discuss where responsibility for such lapses would lie in line with SA 299?
Ans.	In respect of common areas, the joint auditors are only responsible for appropriateness of nature, timing and extent of planned audit procedures agreed among them. The responsibility of individual execution lies with concerned joint auditor.
	In the instant case, audit procedures relating to testing design and operating effectiveness of controls over computer operations including back-up, batch-processing and data center security have been planned jointly as it is a common area.
	However, audit procedures relating to testing controls over batch processing were actually performed by team of DES & Associates although these were planned jointly. In case of any lapses in performing such procedures, DES & Associates would be responsible.
❖	**THEORY QUESTIONS**
1.	A, B and C are joint auditors of a company. B is of the opinion that there are material misstatements in financial statements of a company which, if accounted for, would turn profit reflected in financial statements for ₹ 25 crore to a loss of ₹ 5 crore. He, therefore, wants an adverse opinion to be expressed in audit report. However, A and B do not concur with his views and are inclined to accept management's version. Is B required to go by majority opinion of 2-1?
Ans.	Where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. A joint auditor is not bound by the views of the majority of

	the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. Therefore, B is not required to go by majority opinion of 2-1. In such circumstances, the audit report issued by the joint auditors shall make a reference to the separate audit report issued by the other joint auditor. Further, separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading "Other Matter Paragraph" as per SA 706.
2.	CA. Shelly Goel is offered appointment as auditor of RUTE Limited, a listed company. The audit committee of the company wants her to justify independence in relation to company through proper communication. Although she has ensured that there are no threats to her independence, she feels requirement of audit committee to be beyond its purview. What is your opinion in this regard?
Ans.	As required in SA 260, in the case of listed entities, the auditor shall communicate with those charged with governance: -
(a)	A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence and
(i)	All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor and
(ii)	The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.
	Further, as per the Companies Act, 2013 requires audit committee to review and monitor auditor's independence. Therefore, audit committee requiring auditor to justify her independence is well within its purview.

3.	You are auditor of a social media company. Of late, government has tightened noose around companies operating in this segment by bringing in a maze regulatory legislations to protect interests of users. How you can proceed to verify that company is compliant with new regulatory requirements? Besides, what does above situation underscore to you as an auditor?
Ans.	It needs to be verified that the company has put in place systems and procedures to meet with new regulatory requirements. The same can be verified by examining policies and procedures developed by company in this regard like devising appropriate system of internal control, sensitizing employees regarding new rules, engaging legal advisors etc.
	Further, financial stability of the company may be threatened due to new regulatory requirements. The management may be under pressure. It is also a fraud risk factor and may need to be evaluated by auditor.
4.	Discuss why the potential effects of inherent limitations of an auditor's ability to detect material misstatements described in SA 200 are far greater in respect of non - compliance with laws and regulations?
Ans.	In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following: -
➢	There are many laws and regulations, relating principally to the operating aspects of an entity that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.
➢	Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.
➢	Whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law.
5.	MN & Associates are the statutory auditors of ABC Ltd. for the FY 2021-22. During the course of audit, the engagement partner, Mr. Manohar notices a

	misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. How should the audit team deal with the situation?
Ans.	During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. In such a situation the audit team should:
(a)	Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
(b)	Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
(c)	If the auditor withdraws: -
(i)	Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal and
(ii)	Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
6.	CA Anand is the engagement partner for the audit assignment of NHT Ltd. engaged in manufacture of Iron and Steel bars. The company has its plants in the state of Sikkim. While verifying the wages record of the company, CA Anand found that maximum of the labour employed in the plants of the company was child labour. He questioned the management of the company about the same to which the management replied that looking into the compliance of such law is outside his scope of financial audit. Give your comments with respect to such situation.
Ans.	As per SA 250 "Considerations of Laws and Regulations in an Audit of Financial Statements", the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations. The auditor is

	responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.
	For the compliance with provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements, the auditor's responsibility is to obtain sufficient appropriate audit evidence about compliance with the provisions of those laws and regulations.
	For other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but compliance with which may be fundamental to the operating aspects of the business, the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.
	In the instant case, maximum of the labour employed in the plants of the company was child labour. When CA Anand questioned the management of the company about the same, the management replied that looking into the compliance of such law is outside his scope of financial audit. Such reply by the management is not acceptable as such situation may have a material effect on the financial statements. Therefore, CA Anand should ensure as to whether any penal provisions will be there for non-compliance of such law and also whether the same has been duly disclosed by the company. If CA Anand concludes that such non- compliance has a material effect on the financial statements and the same has not been adequately reflected in the financial statements by the company, he shall express an adverse or a qualified opinion on the financial statements.
7.	Magnet Interiors Ltd. is a listed company engaged in the manufacture of office furniture. The company has its activities divided into four geographic regions. The company has appointed two joint auditors, namely, AB & Co. and CD & Co. to conduct the joint audit of the financial statements of the company for the year ending 31.03.2023. The engagement partners from both the firms, CA Amar and

	CA Chetanya along with their audit teams had a meeting to discuss the areas of the work to be divided and their respective responsibilities. Explain the responsibilities of the joint auditors with respect to such joint audit.
Ans.	As per SA 299 "Joint Audit of Financial Statements", 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 cases where specific divisions, zones or units are allocated to different joint auditors, it is the separate and specific responsibility of each joint auditor to obtain information and explanations from the management in respect of such divisions/zones/units and to evaluate the information and explanations so obtained by said joint auditor. The joint auditors shall have proper coordination and rationality wherever required.
	All the joint auditors shall be jointly and severally responsible for: -
a.	the audit work which is not divided among the joint auditors and is carried out by all joint auditors
b.	decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors.
c.	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
d.	examining that the financial statements of the entity comply with the requirements of the relevant statutes
e.	presentation and disclosure of the financial statements as required by the applicable financial reporting framework
f.	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.
	Where, in the course of the audit, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

	It shall be the responsibility of each joint auditor to determine the nature, timing and extent of audit procedures to be applied in relation to the areas of work allocated to said joint auditor. It is the individual responsibility of each joint auditor to study and evaluate the prevailing system of internal control and assessment of risk relating to the areas of work allocated to said joint auditor.
	As regards decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors, all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing and extent of the audit procedures agreed upon among them, proper execution of these audit procedures is the individual responsibility of the joint auditor concerned.
8.	MNO Ltd. gets its accounting data processed by a service organisation. CA Riya is the statutory auditor of MNO Ltd. CA Riya wants to obtain an understanding as to how MNO Ltd. is using the services of the service organisation. What all understanding should she obtain?
Ans.	When obtaining an understanding of MNO Ltd. (user entity) in accordance with SA 315, CA Riya shall obtain an understanding of how MNO Ltd. uses the services of a service organisation in its operations, including: -
(a)	The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control. Information on nature of services provided by a user organization may be available from sources such as user manuals, contract between the user entity and service organization, reports by service auditors etc.
(b)	The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation. In certain situations, the transactions processed and the accounts affected by the service organisation may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of those controls is necessary in the circumstances.

(c)	The degree of interaction between the activities of the service organisation and those of the user entity. The degree of interaction refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organisation. For example, a high degree of interaction exists between the activities of the user entity and those at the service organisation when the user entity authorises transactions and the service organisation processes and does the accounting for those transactions.
(d)	The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.
9.	UVW & Associates are the statutory auditors of Moon Ltd., a listed company, for the financial year 2022-23. CA Udhav is the engagement partner for the audit assignment. He was of the understanding that as per the requirement of one of the SAs he has a responsibility to communicate following matters to those charged with governance:
(a)	The auditor's responsibilities in relation to the financial statement audit.
(b)	Planned scope and timing of the audit.
(c)	Auditor independence
	Which of the matters is not included in the list prepared by CA Udhav. Discuss such matter in detail.
Ans.	SA 260 "Communication with Those Charged with Governance" deals with auditor's responsibility to communicate with those charged with governance in relation to an audit of financial statements. Among various matters as included by CA Udhav in his list, one of the matters that is not mentioned in the list is Significant findings from the audit. With respect to such matter, the auditor shall communicate with those charged with governance: -
(a)	The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under

	the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;
(b)	Significant difficulties, if any, encountered during the audit;
(c)	Unless all of those charged with governance are involved in managing the entity: -
(i)	Significant matters arising during the audit that were discussed, or subject to correspondence, with management;
(ii)	Written representations the auditor is requesting
(d)	Circumstances that affect the form and content of the auditor's report, if any and
(e)	Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.
	The communication of findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.
❖	CA. Biswajit is conducting audit of "*Have More Limited.*" He is auditor of the company since last three years and has found nothing unusual in operations and financial statements of the company. The company has many locations where substantial inventories are stored and lying. During his fourth year stint, he finds that inventory quantities have risen disproportionately as compared to past few years' trends. He has assessed existence of risk of material misstatement due to fraud.
	The company has revenue of ₹ 750 core during the year. He has deeply verified all aspects pertaining to revenue recognition of the company and has concluded that there is no risk of material misstatement due to fraud related to revenue recognition.
	During the course of audit, it has come to his knowledge that company is also required to install online air pollution control monitoring systems in its plant as mandated in state pollution control legislation and regulations. Non-installation of such online air pollution control monitoring systems may lead to fines and even sealing of plant.

	While verifying pay roll data of the company, it has come to notice that provisions of law preventing employment of child labour are not being adhered to and company is employing child labour in flagrant violation of rules in this regard. The company also exports part of its turnover and matter has gone unnoticed in compliance audits carried out by agencies of overseas buyers.
	On the basis of above, answer the following questions:-
1.	**Considering description of disproportionate rise in inventory quantities, which of the following is not likely to be an appropriate response to outlined assessed risk of material misstatement due to fraud?**
(a)	Observing inventory counts at all locations at same date by employing necessary resources.
(b)	Observing inventory counts at certain locations after prior intimation.
(c)	More rigorous examination of packed items during observing inventory count process.
(d)	Observing inventory count at end of reporting period to minimize risk of manipulation
2.	**It has been concluded by auditor that there is no risk of material misstatement due to fraud related to revenue recognition. Which of the following statements is most appropriate in this respect?**
(a)	The auditor needs to document reasons for arriving at conclusion that there is no risk of material misstatement due to fraud related to revenue recognition.
(b)	Identified and assessed risks of material misstatement due to fraud need to be documented. Since no risk of material misstatement due to fraud pertaining to revenue recognition was identified, separate documentation in this respect is not needed.
(c)	The auditor needs only to document that no risk of material misstatement due to fraud relating to revenue recognition was identified.
(d)	The auditor needs to give reference to discussion among engagement team members to document that no risk of material misstatement due to fraud relating to revenue recognition was identified.
3.	**Which of the following statements most appropriately describes responsibilities of auditor in relation to compliance with state pollution control legislation and regulations?**
(a)	Sufficient appropriate evidence needs to be obtained by auditor to verify compliance.

(b)	Physical verification of workability of such systems is required from an auditor
(c)	Only inquiry of company management personnel and review of correspondence with regulatory authorities are suffice to verify compliance.
(d)	Only physical verification of workability of such systems and review of correspondence with regulatory authorities are suffice to verify compliance.
4.	**The auditor has observed non-compliance of law prohibiting employment of child labour. Which is the most appropriate course of action for him to proceed in this matter?**
(a)	He should obtain further information to evaluate the possible effect on financial statements.
(b)	He must report the matter to concerned government department.
(c)	He should obtain further information to evaluate the possible effect on financial statements. Besides, he should evaluate implications of non-compliance for audit risk assessment.
(d)	He should express a modified opinion in audit report.
5.	**Which of the following statements is most appropriate about documentation of non-compliance with laws and regulations by an auditor in context of SA 250?**
(a)	Instances of identified non-compliance with laws and regulations need to be documented.
(b)	Instances of suspected non-compliance with laws and regulations need to be documented.
(c)	Instances of non-compliance with laws and regulations finally determined by Courts of law need to be documented.
(d)	Instances of identified as well as suspected non-compliance with laws and regulations need to be documented.
	ANSWERS
1.	(b) 2. (a) 3. (c) 4. (c) 5. (d)

CHAPTER - 3

AUDIT PLANNING, STRATEGY & EXECUTION

❖ **TEST YOUR UNDERSTADING**

1. XWL Limited was engaged in dealing in commodity futures trading based in Surat. CA P, based at Delhi, was auditor of the company. The auditor did not even once visit office of the company and failed to understand the nature of business of the company. All the papers and account books were received on emails and audit was concluded.

There were also included in his working papers checklists which had a requirement of test checking of cost of raw material consumed & cost of stores and spares. There was nothing in his working papers showing understanding of nature of business of company. What does it reflect upon planning of audit by CA P?

Ans. SA 300 requires the auditor to plan the audit in such a manner that it is performed effectively. It also requires auditor to establish overall audit strategy including identifying the characteristics of the engagement, facilitating him to define its scope and planning of nature, timing and extent of audit procedures required to be performed to achieve the objective of audit.

SA 300 further requires the auditor to document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to such plans.

In the given situation, auditor didn't even once visit the company and failed to understand about business of the company. Therefore, he has flouted requirement of SA 300 to plan the audit in such a manner that it is performed effectively. The auditor has to plan the audit commensurate to the nature and complexity of the business of the entity and identify and assess the risk of material misstatement.

Further, working papers of auditor also do not show his understanding of nature of business which is again a blatant violation of requirement of SA 300 which requires the auditor to document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to such plans.

Inclusion of a checklist in working papers having requirement of test checking of cost

	of raw material consumed & cost of stores and spares shows that it was a general checklist and specifics of business were never understood and audit was not planned to be conducted in an effective manner in accordance with requirements of SA 300.
2.	CA. Pradyuman is planning for audit of a listed company headquartered in NOIDA. While doing this exercise, he has made a list of various procedures intended to be performed by him during the course of audit. He has further made up his mind to decide about sample size at time of performing various planned procedures. Is above approach proper?
Ans.	SA 300 states that audit plan shall include description about nature, timing and extent of audit procedures. The extent of audit procedures also includes deciding about sample sizes to be tested for performing audit procedures. Therefore, the said approach is not proper. Various procedures planned to be undertaken should also include considerations relating to sample sizes to be tested.
3.	CA. Nikita is conducting audit of a leading society engaged in promoting awareness regarding usefulness of internet among the disadvantaged sections of society through easily understandable means and methods. The society is also registered under FCRA, 2010 for receipt of foreign contributions. During the course of audit, she embarked upon extensive procedures relating to verification of receipt of foreign contributions to rule out "round-tripping" in comparison to procedures originally thought of. She is documenting various procedures performed by her including relevant audit findings. However, she doesn't not feel need for putting into writing about how she planned the whole exercise. Does she require refreshening of her knowledge?
Ans.	SA 300 requires auditor to document audit plan and significant changes made during the audit engagement to the audit plan. It also requires auditor to document reasons for such changes.
	The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.

	Further, changes to audit plan along with reasons thereof due to embarking upon extensive procedures related to verification of foreign contributions in comparison to what was originally envisaged need to be documented.
	Failure to document audit plan could entail risk of not conducting audit according to professional standards in a qualitative manner.
4.	CA. Sourabh is engagement partner conducting statutory audit of BBI Bank for SBT & Associates. The bank has 1034 branches spread all over the country which are audited by branch auditors. In respect of one large branch audited by a branch auditor, there were errors in NPA classification of many advances which were not pointed out by branch auditor in his report through memorandum of changes and NIL memorandum of changes was reported electronically.
	During overall review of financial statements of bank by statutory auditor, the above said errors did not come into light. The statutory auditor had also called soft copies of internal inspection report and concurrent audit reports of above branch as part of overall review procedures. However, these reports did not point towards any irregularities in such accounts.
	Would statutory auditor of bank be liable for above lapses? What precautions have to be taken by him while expressing opinion considering possibilities of such situations?
Ans.	SA 600 states that the principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by the other auditors. When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.
	In the given situation, nothing has come to light of statutory auditor which would arouse his suspicion about reliability of work performed by branch auditor. Therefore,

	he would not be responsible for work performed by branch auditor.
	Further, it should be clearly stated in the report that 1034 branches of bank have been audited by branch auditors.
5.	CA. Keshavraj is conducting statutory audit of a listed company "Live with Nature Limited". The company is engaged in producing environment-friendly niche products for new-born babies. There is also a well-functioning internal audit department in the company. On perusal of internal audit reports, he finds that not only verification of inventories was attended by internal auditor at regular intervals during the year, workings were also made in respect of inventory valuation as at year end.
	He has also attended inventory count at end of financial year and no prima facie adverse inferences were drawn by him. However, ongoing through inventory reports, he gathers that inventories are being held for considerably long period before being sold. The internal audit reports have not taken this aspect into consideration. Should he choose to reply upon inventory valuation work performed by internal auditor?
Ans.	For a particular account balance, class of transaction or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In such circumstances, the external auditor will need to perform more procedures directly and accordingly, make less use of the work of the internal audit function in obtaining sufficient appropriate audit evidence. Furthermore, as explained in SA 200, the higher the assessed risks of material misstatement, the more persuasive the audit evidence required by the external auditor will need to be, and, therefore, the external auditor will need to perform more of the work directly.
	In the given situation, inventories are being held for considerably long period before being sold. As company is dealing in niche products for new-born babies, there is a risk of inventory obsolescence due to changes in customer preferences. It carries a significant risk of material misstatement and requires more judgment on part of statutory auditor in planning and performing procedures.
	In such circumstances, statutory auditor needs to perform procedures directly like comparing net realizable value of products with costs to verify completeness of

	provisions, recomputing of provisions for obsolete stocks etc.
	Therefore, in the given situation, he should perform procedures directly in accordance with SA 610.
❖	**THEORY QUESTIONS**
1.	While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?
Ans.	As per **SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"**, the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:
(i)	The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.
(ii)	How Management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed, in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.
(iii)	The estimation making process adopted by the management including-
(1)	The method, including where applicable the model, used in making the accounting estimates.
(2)	Relevant controls.
(3)	Whether management has used an expert?
(4)	The assumption underlying the accounting estimates.
(5)	Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
(6)	Whether and, if so, how the management has assessed the effect of estimation uncertainty.

2.	KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct audit for the financial year 2022-23. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuarial reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma. Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, was found faulty.
Ans.	**Using the work of an Auditor's Expert:** As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500. Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor. In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as auditors of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on was found faulty. Further, Mr. Z is not in agreement with this report, therefore, he submitted a separate audit report specifically for such gratuity valuation. In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness

	and accuracy of source data used for such report before expressing their opinion.
	Mr. X and Mr. Y will be held responsible for gross negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.
3.	A & Co. was appointed as auditor of Great Airways Ltd. As the audit partner what factors shall be considered in the development of overall audit plan?
Ans.	**Development of an overall plan -** Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:
(i)	Terms of his engagement and any statutory responsibilities.
(ii)	Nature and timing of reports or other communications.
(iii)	Applicable Legal or Statutory requirements.
(iv)	Accounting policies adopted by the clients and changes, if any, in those policies.
(v)	The effects of new accounting and auditing pronouncement on the audit.
(vi)	Identification of significant audit areas.
(vii)	Setting of materiality levels for the audit purpose.
(viii)	Conditions requiring special attention such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
(ix)	Degree of reliance to be placed on the accounting system and internal control.
(x)	Possible rotation of emphasis on specific audit areas.
(xi)	Nature and extent of audit evidence to be obtained.
(xii)	Work of the internal auditors and the extent of reliance on their work, if any in the audit.
(xiii)	Involvement of other auditors in the audit of subsidiaries or branches of the client and involvement of experts.
(xiv)	Allocation of works to be undertaken between joint auditors and the procedures for its control and review.

(xv)	Establishing and coordinating staffing requirements.
4.	As an auditor of garment manufacturing company for the last five year, you have observed that new venture of online shopping has been added by the company during current year. What factors would be considered by you in formulating the audit strategy of the company?
Ans.	**Formulation of Audit Strategy:** While formulating the audit strategy for a company, following factors may be considered –
	General Factors:
	Overall audit strategy would involve –
(i)	**Determination of Characteristics of Audit:** Identify the characteristics of the engagement that defines its scope.
(ii)	**Reporting Objectives:** Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.
(iii)	**Team's Efforts:** Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts.
(iv)	**Considering result of preliminary engagement activities:** Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant.
(v)	**Nature, timing and Extent of Resources:** Ascertain the nature, timing and extent of resources necessary to perform the engagement.
	Specific Factors for Online Shopping:
	The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:
(i)	The classes of transactions in the entity's operations that are significant to the financial statements;
(ii)	The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
(iii)	The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;

	this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
(iv)	How the information system captures events and conditions, other than transactions, that are significant to the financial statements;
(v)	Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.
5.	During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.
Ans.	As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:
•	Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
•	Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
•	Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
	Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

	As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.
	In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.
6.	AKJ Ltd is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and heave their corporate office in Delhi. Recently the company appointed new firm of Chartered Accountants as their statutory auditors. The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter?
Ans.	As per SA 210 'Agreeing the Terms of Audit Engagements', the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.
	The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:
(i)	The objective and scope of the audit of the financial statements;
(ii)	The responsibilities of the auditor;
(iii)	The responsibilities of management;
(iv)	Identification of the applicable financial reporting framework for the preparation of the financial statements; and

(v)	Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.
7.	A private company is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc.) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period. The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.
Ans.	As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re- estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.
	The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:
•	Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.
•	Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.
•	Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

	The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.
	However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.
	In the given case, the management is not correct in refusing the relevant information to the auditor.
8.	X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts-options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise.
Ans.	As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.
	In certain situations, the need for a detailed agreement in writing is required like -
•	The auditor's expert will have access to sensitive or confidential entity information.
•	The matter to which the auditor's expert's work relates is highly complex.
•	The auditor has not previously used work performed by that expert.
•	The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

	In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.
9.	Cineplex, a movie theatre complex, is the foremost theatre located in Delhi. Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe, shops, pubs etc. located in the complex. Its other income includes advertisements exhibited within/outside the premises such as hoardings, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises.
	Cineplex appointed your firm as the auditor of the entity. Being the head of the audit team, you are, therefore, required to draw an audit programme initially in respect of its revenue and expenditure considering the above mentioned facts along with other relevant points relating to such complex.
Ans.	Audit Programme of Movie Theatre Complex:
(i)	Peruse the Memorandum of Association and Articles of Association of the entity.
(ii)	Ensure the object clause permits the entity to engage in this type of business.
(iii)	In the case of income from sale of tickets:
(1)	Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly and accurately accounted.
(2)	Verify the system relating to online booking of various shows and the system of realization of money.
(3)	Check that there is overall system of reconciliation of collections with the number of seats available for different shows in a day.
(iv)	Verify the internal control system and its effectiveness relating to the income from café, shops, pubs, game zone etc., located within the multiplex.
(v)	Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
(vi)	Verify the system of collection from the parking areas in respect of the vehicles

	parked by the customers.
(vii)	In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement, any payment of advance made to the distributor is also adjusted against the amount due.
(viii)	Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.
(ix)	Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.
(x)	Verify the insurance premium paid and ensure it covers the entire assets.
❖	**INTEGRATED CASE SCENARIO**
	CA. Anoothi has been offered appointment as auditor of an NSE listed company. She has already ticked checkboxes relating to her independence vis-à-vis company and integrity of promoters and key management personnel. Being satisfied on this count and after sending formal engagement letter to the company, she is in midst of planning activities for company's audit. Owner of country's one of topmost writing instrument brands, above said company is in business of producing ball pens, gel pens, markers, folders and such general stationery products.
	Business profile of the company including its brief history, detail of its key managerial persons and brief description of company's activities was obtained by her. She has also studied reports relating to growth of India's stationery market due to greater demand and impact of government driven schemes like *Sarv Shiksha Abhiyaan (SSA)*. Besides, she has also obtained risk management policy of the company which contained company's strategy to contain various risks.
	On perusal of financial statements of company, it is noticed that the company's inventories as at close of financial year stood at Rs. 200 crore which constitutes about 25% of its total assets. She is planning to identify significant audit risks pertaining to valuation of inventories.

	She is also considering about materiality level for financial statements as a whole.
	Keeping in view above, answer the following questions:
1.	**The compliance with independence requirements and verification of integrity of promoters and key management personnel has been ensured by CA. Anoothi. In this regard, which of the following statements is likely to be a complete statement?**
(a)	Such activities are required to performed strictly in terms of requirements and procedures outlined in code of ethics issued by ICAI.
(b)	Such activities are required to be performed in respect of an audit engagement in accordance with SA 220 and these preliminary engagement activities are specifically identified in SA 210.
(c)	Such activities are required to performed in respect of an audit engagement in accordance with SA 220 and these preliminary engagement activities form part of planning an audit in accordance with SA 300.
(d)	Such activities are required to be performed in terms of requirements and procedures outlined in code of ethics issued by ICAI and are specifically identified in SA 210.
2.	**The auditor has obtained risk management policy of the company. Which of the following statements is most appropriate in this regard?**
(a)	The understanding of company's risk management policy is required by auditor. It may help the auditor in identifying risks of material misstatement that management failed to identify.
(b)	The understanding of company's risk management policy is not required by auditor. It deals with business risks of company. Audit risk is not influenced by company's business risks.
(c)	The understanding of company's risk management policy is required by auditor. However, it cannot help the auditor in identifying risks of material misstatement that management failed to identify.
(d)	The understanding of company's risk management policy is sufficient for an auditor to develop an audit plan.

3.	**Which of the following is not likely to be a procedure for auditor to understand the company?**
(a)	Performing an online search to identify press reports relating to the company
(b)	Reviewing any new SEBI and stock exchange requirements
(c)	Reviewing whether fresh moneys were raised from public
(d)	Seeking confirmation letters from bankers regarding outstanding balances
4.	**Considering auditor's intention to identify significant audit risks pertaining to inventory valuation, which of the following statements is likely to be true?**
(a)	Procedures planned to identify significant audit risks pertaining to inventory valuation forms part of overall audit plan.
(b)	Procedures planned to identify significant audit risks pertaining to inventory valuation forms part of overall audit strategy.
(c)	Procedures planned to identify significant audit risks pertaining to inventory valuation forms part of tests of controls.
(d)	Procedures planned to identify significant audit risks pertaining to inventory valuation forms part of tests of details.
5.	**In relation to materiality levels for financial statements as a whole, which of the following statements is most appropriate?**
(a)	Materiality has to be decided by auditor after identification and assessment of risks of material misstatements.
(b)	Materiality has to be decided by auditor prior to identification and assessment of risks of material misstatements.
(c)	Materiality has to be decided by auditor after performing risk assessment procedures.
(d)	Materiality has to be decided by auditor at time of designing tests of controls and substantive procedures.
	ANSWERS
1.	(c) 2. (a) 3. (d) 4. (a) 5. (b)

CHAPTER - 4

MATERIALITY, RISK ASSESSMENT AND INTERNAL CONTROL

❖ **TEST YOUR UNDERSTANDING**

1. CA. R is conducting statutory audit of a Divisional office (DO) of a public sector insurance company. On going through delegation of powers laid down by company's head office, it is noticed that surveyors in claims under property insurance policies beyond estimated amounts of ₹30 lac are to be appointed by Divisional Claims Committee (DCC). However, on going through surveyor appointment details of 10 such claims during the year, 5 instances have come to his notice where above delegation of powers has not been followed and appointments were made by Divisional manager in place of DCC.

In the beginning, the auditor had assessed risks of material misstatement to be low. Describe why above finding would change auditor's assessment in relation to above.

Ans. Evaluation of internal controls influences auditor's assessment of risks of material misstatement. Risks of material misstatement also consists of control risk.

In the given situation of statutory audit of a Divisional office of a public sector insurance company, it is noticed that procedure relating to delegation of powers has not been followed and surveyor appointments have been made in violation of laid down procedures. It is a serious violation and shows that controls are not operating effectively as laid down by company management.

Such deviations from established controls may lead auditor to conclude that control risk needs to be revised. Revision of control risk assessment is likely to lead to revision in risks of material misstatement. It may also result in modification of nature, timing and extent of planned substantive procedures.

2. You have recently been appointed as an auditor of NGO working in the field of "upholding democracy" for the first time. The last year accounts of NGO were unaudited and its activities were limited at a small scale. However, it is only in the

	current year that NGO has received substantial donations including foreign funds. The said NGO is also crowd funding its donations. The government has now legislative power to cancel FCRA certificate of NGO. Since it is working in field which encompasses political and social fields, accusations and counter-accusations are flying thick and fast.
	What factors you may consider for assessing audit risk?
Ans.	For assessing audit risk, auditor shall consider all components of audit risk. The said NGO is working in a political-cum-social field which can make its activities inherently risky. Crowdfunding donations may have to be seen in relation to constitution of NGO which may make these risky. Since the NGO is in receipt of foreign funds, it may make transactions inherently risky. The credibility and integrity of persons behind NGO is important. Shady NGOs can be involved in money laundering activities and may be involved in mis utilizing funds from donors. Since last year accounts were unaudited, it also increases inherent risk due to probable effect of misstatements, if any, of last year. Non-compliance with strict laws has the potential to make activities of NGO inherently risky.
	Since NGO has received substantial donations in current year and its activities were on a relatively small scale during last year, formal controls may not be in place. Lack of formal controls may lead to non-compliance with laws. Non-compliance with FCRA can have serious consequences including cancelling such certificate of NGO. Therefore, control risk could be high.
	Further, audit for NGO has been accepted for the first time. There may be a lack of understanding of activities of NGO. It may lead to higher detection risk due to inappropriate sampling procedures or faulty application of audit procedures.
3.	RK Living Limited is engaged in manufacturing and processing of textile fabrics. It purchases its raw material from a company based in Silvassa taxable @ 12%. It takes about 3 – 4 days for raw materials to reach the company's plant. Recently, the company has revamped its internal control system for recording its transactions. You have also assumed charge as head of internal audit department of the company few days before.

	It is noticed that information system requires booking of purchases in purchase ledger and stock records from date of purchase invoice only. How you would deal with above matter as internal auditor of the company?
Ans.	Internal audit involves continuous and critical appraisal of functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity including its strategic risk management and internal control system. Internal audit also involves evaluation of internal control to provide assurance to management regarding design, implementation and operating effectiveness of control. In the given situation, information system requires booking of purchases in purchase ledger and stock records from date of invoice. Such a control system is likely to present a distorted picture of stocks of the company. It would show stocks of raw material as received whereas these goods could be in transit. Therefore, design of the control itself is faulty which allows booking from date of purchase invoice only. Further, such a system can have implications with respect to GST laws. The internal auditor should report above matter asking management for corrective action.
4.	A company as part of its internal control set up has a system under which quarterly budgeted targets in respect of sales are analysed with respect to actual performance achieved. It also involves fixing responsibilities of different product departmental heads and taking timely correction. In case of product departmental heads not achieving quarterly budgeted targets, they have to give a detailed justification for the same and also lay down how shortfalls would be compensated in ensuing quarters. Identify and explain component of internal control alluded to in above scenario.
Ans.	The above referred component of internal control is "Control activities". Control activities that may be relevant to an audit include policies and procedures that pertain to "performance reviews". Such control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data -

	operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance. The control activities pertaining to analysis of budgeted target of sales with respect to actual performance, fixing of responsibilities and taking timely corrective action falls in nature of performance reviews. Such performance reviews are part of control activities which is a component of internal control.
5.	CA. S is statutory auditor of a listed company. On reviewing internal controls of the company, he is of the view that there can be possible situations where insurance premiums for keeping insurance policies current in respect of various assets of company may have become due and payable but internal control systems established by the company may not be able to capture it. Elaborate how he should proceed to deal with the above matter.
Ans.	A deficiency in internal control exists when: -
(i)	A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or
(ii)	A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing. In above situation, there is a possibility that internal control systems established by the company may not be able to capture insurance premiums which may have become due and payable. It is a significant deficiency as failure to keep insurance policies current would render assets of the company uninsured. It may lead to losses for the company in case of any eventuality. Further, in accordance with SA 265, the significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may, therefore, exist even though the auditor has not identified misstatements during the audit. The susceptibility to loss of an asset is a factor in determining whether a deficiency

	constitutes significant deficiency in internal control.
	The auditor shall communicate in writing significant deficiency in internal control to those charged with governance and include in the written communication of significant deficiencies in internal control: -
(a)	A description of the deficiencies and an explanation of their potential effects and
(b)	Sufficient information to enable those charged with governance and management to understand the context of the communication.
❖	**THEORY QUESTIONS**
1.	CA. B was appointed as the auditor of ABC Limited for the financial year 2022-23. During the course of planning for the audit, CA. B intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to the factors that may affect the identification of an appropriate benchmark for this purpose.
	What benchmark should be adopted by CA. B, if ABC Limited is engaged in:
(i)	The manufacture and sale of air conditioners and is having regular profits.
(ii)	The construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic.
Ans.	**Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole: As per SA 320,** determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.
	Factors that may affect the identification of an appropriate benchmark include the following:
•	The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
•	Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
•	The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;

•	The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
•	The relative volatility of the benchmark·
	Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment· There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue·
	In case if ABC Limited is engaged in manufacture and sale of air conditioner, and is having regular profits: CA· B, the auditor may consider profit before tax /Earnings·
	In case if ABC Limited is engaged in the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic: CA· B, the auditor may consider Revenue or Gross Profit as benchmarking· Alternatively, CA B, the auditor may consider the criteria relevant for audit of the entities doing public utility programs/ projects, Total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for that particular program/project activity· Where an entity has custody of the assets, assets may be an appropriate benchmark·
2·	What are the components of an internal control framework?
Ans·	There are **five components** of an internal control framework· They are as follows:
•	Control Environment;
•	Risk Assessment;
•	Information & Communication;
•	Monitoring;
•	Control Activities
3·	During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management· You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system·

Ans·	**Important Points to be kept in Mind While Drafting Letter of Weakness:** As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control –
(i)	A description of the deficiencies and an explanation of their potential effects; and
(ii)	Sufficient information to enable those charged with governance and management to understand the context of the communication·
	In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis· This communication should be, preferably, in writing through a letter of weakness or management letter· Important points with regard to such a letter are as follows-
(1)	The letter lists down the area of weaknesses in the system and offers suggestions for improvement·
(2)	It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management·
(3)	This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation·
(4)	The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control·
4·	Explain briefly the Flow Chart technique for evaluation of the Internal Control system·
Ans·	Refer Para 6·1·2
5·	As auditor of Z Ltd·, you would like to limit your examination of account balance tests· What are the control objectives you would like the accounting control system to achieve to suit your purpose?
Ans·	Basic Accounting Control Objectives: The basic accounting control objectives which are sought to be achieved by any accounting control system are –
(i)	Whether all transactions are recorded;
(ii)	Whether recorded transactions are real;

(iii)	Whether all recorded transactions are properly valued;
(iv)	Whether all transactions are recorded timely;
(v)	Whether all transactions are properly posted;
(vi)	Whether all transactions are properly classified and disclosed;
(vii)	Whether all transactions are properly summarized.
6.	New Life Hospital is a multi-specialty 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.
Ans.	**Basic system of Control:** Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof.
	In the given case of New Life Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.
	The general condition pertaining to the internal check system may be summarized as under-
(i)	No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
(ii)	Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.

(iii)	Every member of the staff should be encouraged to go on leave at least once a year.
(iv)	Persons having physical custody of assets must not be permitted to have access to the books of accounts.
(v)	There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
(vi)	Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
(vii)	Budgetary control should be exercised and wide deviations observed should be reconciled.
(viii)	For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
(ix)	The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
(x)	Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.
7.	Compute the overall Audit Risk if looking to the nature of business there are chances that 40% bills of services provided would be defalcated, inquiring on the same matter management has assured that internal control can prevent such defalcation to 75%. At his part the Auditor assesses that the procedure he could apply in the remaining time to complete Audit gives him satisfaction level of detection of frauds & error to an extent of 60%. Analyse the Risk of Material Misstatement and find out the overall Audit Risk.
Ans.	According to SA-200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the Audit Risk is a risk that Auditor will issue an inappropriate opinion while Financial Statements are materially misstated.
	Audit Risk, has two components: Risk of material Misstatement and Detection Risk.
	The relationship can be defined as follows.
	Audit Risk = Risk of material Misstatement X Detection Risk

	Risk of material Misstatement: - Risk of Material Misstatement is anticipated risk that a material Misstatement may exist in Financial Statement before start of the Audit. It has two components Inherent risk and Control risk. The relationship can be defined as
	Risk of material Misstatement = Inherent risk X control risk
	Inherent risk: it is a susceptibility of an assertion about account balance; class of transaction, disclosure towards misstatements which may be either individually or collectively with other Misstatement becomes material before considering any related internal control which is 40% in the given case.
	Control risk: it is a risk that there may be chances of material Misstatement even if there is a control applied by the management and it has prevented defalcation to 75%.
	Hence, control risk is 25% (100%-75%)
	Risk of material Misstatement: Inherent risk X control risk i.e. 40% X 25 % = 10%
	Chances of material Misstatement are reduced to 10% by the internal control applied by management.
	Detection risk: It is a risk that a material Misstatement remained undetected even if all Audit procedures applied, Detection Risk is 100-60=40%
	In the given case, overall Audit Risk can be reduced up to 4% as follows: Audit Risk: Risk of Material Misstatement X Detection Risk = 10X 40% = 4%
8.	ST Ltd is a growing company and currently engaged in the business of manufacturing of tiles. The company is planning to expand and diversify its operations. The management has increased the focus on the internal controls to ensure better governance. The management had a discussion with the statutory auditors to ensure the steps required to be taken so that the statutory audit is risk based and focused on areas of greatest risk to the achievement of the company's objectives. Please advise the management and the auditor on the steps that should be taken for the same.
Ans.	Refer Para 2.2

9.	Y Co. Ltd. has five entertainment centers to provide recreational facilities for public especially for children and youngsters at 5 different locations in the peripheral of 200 kilometers. Collections are made in cash. Specify the adequate system towards collection of money.
Ans.	**Control System over Selling and Collection of Tickets:** In order to achieve proper internal control over the sale of tickets and its collection by the Y Co. Ltd., following system should be adopted –
(i)	**Printing of tickets:** Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.
(ii)	**Ticket sales:** The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.
(iii)	**Daily cash reconciliation:** Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.
(iv)	**Daily banking:** Each day's collection should be deposited in the bank on next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.
(v)	**Entrance ticket:** Entrance tickets should be cancelled at the entrance gate when public enters the centre.
(vi)	**Advance booking:** If advance booking of facility is made available, the system should ensure that all advance booked tickets are paid for.
(vii)	**Discounts and free pass:** The discount policy of the Y Co. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.
(viii)	**Surprise checks:** Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.

10.	The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Explain.
Ans.	**Control Environment**
	The control environment encompasses the following elements:
(a)	**Communication and enforcement of integrity and ethical values:** The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the product of the entity's ethical and behavioral standards, how they are communicated, and how they are reinforced in practice.
(b)	**Commitment to competence:** Competence is the knowledge and skills necessary to accomplish tasks that define the individual's job.
(c)	**Participation by those charged with governance:** An entity's control consciousness is influenced significantly by those charged with governance. The importance of the responsibilities of those charged with governance is recognised in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance.
(d)	**Management's philosophy and operating style:** Management's philosophy and operating style encompass a broad range of characteristics.
(e)	**Organisational structure:** Establishing a relevant organizational structure includes considering key areas of authority and responsibility and appropriate lines of reporting.
(f)	**Assignment of authority and responsibility:** The assignment of authority and responsibility may include policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties.
(g)	**Human resource policies and practices:** Human resource policies and practices often demonstrate important matters in relation to the control consciousness of an entity.
11.	Your engagement team is seeking advice from you as engagement partner regarding steps for risk identification. Elaborate.
Ans.	Refer Para 1.3

12. BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2019-20. In order to review internal controls of the Sales Department of the company, you visited the Department and noticed the work division as follows:

(1) An officer was handling the sales ledger and cash receipts.

(2) Another official was handling dispatch of goods and issuance of Delivery challans.

(3) One more officer was there to handle customer/ debtor accounts and issue of receipts.

As an internal auditor, you are required to briefly discuss the general condition pertaining to the internal check prevalent in internal control system. Do you think that there was proper division of work in BSF Limited? If not, why?

Ans. The general condition pertaining to the internal check system may be summarized as under: refer para 4.5

In the given scenario, Company has not done proper division of work as:

(i) the receipts of cash should not be handled by the official handling sales ledger and

(ii) delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

❖ **INTERGRATED CASE STUDY**

Following is extract of information taken from draft financial statements of Find me Limited engaged in manufacturing of bicycles put up before you for audit for year 2022-23: - (₹ In lacs)

Particulars	**2022-23**	**2021-22**
Revenue from operations	35000	25000
Cost of sales	26950	20000
Gross Profit	8050	5000
Operating expenses	3825	3825
Finance costs	225	275
Depreciation and amortization expenses	1200	1300
Profit before tax	2800	(400)
Tax expense - current tax	750	0
Deferred tax	(50)	(385)
Total tax expense	700	(385)

Profit after tax	2100	15
Trade receivables	6000	3000
Inventories	10000	6000

The company has not made any substantial additions in its plant capacity during year 2022-23. It has reduced its dealer network and is approaching customers directly using its online platform. Encouraging response has been received from customers and sales have gathered momentum through online platform.

You are planning to use analytical procedures as risk assessment procedures. Keeping in view above, answer the following questions: -

1. **The revenue from operations of company has increased by 40% in year 2022 - 23 as compared to last year. There are no additions in plant capacity. Which of the following statements is most appropriate in this regard?**

(a) There is audit risk that revenue from operations is overstated.

(b) There is audit risk that revenue from operations is not overstated.

(c) There is audit risk that fresh customers of company do not make payments.

(d) There is audit risk that company is over utilizing its plant capacity leading to rapid plant obsolescence.

2. **The operating expenses of financial year 2021-22 and 2022-23 are same. Which of the following statements is most appropriate in overall context of case study?**

(a) Operating expenses figures of two years can be same. There is no audit risk involved.

(b) It is an anomaly. However, there is no audit risk involved.

(c) There is audit risk that previous year figures need to be revised under Companies Act.

(d) There is audit risk that previous year figures have been presented in place of current year figures in draft financial statements

3. **Trade receivables turnover ratio has increased from 1.44 months in year 2021 - 22 to more than 2 months in year 2022-23. Identify the most appropriate statement.**

(a) In direct distribution through online platform, trade receivables turnover ratio is estimated to be high. Therefore, there is no audit risk involved.

(b)	In direct distribution through online platform, trade receivables turnover ratio should have fallen. Therefore, there is no audit risk involved.
(c)	In direct distribution through online platform, trade receivables turnover ratio should have fallen. It is possible that some of the dealers may not be meeting their commitments of past contracts. Therefore, there is audit risk that trade receivables could be undervalued.
(d)	In direct distribution through online platform, trade receivables turnover ratio should have fallen. It is possible that some of the dealers may not be meeting their commitments of past contracts. Therefore, there is audit risk that trade receivables could be overvalued.
4.	**The gross profit ratio of company has increased by 3% during year 2022 - 23 in comparison to last year. Which of the following statements is most appropriate?**
(a)	There is audit risk that there is overstatement of cost of sales.
(b)	There is audit risk that margins with customers may have increased.
(c)	There is audit risk that closing inventories may be undervalued.
(d)	There is audit risk that cost of sales may not be completely recorded.
5.	**Inventory turnover ratio has increased from 2.88 months in year 2021-22 to about 3.42 months in year 2022-23. Which of the following statements is likely to be in accordance with overall context of case study?**
(a)	Revenue jump in current year may have led to need for raising inventory holding levels. Therefore, there is audit risk pertaining to misstatement of inventories.
(b)	Raising of inventory levels may raise locked up funds in inventories. There is audit risk that it can lead to rise in costs.
(c)	Revenue jump in current year may have led to need for raising inventory holding levels. However, there is also a risk that some of inventories with dealers could have become obsolete. It leads to audit risk that inventories may be overvalued.
(d)	There is audit risk on account of both the factors stated at [b] & [c].
	ANSWERS
1.	(a) 2. (d) 3. (d) 4. (d) 5. (c)

CHAPTER - 5

AUDIT EVIDENCE

❖ TEST YOUR UNDERSTANDING

1. During the course of the audit of TK Home Private Limited, a recognized export house engaged in manufacturing of T-shirts under brand name of "TK". CA Tripti is verifying export revenues of the company for the year 2022-23. She has verified transactions entered in "Export Sales" account maintained in accounting software from relevant export invoices. The export sales are being made on payment of IGST, for which a refund is automatically credited in the account of the company after the goods are shipped.

On enquiring from internal audit staff regarding the recognition of export revenues, she is told that export sales are recognised for the year on the basis of "Bills of Lading". However, she is not convinced with such a response and feels that the same does not appear to be proper.

She finds that three export invoices bearing dates in the month of March 2023 having a value of ₹ 75.00 lacs have not been recognized in export revenue on the ground that bills of lading for these invoices were issued in the month of April 2023.

Discuss from what sources she can obtain reliable audit evidence in this regard. How can she challenge management's assertion regarding the completeness of export revenues for the year 2022-23?

Ans. She can obtain reliable audit evidence by going through GST returns filed by the company on GST portal and correlating the same with e-way bills. She can obtain audit evidence about how company has reflected its export sales in its GST returns and whether export sales pertaining to three invoices having value of ₹ 75.00 lacs are reflected in such returns.

Further, e-way bills generated on the portal would provide evidence that goods have moved out of the company's premises. The export revenue should have been booked at the time the goods moved out of the company's premises. The company is claiming an IGST refund. The refund is linked to the monthly sales return. This aspect can also be verified.

	"Bill of Lading" is only a document issued by the carrier to the shipper of goods that goods have been taken on board. She should challenge and counter management's assertion on the above grounds and point out violations of relevant accounting standards and principles. In this way, she can obtain reliable audit evidence. Highlighting such digital and other evidence, she can challenge management's assertion regarding the completeness of export revenues and point out that export revenues are understated.
2.	CA Prabhjot has planned observing the physical count of inventories at the plant of a company located in remote area in the state of Uttarakhand as part of a statutory audit exercise as at close of year ending 31st March 2023. He has already informed the management of his intention to reach the plant site by evening of 29th March 2023. He plans to inspect inventories, observe the counting process and perform test counts among other matters. The management has made all necessary arrangements to facilitate the above exercise. However, an agitation in Himalayan hills has started on 28th March 2023 for the promulgation of a strict law relating to the conversion of agricultural land for commercial use. Many civil society groups are participating in the agitation. NH-7 leading to the plant site is blocked by protestors. The plant is not accessible through any other mode. The blockade is lifted after one month when state government announced the formation of a committee to look into protestors' demands. Does the above case highlight to a situation of "impracticability of attendance" at inventory counting in terms of requirements of SA 501? How should the auditor proceed in above situation?
Ans.	The above situation does not highlight the impracticability of attendance at inventory counting. It only shows that the auditor is unable to attend physical inventory counting due to unforeseen circumstances arising out of agitation by protestors. It has led to the inaccessibility of the plant site for a month. The blockade is lifted after a month. SA 501 states that if the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical

	counts on an alternative date and perform audit procedures on intervening transactions. Therefore, the audit should attend to the physical inventory count after the blockade is lifted and perform audit procedures on intervening transactions.
3.	On reviewing legal expenses account of Zed Ltd., CA. Sunitha, auditor of company, finds that legal fees amounting to Rs. 10 lac was paid to B. George, a reputed lawyer, during the year 2022-23. On inquiry with management regarding the purpose of such expenditure, evasive reply was received from management stating that a lot of work is performed by the said lawyer on behalf of the company. However, no specific details were provided. She finds it proper to correspond directly with the lawyer. She obtains the address and mail id of the lawyer from his professional services bill. She shoots off an inquiry letter asking for the nature and status of litigation claims against the company on her letterhead. Is her approach proper? Irrespective of the merits of the approach followed by her, what she is trying to achieve by corresponding with lawyer of the company?
Ans.	SA 501 states that when audit procedures performed indicate that material litigation or claims may exist, the auditor shall seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor. Therefore, her approach in communicating with an external lawyer is wrong. She has to make management aware of her intention to communicate directly with the lawyer. The letter of enquiry has to be prepared by management and sent by her. Her purpose in corresponding with the lawyer of the company is to identify litigation and claims involving the entity which may give rise to a risk of material misstatement. It is due to the reason that litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.
4.	On going through financial statements and records of "TS Ltd.," during the course

	of statutory audit, CA Tanmaya finds that substantial inventories of the company consisting of mast lighting poles remain with "Super Industries" for certain finishing works. While planning audit procedures, he had planned about seeking confirmation from "Super Industries" regarding existence and condition of such mast lighting poles belonging to TS Ltd. lying with them as on 31st March, 2023.
	However, the premises of "Super Industries" were raided by DGGI officials (Director General of GST Intelligence) in connection with the busting of a fake billing scam. The proprietor of the firm was arrested in November 2022 and came out on bail in the month of March 2023. The details of proprietor and his firm were flashed prominently in local newspapers of the city where company is located. CA. Tanmaya also belongs to the same place. Discuss how he should proceed in the above matter as auditor of TS Ltd.
Ans.	SA 501 states that when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:
(a)	Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
(b)	Perform inspection or other audit procedures appropriate in the circumstances.
	It further states that where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party.
	Examples of other audit procedures include:
•	Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
•	Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
•	Inspecting documentation regarding inventory held by third parties
	In the given case, the integrity of the third party appears to be doubtful in view

	of DGGI raids and his possible involvement in a fake billing scam. He has already been behind bars.
	Keeping in view above, besides obtaining confirmation from such party, he may attend a third party's physical counting or ask some other auditor to attend physical counting as on reporting date, depending upon practical considerations. He can also inspect the record of goods sent and received back from such party by tracing it to challans, e-ways bills etc. and correlate the above information.
5.	As auditor of Groom Limited, you have sent positive confirmation requests to 30 creditors of the company in March 2023. All of the creditors in informal sector are small concerns. You choose to send positive confirmation requests to all the above parties at their business addresses stated on respective bills after discussing the matter with CFO of the company. The CFO is cooperative and does not raise any hassles in the matter.
	Responses to confirmation requests are received within a week's time. Your articled clerk informs you that out of above 30 creditors, GST registrations of 25 concerns have been cancelled during financial year 2022-23 itself by collating information from GST portal. He further informs you that there are no fresh registrations pertaining to PANs of these parties.
	How you would proceed to deal with the situation as auditor of the company?
Ans.	SA 505 states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.
	In the instant case, GST registrations of 25 concerns have been cancelled in the year 2022-23. It indicates that businesses on those addresses were closed. Further, there are no fresh registrations pertaining to the PANs of these parties. However, the auditor sent external confirmation requests in March 2023, which were duly responded. It raises questions on the reliability of responses received.
	SA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry

	some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include:
•	Was received by the auditor indirectly or
•	Appeared not to come from the originally intended confirming party.
	Keeping in view the circumstances described in the case situation, there is a risk that the response has not come from the originally intended confirming party.
	Unreliable responses may indicate a fraud risk factor that requires evaluation.
6.	CA M. Hussain is appointed auditor of a firm for year 2022-23 on 31st July, 2022. The accounts of firm were unaudited in year 2021-22. The firm had material inventories reflected in its financial statements even as on close of 31st March, 2022. He is performing audit procedures, including attending physical inventory count as on 31st March, 2023. However, there is a lingering doubt in his mind regarding opening inventories reflected in financial statements.
	Does there exist any responsibility on his part in such a situation?
Ans.	SA 510 states that in conducting an initial audit engagement, one of the objectives of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether opening balances contain misstatements that materially affect the current period's financial statements. The auditor has to evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances or specific audit procedures are required to be performed to obtain evidence regarding the opening balances.
	In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:
•	Observing a current physical inventory count and reconciling it to the opening inventory quantities.
•	Performing audit procedures on the valuation of the opening inventory items.
•	Performing audit procedures on gross profit and cut-off.

7.	CA. Ritesh Deshpande has drawn some samples during the course of audit of a manufacturing company for testing controls as well as for tests of details. On the basis of the samples selected, he reaches an erroneous conclusion that access controls on applications are less effective.
	Further, on the basis of samples selected, he concludes erroneously that work-in progress inventories amounting to ₹ 5 crore in financial statements are materially misstated.
	Outlining the above risk involved, discuss how it is going to affect his audit of the company.
Ans.	The described risk is sampling risk. It is a risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.
	In the given case, the auditor has arrived at erroneous conclusions on the basis of the samples selected. In the case of a test of controls, he has concluded that access controls are less effective than they actually are. In the case of a test of details, he has concluded erroneously that a material misstatement exists when in fact, it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.
8.	"Living Well Private Limited" is engaged in the manufacturing and export of floor coverings. Such products are labour-intensive and do not require much of capital investment in machinery. The company has no plans to diversify in other product lines. Its directors are also holding significant interest in another company "My Living Private Limited" engaged in manufacturing of blankets using capital intensive machinery.
	During the course of the audit of "My Living Private Limited", it was noticed by you that the company has sold machinery of ₹ 1 crore to "Living Well Private Limited" during the year. The transaction has been done at normal market rates applicable to such used machinery.
	How do you view the above transaction as auditor of "My Living Private Limited"?
Ans.	In respect of significantly related party transactions outside the normal course of

	business of an entity, it is the responsibility of the auditor, in accordance with SA 550, to evaluate the business rationale or lack thereof of transactions that may have been entered to indulge in fraudulent financial reporting or conceal misappropriation of assets.
	The auditor has to seek to understand the business rationale of such a transaction from a related party's perspective. It would help him understand the economic reality of such a transaction and why it was carried out.
	In the given situation, there is no primary rationale for such a transaction. Living Well Private Limited does not manufacture blankets, and the purchase of part of old machinery pertaining to blanket manufacturing has no rationale for it primarily. A business rationale from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.
❖	**THEORY QUESTIONS**
1.	Coccyx Ltd. supplies navy uniforms across the country. The company has 3 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. Coccyx Ltd. appointed M/s OPAQE & Co. to conduct its audit for the financial year 2022-23. Mr. P, partner of M/s OPAQE & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.
	You are required to advise M/s OPAQE & Co.,
(I)	How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?
(II)	How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?
Ans.	
(i)	**Special Consideration with Regard to Inventory:** As per SA 501 "Audit Evidence-Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(1)	Attendance at physical inventory counting, unless impracticable, to:
(i)	Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
(ii)	Observe the performance of management's count procedures;
(iii)	Inspect the inventory; and
(iv)	Perform test counts; and
(2)	Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
(ii)	**Attendance at Physical Inventory Counting Not Practicable:** In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.
	Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.
	In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.
2.	GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed

	company for the year ended 31·03·2023 is concerned with the presentation and disclosure of segment information included in Company's Annual Report· GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework· Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing·
Ans·	The auditors, GHK Associates wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information· SA 501 guides in this regard· As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:
(i)	Sales, transfers and charges between segments, and elimination of inter-segment amounts·
(ii)	Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales·
(iii)	The allocation of assets and costs among segments·
(iv)	Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies·
3·	Chintamani Ltd· appoints Chintan & Mani as statutory auditors for the financial year 2022- 2023· Chintan & Mani seem to have different opinions on Audit approach to be adopted for audit of Chintamani Ltd· Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population· Chintan is concerned that whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested·

	You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.
Ans.	As per SA 530, "Audit Sampling", the auditor shall evaluate:
(a)	The results of the sample; and
(b)	Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.
	If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:
(i)	Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
(ii)	Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.
4.	During the audit of Star Ltd. a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of ₹ 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation.
Ans.	**External Confirmation:** As per SA 505, "External Confirmation", negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.
	The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.

Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 20 lakh has not sent the confirmation on the credit balance. In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non-response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

❖ **CASE STUDY - 1**

1. Honest Specialty Chemicals Private Limited is a ₹ 1,000 crore turnover company having plants in Khopoli, Mahad, and Ankleshwar for manufacturing various products for fertilizer units, cosmetics and paint industry, etc. The company has built up a good reputation, and apart from the domestic market, it exports to the European market and the Middle East. The company is a closely held company owned by three friends and their family members. The types of materials handled and produced are hazardous.

Following further latest information relating to the company is as under: -

- The company needs to import the key raw materials and is exposed to high risk of price fluctuations and currency risks.
- The company carries high inventory due to the long import cycle & seasonal sales pattern.
- The working capital is almost 60% blocked in inventory and rest in receivables.
- The company has huge investments in plant and machinery financed through term loans from financial institutions.
- Since the company has large imports, it buys import licenses from the open market.

•	The company has received customs notices about using fake licenses for importing materials without paying duty. The company has filed an appeal against the said notice and the same is pending with the Appellate Tribunal. The amount involved is material and, along with interest and penalty, could be more than 10% of turnover.
•	The company has liquid chemicals stored in huge tanks.
•	The powdered form of chemicals is stored in standard-sized drums
•	Few items of stocks like coal, sulphur are lying in the open area.
•	The company has huge domestic sales on a consignment basis, and vast quantities of finished inventories are lying with the consignees across India.
•	The company has received an order from NGT to pay a fine of INR 1.5 crores for the emission of toxic chemicals in the air and water. The company has filed an appeal against the said order.
•	The type of plant is such that it has to be a continuous process, and at any time, huge quantities of materials are in process.
•	Raw Materials are stored in huge tanks located 2 kilometres from the plant, and to transport the chemicals (liquid), there is a network of pipes connecting them, and at any point in time, there are huge quantities of materials lying in the pipeline.
•	The company has prepared its inventory details by involving a management expert.
•	During the year, the previous auditor resigned, and a new auditor got appointed.
	Theoretical Questions
	Based on the case study, please advise the auditor on the important aspects of carrying out the audit procedures to obtain sufficient appropriate audit evidence in respect of the following:-
1.	Which audit procedures are required for verifying existence and condition of company's inventories with specific reference to its nature of operations?
2.	The company has prepared inventory details by involving a management's expert. Elaborating upon its rationale, discuss responsibilities of auditor in regard to information prepared by company involving such an expert.
3.	What additional procedures does the auditor need to carry out in respect of stocks lying with consignees all over the country?
4.	What procedures should the auditor need to undertake for litigation matters?

	Multiple Choice Questions
1.	The objectivity of the management's expert is likely to be lesser if:
(a)	The expert is competent
(b)	The expert is capable
(c)	The expert has relevant experience
(d)	The expert is employed by the entity
2.	Which of the following matters is irrelevant for auditor in planning attendance at physical inventory counts?
(a)	Nature of inventory
(b)	The timing of physical inventory counting
(c)	The nature of the internal control related to inventory
(d)	Whether 100% of inventory is covered in the count
3.	External confirmations for receivables are not reliable in which of the following situations:
(a)	The response directly received by the auditor
(b)	The confirmation has come from the address of the confirming party
(c)	The confirmation is signed by the plant manager
(d)	The confirmation is positive confirmation
4.	The new auditor planned certain procedures with respect to opening balances. Which of the following procedures is not in accordance with SA 510?
(a)	Reading the most recent financial statements and audit report
(b)	Where the prior period report is modified, the impact on the current period
(c)	Correctly bringing forward of prior period closing balances
(d)	Ascertaining whether predecessor auditor had attended physical inventory count
	ANSWERS:
1.	The auditor needs to obtain sufficient appropriate audit evidence regarding existence and condition of inventory.

	For the above, the auditor needs to do all the following: -
(a)	Attendance at physical inventory counting to:
(i)	Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting like:
-	The existence of appropriate control activities: collection of used physical inventory count records, accounting for unused physical inventory count records, count and recount procedures·
-	The accurate identification of the stage of completion of work-in- progress, of slow moving, obsolete, or damaged items and of inventory lying in tanks, in pipes and in open areas·
-	The procedures used to estimate physical quantities, for liquid chemicals lying in process, tanks, pipelines, in open areas like coal pile, sulphur pile, etc·
-	Control over the moment of inventory between areas and the shipping and receipt of inventory before and after the cut off date·
(b)	Observe the performance of Management's count procedure by observing the control over the movement of inventory before, during and after the count to determine adequacy and effectiveness of count procedure·
(c)	Inspect the inventory to assist in identifying obsolete, damaged or ageing of inventory·
(d)	Perform the test counts to obtain the sufficient appropriate audit evidence
(i)	By tracing items selected from the physical inventory to management's count records,
(ii)	By obtaining copies of Management's completed physical inventory count records
(e)	Cross matching the final inventory records with the actual inventory count results·
2·	The company deals with speciality chemicals which are in liquid condition, powdered condition, lying in the huge tanks or in plants under process, lying in pipelines or lying in open areas like coal and sulphur· The unit of measurement for each of the above categories may be different and could involve technical and mathematical principles involving technical and scientific expertise· Keeping these matters in view, inventory details have been prepared by involving management's expert·
	When information to be used as audit evidence has been prepared using the work of

	a management's expert, the auditor shall, having regard to the significance of that expert's work for the auditor's purposes:
(a)	Evaluate the competence, capabilities and objectivity of that expert
(b)	Obtain an understanding of the work of that expert and
(c)	Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion·
3·	Apart from obtaining the confirmation from the third party as to the quantities and condition of the inventory held on behalf of the entity, the auditor may perform the following other audit procedures:
-	Attending, or arranging for another auditor to attend, the third party's physical counting of inventory,
-	Obtaining another auditor's report or a service auditor's report on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded·
-	Inspecting documentation regarding inventory held by third parties
4·	The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity by:-
-	Inquiry of management and, where applicable, others within the entity including in- house legal counsel·
-	Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel·
-	Reviewing legal expense account·
	The legal claims involving customs and fine of NGT are material· In such circumstances if auditor assesses risk of material misstatements regarding litigation, he can seek letter of specific inquiry from the external legal counsel including: -
•	A list of litigation and claims
•	Where applicable, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including cost involved and

- A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered incomplete or incorrect.
- The auditor may seek meeting with the external legal counsel if the matter is having significant risk, it is complex or there is disagreement between management assertion and legal counsel's views.
- Obtaining written representation from the management and where appropriate those charged with governance that all the known actual or possible litigation and claims whose effects should be considered when preparing the financial statement have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

❖ **MULTIPLE CHOICE QUESTIONS ANSWERS**

1. (d) 2. (d) 3. (c) 4. (d)

2. CASE STUDY – 2

"Trustworthy Real Estate Private Limited" with Mr. Bharose Lal as MD along with his wife, Maya, owned the company.

The company had floated one SPV "Real Trust Developers Private Limited" in which a foreign entity became a Joint Venture partner with a 50% stake.

The venture was formed with its Head Office in Mumbai to invest in SRA projects (Slum rehabilitation authority) and develop them into commercial units for sale.

Mr. Bharose Lal was going through a rough patch in his life. He was in financial difficulty and had mounting dues and huge outstanding exposure to banks and suppliers in his companies. Mrs. Maya was from a very wealthy family and had fallen in love with Mr. Bharose Lal, who was from a middle-class family. Mrs. Maya had an expensive lifestyle and was always short of funds to maintain her lifestyle. Mr. Bharose Lal sensed a golden opportunity in the new venture because the foreign partner had no knowledge of Indian regulations and how the SRA projects worked and was solely dependent on the local partner to get all the permissions, scouting for the projects, getting consents from the slum dwellers for the project, giving contracts for the

	construction of projects and such matters.
	M/S ABC and Company, Chartered Accountants were appointed as the auditor of the joint venture, and the engagement team was headed by CA Sceptic, who had, in his stint with the firm, was instrumental in unearthing two major frauds and had the ability to sniff out any such scenarios.
	Mr. Bharose Lal has a dominant personality and a powerful influence on functioning, and everybody looks to him for guidance. The governance structure was very poor in the organization, and Mr. Bharose Lal used to dictate the decisions. Even though as part of the Joint Venture, there was a detailed governance structure and policies and procedures in place for the decision-making process at the joint venture. However, the representative on the board of the Joint Venture of the foreign partner who had shifted to India to supervise the SRA project had grown friendly with Mr. Bharose Lal, and Mr. Bharose Lal had even gone out of the way to help him get good accommodation and second- hand Mercedes. Often, they both go to a club in the evening for a drink. The dealings in the SRA project are not very transparent and above board but are very opaque. Given the above situation, CA Sceptic wants to discuss with the audit team areas and situations where risk of material misstatement is possible and there are chances of having an undisclosed related party relationship to misappropriate the funds.
	Theoretical Questions
1.	Please guide the engagement team on the further course of action as per SA 550.
2.	What are fraud risk factors in given case?
3.	Given the situation that each partner in the joint venture has to bring into the entity a contribution of 5 crores each and given the situation that Mr. Bharose Lal had appointed one agency, the name Useless & Sons Private Limited, to get consent from the slum dwellers, for which the agency was paid 20 crores as Kitty to get the job done.
	CA Sceptic inclines that there is some connection between the 20 crores paid and, simultaneously, within a short span, the infusion of INR 5 cerosras equity contribution by Mr. Bharose Lal.
	Please guide CA Sceptic in establishing this link based on the guidance available in SA 550 and SA 240.
	What additional audit procedures does his team need to undertake for the conclusion?

4.	If, based on additional audit procedures undertaken by CA Sceptic, it is established that there is a likelihood of misappropriation of funds and the financial statements as a whole may be materially misstated, how CA Sceptic needs to plan the future course of action?
	Multiple Choice Questions
1.	Which of the following best describes the method that Mr. Bharose Lal can indulge to commit fraud?
(a)	Concealing and not disclosing facts that could affect the amounts recorded in financial statements.
(b)	Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
(c)	Causing an entity to pay for goods or services not received.
(d)	Using undisclosed business partners to misappropriate funds in the garb of making a business transaction and thus siphoning off the funds.
2.	In the given case scenario, the main factor giving rise to risk of material misstatement is:
(a)	The expensive lifestyle of owners.
(b)	Appointment of an auditor having experience in unearthing of frauds
(c)	The deteriorating financial condition of the owner's business.
(d)	The vulnerability and dependence of the foreign partner on the local partner.
3.	In the given case scenario, which is the most important red flag for auditor:
(a)	Expensive lifestyle
(b)	Undisclosed related party relationships to siphon off the funds.
(c)	Financial crunch
(d)	The dominant influence of the owners
4.	Which of the following is not a fraud risk factor?
(a)	Dominant influence of the owners
(b)	Expensive lifestyle
(c)	Fraud risk due to the nature of the industry
(d)	Floating of a new SPV itself

	ANSWERS THEORETICAL QUESTIONS:
1.	The engagement team shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.
-	The nature and extent of the entity's relationships and transactions with related parties as identified independently by the Auditor by verification of MBP-1 data and data available on MCA website relating to directors and companies, etc.
-	An emphasis on the importance of maintaining Professional Skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
-	The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special purpose entities off-balance sheet transactions, or an inadequate information system).
-	The records or documents that may indicate the existence of related party relationships or transactions.
-	The importance of management and those charged with governance attached to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirement), and the related risk of Management override of relevant controls.
	In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:
(a)	How special-purpose entities controlled by management might be used to facilitate earnings management
(b)	How transaction between the entity and known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.
-	An exchange of ideas among engagement team members about how and where they believe the entity's financial statements may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
-	A consideration of circumstances that might be indicative of earnings management and

	the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
-	A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
-	A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
-	A consideration of any unusual or unexplained changes in behaviour or lifestyle of management or employees which have come to the attention of the engagement team.
-	An emphasis on the importance of maintaining a proper state of mind through out the audit regarding the potential for material misstatement due to fraud.
-	A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
-	A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
-	A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statement to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.
-	A consideration of any allegations of fraud that have come to the auditor's attention.
-	A consideration of the risk of management override of controls.
2.	The fraud risk factors are the events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.
	The fraud risk factors are classified based on the three conditions that are generally present when fraud exists:
(i)	An incentive or pressure to commit fraud
(ii)	A perceived opportunity to commit fraud
(iii)	An ability to rationalize the fraudulent action.
	In the given case scenario following fraud risk factors can be segregated in the 2 conditions of incentive or pressure to commit fraud in a perceived opportunity to commit fraud.

1)	An incentive or pressure to commit fraud:
-	Financial difficulty with huge outstanding dues towards vendors & Financial Institutions.
-	Expensive lifestyle.
-	Requirement to fund ₹ 5 crore as equity contribution in the SPV.
2)	A perceived opportunity to commit fraud:
-	Dependency of the foreign partner and no knowledge of the foreign partner of local laws and the SRA business model in India
-	The risk is due to the way the real estate industry functions and particularly risk due to the SRA business model.
-	Dominant personality of MD, which can lead to management override of controls for undisclosed business relationships with M/s. Useless and Sons (P) Ltd.
3.	If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditors, the auditor shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.
	In such situations, the auditor shall:
-	Promptly communicate the relevant information to the other members of the engagement team in order to assist them in determining whether this information affects the results of and conclusions drawn from risk assessment procedures already performed, including whether the risk of material misstatement needs to be reassessed.
-	Where the applicable financial reporting framework establishes related party requirements:
(i)	Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and
(ii)	Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;
-	Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions.
-	Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclose to the auditor, and perform additional audit procedures as necessary; and

-	If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit. In such cases, the requirements and guidance in SA-240 regarding the auditor's responsibilities relating to fraud in an audit of financial statements are relevant where management appears to have intentionally failed to disclose related parties or significant related party transactions to the auditor. The auditor may also consider whether it is necessary to re-evaluate the reliability of management's responses to the auditor's inquiries and management's representations to the auditor.
-	The Auditor needs to carry out verification and inspection of the ownership structure and the review of the financial statements of the M/s. Useless and Sons (P) Ltd through the MCA website and establish the nexus between the two.
-	The Auditor needs to carry out an inspection of the data filed by Mr. Bharose Lal for his group companies to establish any past transactions/relationships between the two entities.
-	The Auditor needs to ask for all the documents for the utilization of INR 20 crore and can investigate by visiting the parties involved and asking for confirmation directly.
4.	The Auditor needs to reassess the reliability of evidence previously obtained as there are doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and documentation.
(a)	Determine the professional and legal responsibilities applicable in the circumstances, including whether there is the requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
(b)	Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
(c)	If the auditor withdraws:
(i)	Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
(ii)	Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

MULTIPLE CHOICE QUESTIONS ANSWERS

1. (d) 2. (d) 3. (b) 4. (d)

❖ INTERGRATED CASE STUDY

Black & White Ltd. is into the business of manufacturing readymade garments in Amritsar. It procures all the raw material required for its production from Punjab, Himachal Pradesh & J&K. Its sales market, however, covers almost all the northern parts of the country. CA Anu is the engagement partner of Maheshwari & Co appointed as the statutory auditor of the company. She calls for a meeting of the engagement team to delegate work and responsibilities. During the audit, the engagement team comes across the following facts:-

- Woolen Private Limited is one of the vendors of the company from which the company has been purchasing wool for many years on a current account basis, but no single purchase has been made in the last nine months, and the outstanding balance stands as it is in the books of accounts. CA Anu wants to confirm the balance and requests the CFO of the company for sending a balance confirmation request to Woolen Private Ltd., to which he refuses and is not willing.
- The Fashion Jingo Ltd. is one of the customers of the company and hasn't replied to CA Anu's positive balance confirmation request sent.
- Mr X, one of the fashion designers, had sold his designs to the company but owing to a dispute, the contract got cancelled, and now both the parties are under litigation in the local court of law. The engagement team is guided as to the procedures to be designed and performed to identify this matter.
- CA Anu simultaneously seeks direct communication with the company's external legal counsel sensing the risk of material misstatement. However, it ends up in vain as the external legal counsel, Mr. Chadha, refuses to comment. She is unable to obtain sufficient appropriate audit evidence in this regard through alternative audit procedures either.

The team documents all the relevant information w.r.t. the above facts, and CA Anu issues the audit report accordingly.

Multiple Choice Questions

1. **Fashion Jingo Ltd. has not responded to CA Anu's request. What should be proper**

	course of action for her in such a situation?
(a)	Perform alternative audit procedures
(b)	Consider it as a negative confirmation
(c)	Give a Qualified opinion
(d)	Should visit the customer company premises herself and confirm the balance on the spot.
2.	**With respect to advocate Chadha's cold shoulder to CA Anu's request, what she should do?**
(a)	Modify her audit opinion
(b)	Give an unqualified opinion
(c)	Give a disclaimer of opinion
(d)	Withdraw from this engagement
3.	**What should be CA Anu's first and foremost response in the case of request made relating to balance confirmation from Woolen Pvt. Ltd.?**
(a)	Perform alternate audit procedures.
(b)	Withdraw from the engagement.
(c)	Communicate with Those charged with Governance telling the effects on his audit opinion.
(d)	Inquire as to the reasons behind the management's response and seek audit evidence as to its validity and reasonableness.
4.	**Which of the following procedures will not be performed by the engagement team as audit procedures while dealing with the case of Mr. X?**
(a)	Inquiry of Management.
(b)	Inquiry of Mr. X
(c)	Reviewing Minutes of Meetings
(d)	Reviewing Legal expenses account
	ANSWERS
1.	(a) 2. (a) 3. (d) 4. (b)

CHAPTER - 6

COMPLETION AND REVIEW

❖ **TEST YOUR UNDESTANDING**

1. "Move Fast Limited" is engaged in the manufacturing of shoes and slippers located in Bahadurgarh in Haryana. Due to unprecedented rains in the area in the month of September 2022, many areas of the town got inundated due to the choking of sewer systems. As a result of the above, the company's premises located in town were also affected, resulting in damage of stocks.

The company has lodged a claim with the insurance company for Rs.1 crore, and the same is shown as a claim receivable as of 31st March 2023, as the claim was not settled at year end.

The insurance surveyor appointed in the case submitted a report to the insurance company recommending a claim of ₹45 lacs in the month of April 2023. The company has also given its consent for the same, and the settled amount of ₹45 lacs was transferred to the bank account of the company on 15th May 2023.

You have just finished performing substantive procedures of the company by the end of May 2023. Is there any responsibility cast upon you as auditor of the company in the above situation?

Ans. The given situation provides evidence of conditions that existed at the date of financial statements. Initially, the company had lodged claim of ₹1 crore and the same is reflected as claim receivable in financial statements as on 31st March, 2023.

However, subsequent events occurring have provided evidence that claim was settled for ₹ 45 lacs only. Such settled amount has already been accepted by the company by providing its consent. Therefore, such events have provided fresh information about items included in financial statements.

Further, performance of substantive procedures has been finished implying that audit report is not yet issued.

Therefore, financial statements as on 31st March, 2023 should be adjusted to reflect fresh information emanating from described events and management should be asked to take appropriate action in this regard so that adjustment pertaining to above is

	properly reflected in financial statements in accordance with applicable financial reporting framework.
2.	CA Anuj is the auditor of a listed company, and he is in the midst of conducting an audit of the said company for the financial year ending 31st March 2023. At a meeting of the Board of Directors held on 17th April 2023, a dividend of ₹1 crore is proposed to equity shareholders @ ₹10/- per share, and such a proposal has a good chance of being approved in the AGM of the company to be held after few months. His audit procedures are near completion. He is contemplating finalizing the audit report by 31st July 2023. Is there any responsibility thrust upon him as auditor of the company?
Ans.	In the given situation, dividend has been proposed by Board of Directors on 17th April, 2023. It is an example of condition that arose after the reporting period. No liability exists for the company on reporting date because there is no obligation to pay at the reporting date in accordance with Ind AS 1. Therefore, above situation does not require recognition of above proposed dividend in financial statements. It is an example of events which does not require adjustments. However, it should be disclosed in financial statements in notes to accounts. Therefore, it should be ensured that it is disclosed in notes to accounts in financial statements. He should verify in accordance with SA 560 that it is so disclosed in notes to accounts.
3.	CA. Somya is auditor of a company engaged in rearing of poultry birds and obtaining eggs therefrom. The company has performed very well since its incorporation in 2013. Its sales had also grown and the company had expanded its market from the native northern state of promoters to far-flung areas in eastern parts of country. However, since last two years, company's fortunes have nosedived. First, due to the effects of the pandemic and then due to recurrent outbreaks of bird flu thrice in a span of two years. The company's sales have dipped from around ₹ 50 crores to ₹10 crores. Further, a major part of its livestock was also wiped off during bird flu. She is not optimistic about the going concern assumption followed by management.

	The management now wants to start with new batches of birds. The earlier working capital facilities of the company granted by bank have also been restructured to support the business. She was informed that the repayments of restructured working capital term loans are to begin from ensuing year. No fresh credit facilities have been granted by the bank. The company also plans longer credits from animal feed suppliers. The company plans to take additional measures to prevent the safety of live stocks, including aggressive vaccination, preventive health check-ups, and more frequent visits of veterinary staff.
	The villagers in surrounding areas have accused the company of spreading air pollution. The management has prepared a cash flow forecast for her examination. Discuss the approach to be adopted by her in examining the "going concern" assumption keeping in view above with specific reference to cash flow forecast.
Ans.	In accordance with SA 570,"Going Concern", if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern by performing additional audit procedures, including consideration of mitigating factors. Where the entity has prepared a cash flow forecast, and analysis of forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions, it includes
(i)	Evaluating the reliability of the underlying data generated to prepare the forecast and
(ii)	Determining whether there is adequate support for the assumptions underlying the forecast.
	In the above situation, cash flow forecast has been prepared by management. Therefore, she should carefully evaluate assumptions underlying forecast and also reliability of data to prepare the forecast. For example: -
•	She should verify assumption regarding fresh batch of livestock. The bankers have not provided fresh credit facilities. How funds from the same would be arranged? The reasonability of assumption in cash flow forecast needs to be looked into.

•	She needs to check loan sanction letters/agreement to verify when repayments are beginning to see their accuracy in cash flow forecasts.
•	The company plans to avail longer credits from animal feed suppliers. In the downturn situation of the company, how would suppliers extend longer credits? This is going to have effect on the cash flow forecast.
•	Whether company has accounted for increased expenditure on preventive health check-up, vaccination and more frequent visits of veterinary staff in cash flow forecast.
•	Since villagers have accused the company of spreading air pollution, how does the company plan to deal with the same? Whether any proposed expenditure in this regard is accounted for in the cash flow statement. She may also consider other implications of this issue and possible effect on cash flows.
4.	CA Sooraj finds that key financial ratios of a company, like current ratio, debt-service coverage ratio, inventory turnover ratio, and trade receivables turnover ratio, are in red and have deteriorated considerably as compared to last year. The company is also not able to pay to its creditors on time. The company is requesting time and again to its bankers to grant additional credit facilities, but bankers are not listening.
	There have been significant losses to the company due to the lack of response of the company's products in the market. As a result of it, many products are sold at below cost price. There have been situations where the company is not able to pay the salaries of staff on time.
	All these negative findings have led him to conclude that the use of going concern as the basis of accounting is not appropriate. He brings this matter to the knowledge of CFO of the company. What is reporting duty cast upon him in such a scenario?
	The CFO informs him that the management, in turn, is ready to include in the disclosures the inappropriateness of its use of going concern assumption of accounting. How should it impact the auditor's opinion in case management itself discloses the inappropriateness of its use of going concern assumption of accounting now?
Ans.	If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the financial statements is inappropriate, the auditor shall

	express adverse opinion.
	The requirement for an auditor to express an adverse opinion applies regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern basis of accounting.
	Therefore, even if management discloses that its use of going concern assumption of accounting is inappropriate, it would have no impact on auditor's opinion. He would need to express adverse opinion.
5.	Following is a written representation given by RES Limited to its statutory auditors i.e. M/s CTK & Associates for audit of financial year 2022-23. The audit was completed and report dated 31.7.23 was issued.
	Point out, if there is any, anomaly in written representation reproduced below.
	15th April, 2023
	To
	CTK & Associates
	Chartered Accountants
	Dear Sir,
	This representation letter is provided in connection with your audit of the financial statements of RES Limited for the year ended March 31, 2023 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the applicable accounting standards in India.
	We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):
	Financial Statements
•	We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated 17th August 2022 for the preparation of the financial statements in accordance with financial reporting Standards, in particular, the financial statements give a true and fair view in accordance with the applicable accounting standards in India.
•	Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
•	Related party relationships and transactions have been appropriately accounted for and

	disclosed in accordance with the requirements of applicable accounting standards in India· (SA 550)
•	All events subsequent to the date of the financial statements and for which applicable accounting standards in India require adjustment or disclosure have been adjusted or disclosed· (SA 560)
•	The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole· A list of the uncorrected misstatements is attached to the representation letter· (SA 450)
	Information provided
•	We have provided you with: -
-	Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
-	Additional information that you have requested from us for the purpose of the audit; and
-	Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence·
•	All transactions have been recorded in the accounting records and are reflected in the financial statements·
•	We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud·
•	We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves: -
-	Management;
-	Employees who have significant roles in internal control; or
-	Others where the fraud could have a material effect on the financial statements·
•	We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others·
•	We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements·
•	We have disclosed to you the identity of the entity's related parties and all the

	related party relationships and transactions of which we are aware. (SA 550)
	Chief Financial Officer
Ans.	The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. As the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.
	In the given situation, written representation is dated 15th April 2023. The audit report is dated 31st July 2023. There is a considerable lag between date of written representations and date of audit report.
	It could signify that all subsequent events after date of financial statements requiring adjustments or disclosure may not have been adjusted or disclosed in the financial statements by management.
	As audit report is dated 31st July, 2023, it reflects that auditor has considered subsequent events occurring between date of financial statements and date of auditor's report. However, written representations pertain to 15th April 2023.
❖	**THEORY QUESTIONS**
1.	Ramadhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2023. The Audit Report for that year was signed by the Auditors on 04/05/2023. The Annual General Meeting was decided to be held during the month of August 2023. On 06/05/2023, the Company had received a communication from the Central Government that an amount of ₹ 5800 crore kept pending on account of incentives pertaining to Financial Year 2022-23 had been approved and the amount would be paid to the Company before the end of May 2023. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on

	31/03/2023. On 08/05/2023, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2023. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.
Ans.	**Facts Which Become Known to the Auditor after the Date of the Auditor's Report but Before the Date the Financial Statements are issued:** As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall
(i)	Discuss the matter with management and, where appropriate, those charged with governance.
(ii)	Determine whether the financial statements need amendment and, if so,
(iii)	Inquire how management intends to address the matter in the financial statements.
	If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.
	In the instant case, XYZ Company Ltd. received an amount of rupees 5800 crore on account of incentives pertaining to year 2022-23 in the month of May 2023 i.e. after finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Ramadhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2023.
	After applying the conditions given in SA 560, Ramadhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

2.	M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2023 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the issue involves uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the "Going Concern" would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter.
Ans.	**Reporting requirements in case of Uncertainty clamping on the Going Concern:** As per SA 570 "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements : (i)adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and (ii) disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business. If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
(i)	Draw attention to the note in the financial statements that discloses the matters set out above; and
(ii)	State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

	In the instant case, M/s Aircraft Ltd. is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of its ability to continue in near future. Therefore, a committee has been constituted to study this aspect and till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts. Therefore, the auditor should disclose about the material uncertainty and express an unmodified opinion and in his audit report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to draw attention to the note in the financial statements that discloses the matters set out above; and state that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.
3.	PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2000 crores and profits are INR 190 crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of and period covered by written representation in view of SA 580.
Ans.	As per SA 580, "Written Representations", as written representations are necessary

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

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

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

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

❖ **INTERGRATED CASE STUDY**

1. CA Sneha, a partner in M/s J & Associates, is carrying out a statutory audit of M/s ABC Stores Ltd. for the Financial Year 2022-23, and she is ready to sign her audit report on 01.07.2023. There are some written representations which are pending with the management of the company pertaining to such an audit, and she sent Deepak (her articled trainee), who is also a member of the engagement team, to the company's office for collection of the same.

	On returning back, Deepak tells CA Sneha that major stocks of the company got destroyed because of a fire in their plant on 27·06·2023, and it has affected the company's operations badly· However, the business operations are likely to be resumed by management at an alternate place·
	CA Sneha postponed the issuance of the audit report to consider the impact of such an event on the financial state of affairs of the company· She wants the management to disclose the impact of this unfortunate event in financial statements for the year 2022-23, to which management is disinclined· After the management's refusal, she issued her audit report on 15·07·2023·
	The management of the company seeks an appointment from CA Sneha to discuss an important matter on 20·07·2023· They informed her that the company had lost a lawsuit filed against it by one of the creditors on 18·07·2023 in a fast-track court, and now the company has to pay the plaintiff a huge amount of ₹2 crores· The events causing this lawsuit arose after 31·03·2023·
	CA Sneha is a bit perplexed, and her first question to the people from management visiting her office was whether audited financial statements have been made available to any third parties or filed with the regulator· The management responded negatively· Now, CA Sneha wants them to amend the financial statements to include the impact of this lawsuit on the financial affairs of the company· This time, they agreed and amended the financial statements accordingly to cover the impact of both the events - that of the fire in the plant and losing the lawsuit, but they requested CA Sneha to issue a new audit report against the earlier one dated 15·7·2023· The management amends the financial statements, which are finally approved on 25·7·2023· CA Sneha issues a new audit report·
	Considering the above situation, answer the following questions: -
1·	**What should be the appropriate date of signing of the new audit report?**
(a)	20·07·2023
(b)	Anytime between 15·07·2023 & 18·07·2023
(c)	On or after 25·07·2023
(d)	Anytime between 15·07·2023 & 25·07·2023

2.	**CA Sneha would have taken into account a lot of procedures to get knowledge of the events occurring after the balance sheet date up to the date of the audit report relating to the company. Which of the following does not fall under such audit procedures as per SA 560?**
(a)	Obtaining an understanding of the management's procedures set up to identify subsequent events.
(b)	Inquiring of the management w.r.t the occurrence of any such subsequent events.
(c)	Reading the minutes of the meetings of the board held after the balance sheet date during this period.
(d)	Getting the Interim financial statements prepared till the date of the audit report mandatorily as a condition to issue the audit report
3.	**W.r.t the first audit report dated 15.07.2023, which type of opinion was most likely provided by her?**
(a)	Modified opinion
(b)	Unqualified opinion
(c)	Disclaimer of opinion
(d)	Including a statement in Emphasis of Matter/Other matters para
4.	**W.r.t the new audit report issued, which type of opinion is most appropriate?**
(a)	Disclaimer of opinion
(b)	Unqualified opinion
(c)	Adverse opinion
(d)	Unqualified opinion and a statement in Emphasis of Matter/Other matters para.
5.	**The fire event occurring on 27.6.2023 in the company's plant requires the following action on part of management-:**
(a)	Disclosure in notes to accounts
(b)	Adjustment in financial statements
(c)	Waiting for the insurance company to settle the claim
(d)	Preparing financial statements afresh

ANSWERS

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

CASE STUDY – 2

CA Namit, a partner in M/s J & Associates, is carrying out a statutory audit of M/s XYZ Gears Ltd. for the Financial Year 2022-23 and is in the process of issuing an audit report. His articled trainee, Manpreet, is very curious about knowing the various facts relating to the consideration of Standards on Auditing while carrying out an audit and issuing the audit report.

She asks CA Namit about the relevance of the Going concern assumption in their audit and further reporting to which CA Namit explains to her that both parties have got their own responsibilities w.r.t this accounting assumption. The management of the company has its own set of responsibilities while reporting upon the same is a very strict and sensitive matter for the auditor as per the requirement of the relevant standard on auditing.

He tells Manpreet to prepare a list of procedures as she thinks that an auditor should carry out when he identifies that the company is facing a downfall in business never seen before due to newer technology in the market and other competitors having sprung up swiftly adopting new technology.

He finds that this condition may cast significant doubt on the company's ability to continue as a going concern.

Manpreet thinks and researches and hands over a list of audit procedures to CA Namit for a final discussion. CA Namit clarifies accordingly. CA Namit concludes that the use of a going concern basis of accounting is appropriate in this company's case, but a material uncertainty exists as to the future prospects of the current business. However, the management has made an appropriate disclosure w.r.t such material uncertainty in the financial statements.

Manpreet's list of audit procedures includes: -

(I) Requesting management to make its assessment relating to the company's ability to continue as a going concern.

(II) Evaluating management's plan of future actions.

(III)	Make a specific assessment of the company's ability to continue as a going concern.
(IV)	Analysing the cash flow forecast of the company.
(V)	Considering the additional facts or information available since the date of management's assessment
(VI)	Make appropriate disclosures in the financial statements in connection with going concerns.
(VII)	Requesting Written Representation from management regarding the plans of future actions and the feasibility of these plans.
(VIII)	Writing a para addressed to the stakeholders in the audit report citing the results of procedures adhered to relating to the going concern assumption.
	Keeping in view above, answer the following questions: -
1.	**CA Namit tells Manpreet about the auditor's responsibilities in the above case on the matter under discussion. Which of the following doesn't fall under the auditor's responsibilities?**
(a)	Obtaining sufficient and appropriate audit evidence on the matter under discussion.
(b)	Conclude on the appropriateness of the management's use of going concern.
(c)	Assessing whether a material uncertainty exists about the company's ability to continue as a going concern.
(d)	Guarantee the company's ability to continue as a going concern based upon his audit procedures.
2.	**Identify which set of audit procedures are relevant in the above case scenario as per the list prepared by Manpreet.**
(a)	(I), (II), (IV), (V) & (VII)
(b)	(I), (III) & (V)
(c)	(II), (IV), (VI), (VII) & (VIII)
(d)	(I), (II), (III), (IV) & (V).
3.	**CA Namit's conclusion in the above case will lead him to give which type of audit opinion from the following?**
(I)	Modified opinion

(II)	Unmodified opinion.
(III)	A separate section "Material uncertainty wrt. Going concern" in his audit report.
(a)	(I) only
(b)	(II) only
(c)	(I) & (III)
(d)	(II) & (III)
4.	**Consider the following statements: -**
	<u>Statement</u> I: - The Management is under a responsibility to make specific assessment
	of the company's ability to continue as a going concern.
	<u>Statement</u> II: The Management is under a responsibility to make appropriate disclosures
	in connection with going concern in the financial statements.
(a)	Statement I is correct only.
(b)	Statement II is correct only as Statement I falls under the auditor's responsibilities.
(c)	Both statements are correct.
(d)	Both statements are incorrect.
5.	**Which of the following is most appropriate regarding "going concern" assumption?**
(a)	It signifies that company is reflecting net losses in its financial statements.
(b)	It signifies that company is not modernising its plant and machinery.
(c)	It signifies that company has no intention of curtailing materially the scale of its operations in foreseeable future.
(d)	It signifies that assets are likely to be recorded at the prices they would fetch.
	ANSWERS
1.	(d) 2. (a) 3. (d) 4. (c) 5. (c)
	CASE STUDY 3
	Infinity Hospitality Private Limited was established in 1996 and was in the business of running hotels in tourist destinations in state of Kerala. It took leased properties on long-term leases ranging from 10 to 12 years, most with a lock-in of a whole term. The terms did not cover the *force majeure clause* The Company was family-owned

business and had created a good reputation as value for a money- budget hotel. Most of the time, hotels clocked 60 to 75% occupancy rate, and during the festive season/ vacations, hotel business clocked 100% Occupancy.

The capital structure of the company was debt oriented and over-leveraged. Primary working capital was blocked in maintaining and up-keeping the leased properties, running the restaurant, leases, food and beverages, salary, Director's remuneration etc.

The owners looked at the business as a cash cow and did not plough back the funds to expand the business but were content with the decent profits the hotels were generating.

As the properties were leased and not owned, most of the cash flow generated from operations was used in servicing the property and huge loans from financial institutions. What was left was withdrawn as Directors' remuneration and dividend.

Everything was going on smoothly. However, there were flash floods in Kerala due to unprecedented rains. There were landslides and roads were blocked. The entire tourist season was washed away due to infrastructural challenges. Accessibility to resorts and hotels was badly hindered. Logistics support took time to reach in far flung areas. Visit to the "The God's own country" as last on the mind of tourists. The company was hardly trying to get back to some semblance of normalcy when pandemic struck. It was double whammy for the company.

The impact on travel, tourism and hospitality business was very severe. The management of Infinity Hospitality Private Limited believed that bad days would end soon and the business would be back to normal. They also were optimistic about the government coming up with support for the industry and were hopeful of negotiating with lessors and Financial Institutions for relief. They decided on humanitarian grounds not to terminate the employees and continued paying them a regular salary, maybe deferring 25% to be paid after one year. The immediate fallout was on the top line as suddenly, the business stopped.

The auditors, M/s XYZ and Associates, were conducting the audit of the company and were grappling with the situation and are seeking your guidance for the course of action they need to follow.

	THEORETICAL QUESTIONS
	Based on the case scenario, you are required to provide your answers to the following:-
1.	What additional audit procedures must the auditor undertake as per requirements of SA 570 based on the facts given in the case?
2.	According to your judgment, what risk assessment procedures should the auditor consider for arriving at a conclusion based on the management assertion of the entity being Going Concern?
3.	What should be approach of the auditor if the management agrees that the material uncertainly exists, but the entity is a Going Concern? Also discuss reporting requirements.
4.	What if the auditor believes, on the basis of his additional audit procedures conducted to conclude that the entity is not a Going Concern, but the management is not accepting the same? What course of action the auditor needs to undertake?
5.	What kind of written representation does the auditor need to obtain in case of the scenario covered in Q3 above?
	Multiple Choice Questions
1.	**Which of the following is not a financial event/ condition that may cast significant doubt on companies' ability to continue as a going concern as per SA 570?**
(a)	Change from credit to cash on delivery model with suppliers
(b)	Arrears or discontinuance of dividend
(c)	Opening of a new chain of hotels by renowned competitor near the entity's area
(d)	Adverse key financial ratios
2.	**Please choose the mitigating measure as the management is unable to pay lease rentals.**
(a)	Cancel the lease
(b)	Restructure the lease agreement and negotiate for deferment and relief
(c)	Terminate the employees and pay the lessor
(d)	All the above
3.	**Which one of the following is not a responsibility of the auditor relating to**

	communicating events or conditions identified that may cast significant doubt on the entity's Going Concern assertion?
(a)	Perform additional audit procedures to identify events/ conditions beyond 12 months from the date of financial statements
(b)	Whether the events constitute a material uncertainty
(c)	The adequacy of related discloses in the financial statements
(d)	The implications for the auditor's report
4.	**Written Representation need to be mandatorily obtained from:**
(a)	Audit Committee
(b)	Client relationship Managers
(c)	Company Secretary
(d)	CFO
5.	**Which of the following is not main pillar of written representations?**
(a)	The management responsibility for preparation of financial statement
(b)	Assertion related to completeness
(c)	Assertion related to access to data and information
(d)	Written representation provides sufficient appropriate audit evidence
	ANSWERS
1.	In the given case scenario the events and conditions have been identified which cast significant doubt on the entity's ability to continue as a Going Concern, the auditor needs to obtain sufficient appropriate audit evidence to determine whether or not material uncertainty and gather evidence including of mitigating factors. It can be done by performing following additional procedures: -
•	Analysing and discussing cash flow, profit and other relevant forecast with management.
•	Analysing and discussing the entity's latest available interim financial statement.
•	Reading the terms of loan agreements and determining whether any have been breached.

•	Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties·
•	Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their out come and the estimate of their financial implications·
•	Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third party and assessing the financial ability of such parties to provide additional funds·
•	Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern·
•	Confirming the existence, terms and adequacy of borrowing facilities·
•	Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment·
•	Evaluating management's plans for further actions in relation to its going concern assessment, whether the outcome of these plan is likely to improve the situation and whether the management's plans are feasible in the circumstances·
•	Evaluating management's plans for future actions may include inquiries of management as to its plan for future action, including, for example, its plan to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital·
•	Considering whether any additional facts or information have become available since the date on which management made it assessment·
•	Requesting written representation from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans·
2·	When performing risk assessment procedures as required by SA-315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue the going concern· In so doing, the auditor shall consider whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern·
•	The auditor shall discuss the assessment with management and determine whether

	management has identified events and conditions that, individually or collectively, cast significant doubt on the entity's ability to continue as a going concern and if so, management's plan to address them.
•	The auditor shall specifically draw attention of Management on following events or condition and get the response on how they plan to address them:
	The company is debt heavy and over leveraged. The leased properties are having considerable lock-in period with absence of force majeure clause. There are no contingency reserves available with company. All these factors shall be taken into account while performing risk assessment procedures.
3.	If the auditor concludes that the management's use of going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditors shall determine whether the financial statements:
(a)	Adequately disclose the principal events or conditions that make a significant doubt on the entity's ability to continue as a going concern and management's plan to deal with these events or conditions, and
(b)	Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on entity's ability to continue as a going concern and therefore, that it may be unable to realize its assets, and discharge its liabilities in the normal course of business.
(c)	The disclosures may include:
i.	Management's evaluation of the significance of the events or conditions relating to the entity's ability to meet its obligations; or
ii.	Significant judgements made by management as a part of its assessment of the entity's ability to continue as a going concern
iii.	Disclosures about the magnitude of the potential impact of the principal events or conditions, and the likelihood and timing of the occurrence.
iv.	The auditor shall express and unmodified opinion and the auditor's reports shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
•	Draw attention to the note in the financial statement that discloses the events or conditions and

•	State that these events are conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and the auditor's opinion is not modified in respect of the matter and how the matter was addressed in the audit.
4.	If management has prepared financial statements using the Going Concern assertion to which auditor differs as according to his judgement, the Going Concern assertion by the management is not appropriate, then the auditor is required to express an adverse opinion.
5.	The auditor needs to obtain written representation from management and where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.
	MULTIPLE CHOICE QUESTIONS ANSWERS
1.	(c) 2. (b) 3. (a) 4. (d) 5. (d)

CHAPTER - 7

REPORTING

❖ **TEST YOUR UNDERSTANDING**

1. The auditors of a listed company have affirmed in their audit report communication of significant audit findings including significant deficiencies in internal control of the company identified to those charged with governance. Where are such matters included in audit report of a listed company? Also well upon importance of such communication.

Ans. Such matters are in nature of auditor's responsibilities and are stated in "The Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report in accordance with SA 700. Communication of significant audit findings and deficiencies identified in internal control to those charged with governance is one of important responsibilities of auditor.

Such communication assists those charged with governance in fulfilling their responsibility to oversee the financial reporting process and in fulfilling their oversight responsibilities.

2. **Below is draft extract of audit report of a listed company. Para (A) below reflects certain matter stated in audit report communicated with CFO of company and Para (B) is in nature of auditor's response to said matter.**

(A) The Company recognizes revenues when the control of goods is transferred to the customer at the net consideration which the Company expects to receive for those goods from customers in accordance with contracts terms and conditions.

The terms of sales arrangements based on the terms and conditions of relevant contract and nature of discount and rebates create complexities that require judgment in determining revenues.

(B) We read the Company's revenue recognition policy and assessed its compliance in terms of Ind AS 115 "Revenue from contracts with customers".

We assessed design and tested the operating effectiveness of internal controls related to sales and rebates/discounts.

We tested on a sample basis that revenue has been recognized in the proper period

	with reference to the supporting documents including confirmations from customers.
	From description given above, identify what auditors are trying to report and under what heading such matter should be reflected in audit report of the company?
Ans.	The above matter is in nature of Key audit matter and should be stated under heading "Key audit matters" in audit report. Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.
	SA 701 states that the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, significant auditor judgments relating to areas in the financial statements that involved significant management judgment including accounting estimates that have been identified as having high estimation uncertainty be taken into account.
	The above described matter relates to revenue recognition and creation of complexities requiring judgment in revenues. Further, the description also describes how the matter was addressed by auditors by performing various audit procedures in accordance with SA 701.
3.	PTD Limited is engaged in business of executing construction contracts for its clients. There are non-current receivables outstanding in financial statements of the company as on 31st March, 2023 for ₹500 crore. Such amounts represent claims raised by the company on its clients relating to cost overruns necessitated due to delays caused by clients, change in work specifications & related matters. Besides negotiations, the company has also gone for arbitration in some of the said cases. The management of company has considered above amounts to be fully recoverable as stated in notes to accounts.
	CA. Piyush, auditor of the company, has relied only upon management representation in this regard. Besides, he has decided to include the said matter in "Emphasis of Matter" Paragraph in audit report.
	How do you view decision to include above matter in "Emphasis of Matter" Paragraph by auditor of the company?

Ans·	In accordance with SA 706, Emphasis of Matter Paragraph is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements·
	As per SA 706, the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:-
(a)	A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements or
(b)	As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report·
	Further, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor would not be required to modify the opinion in accordance with SA 705 as a result of the matter·
	In the given situation, auditor has relied upon management representation letter only· He has not performed any other audit procedures like verifying contracts with customers, status of arbitration proceedings etc· Since management representations by themselves do not constitute sufficient appropriate evidence, performing necessary audit procedures may lead auditor to conclude that modification in opinion is necessary· In such circumstances, matter cannot be included in Emphasis of matter Paragraph·
	Therefore, auditor should form his opinion by performing necessary audit procedures and obtaining sufficient appropriate evidence· It is only when he concludes that modification of opinion is not required as a result of said matter in terms of SA 705, the said matter may be included in Emphasis of Matter paragraph·
❖	**THEORY QUESTIONS**
1·	Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?

Ans·	Refer Para 5·
2·	Write a short note on Emphasis of matter paragraph in Audit Reports·
Ans·	Refer Para 6·
3·	Write a short note on Certificate for Special Purpose vs· Audit Report·
Ans·	**Certificate for Special Purpose vs· Audit Report:** A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion· The term 'certificate' is, therefore, used where the auditor verifies the accuracy of facts· An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company· An auditor's certificate represents that he has verified certain figures and is in a position to vouch safe their accuracy as per his examination of documents and books of account· A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon· Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein· On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill· The 'report' involves expression of opinion which may differ from one professional to another· There is no question of exactitude in case of a report since the information contained therein is based on estimates and involves judgement element·
4·	Compare and explain the following:
(i)	Reporting to Shareholders vs· Reporting to those Charged with Governance
(ii)	Audit Qualification vs· Emphasis of Matter·
Ans·	**(i)** Reporting to Shareholders vs· Reporting to those Charged with Governance:

REPORT	
Reporting to Shareholders	**Reporting to those Charged with Governance**
• Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.	• Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.
• Statutory Audit Report is on true and fair view and as per prescribed Format.	• It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
• Statutory Audit Reports are in public domain.	• Reporting to those Charged with Governance is an internal document i.e., private report.

(ii) Audit Qualification vs. Emphasis of Matter:

REPORT	
Audit Qualification	**Emphasis of Matter**
• Standard on Auditing 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with the provisions relating to Audit Qualification.	• Standard on Auditing 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with the provisions relating to Emphasis of Matter.
• Audit Qualifications are modifications to the opinion of the Auditors opinion where the auditor concludes that there is a material misstatement in the financial statement due to which the modification to the opinion of the auditor is necessary.	• Emphasis of Matter is a paragraph which is included in auditor's report to draw users' attention to important matter(s) which are already disclosed in Financial Statements and are fundamental to users' for understanding of Financial Statements. • The Emphasis of matter pre- supposes that there is Sufficient Appropriate audit evidence and the matter has been correctly disclosed.

• Audit Qualifications are given when auditor has concluded that the financial statements are materially misstated or do not confirm to the financial reporting framework. Depending upon the nature of material misstatement being pervasive or otherwise the appropriate type of modified opinion is issued.	• Emphasis of Matter is a paragraph which is issued when the auditor feels that it is necessary to invite attention to a particular mater which has been appropriately disclosed in the financial statements which in the opinion of the auditor is necessary for better understanding of the financial statement.

5. "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 considerationrenqsuired for expressing:

(a) Qualified Opinion;

(b) Adverse Opinion and

(c) Disclaimer of Opinion

Ans. Refer Para 5.8

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

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

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

(i)	Qualified Opinion: The auditor shall express a qualified opinion when:
(a)	The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
(b)	The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive·
(ii)	Adverse Opinion: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements·
(iii)	Disclaimer of Opinion: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive· The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements·
	If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation·
	If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity, and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence·
7·	KPI Ltd is a joint venture of KPI Inc, a company based in US, and OPQ Ltd, a

company based in Japan (hereinafter referred to as 'JV partners'). KPI Ltd was registered in India and is operating as a marketing support company for KPI Inc. All the costs of KPI Ltd are incurred in India and entire revenue of KPI Inc is generated in USD. The entire funding requirements of KPI Ltd are taken care of by the JV partners. Since KPI Ltd is based in India, hence it is also required to get its financial statements audited.

The company appointed new auditors for the audit of the financial statements for the year ended 31 March 2023 after doing all appointment formalities wherein auditors are required to ensure compliance with Standards on Auditing and Internal Standards on Auditing.

As an expert you are required to advise the auditor about the requirements regarding auditor's report for audits conducted in accordance with both Standards on Auditing issued by ICAI and International Standards on Auditing.

Ans. Refer Para 3.4

8. TUV Ltd. is a company engaged in the business of manufacture of spare parts. Saroj & Associates are the statutory auditors of the company for the FY 2022-23. During the course of audit, CA Saroj noticed that the company had a major customer, namely, Korean Mart from South Korea. Owing to an outbreak of war and subsequent destruction leading to government ban on import and export in South Korea, the demand from Korean Mart for the products of TUV Ltd. ended for an unforeseeable time period. When discussed with the Management, CA Saroj was told that the company is in the process of identifying new customers for their products. CA Saroj understands that though the use of going concern assumption is appropriate but a material uncertainty exists with respect to the identification of new customers. This fact is duly reflected in the financial statements of TUV Ltd. for the FY 2022- 23. How should CA Saroj deal with this matter in the auditor's report for the FY 2022-23?

Ans. As per SA 570, "Going Concern", loss of a major market or a key customer is one of the operating indicators that may cast significant doubt on the company's ability to continue as a going concern.

In the present case, TUV Ltd. has a key customer in South Korea from which the

	demand for its products has ended on account of outbreak of war, subsequent destruction and government ban on import and export in South Korea. Further, the company has not yet identified new customers and is in the process of doing the same. As such, the identification of new customer is a material uncertainty that cast a significant doubt on the company's ability to continue as a going concern.
	However, this matter is duly disclosed by the management of TUV Ltd. in the financial statements for the year ended 31.03.2023.
	As such, considering that the going concern assumption is appropriate but a material uncertainty exists with respect to identification of new customer, CA Saroj should:
(1)	Express an unmodified opinion and
(2)	Include in his audit report, a separate section under the heading "Material Uncertainty Related to Going Concern" to:
(i)	Draw attention to the note in the financial statements that discloses the matters and
(ii)	State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.
	Thus, CA Saroj should deal with this matter in his auditor's report in the above mentioned manner.
9.	Sun Moon Ltd. is a power generating company which uses coal as raw material for its power generating plant. The company has been allotted coal blocks in the state of Jharkhand and Odisha. During the FY 2022-23, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Sun Moon Ltd. This happened in the month of December 2023 and as such entire power generation process of Sun Moon Ltd, came to a halt in that month. As a result of such ban, and the resultant stoppage of the production process, many key managerial personnel of the company left the company. There were delays in the of payment of wages and salaries and the banks from whom the company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of the company.

	Further, when discussed with the management, the statutory auditor understood that the company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected the financial statements of Sun Moon Ltd. What course of action should the statutory auditor of the company consider in such situation?
Ans.	SA 570 - "Going Concern" deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.
	The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.
	When the use of Going Concern Basis of Accounting Is Inappropriate i.e. if the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.
	Also when adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements the auditor shall:
(i)	Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and
(ii)	In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.
	In the present case, the following circumstances indicate the inability of Sun Moon Ltd. to continue as a going concern:
•	Ban on the allotment of coal blocks
•	Halt in power generation
•	Key Managerial Personnel leaving the company.

•	Banks decided not to extend further finance and not to fund the working capital requirements of the company.
•	Non availability of sound action plan to mitigate such circumstances.
	Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the company. Further, such circumstances are not reflected in the financial statements of the company. As such, the statutory auditor of Sun Moon Ltd. should:
(1)	Express an adverse opinion in accordance with SA 705 (Revised) and
(2)	In the Basis of Opinion paragraph of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.
	The auditor is also required to report as per clause (xix) of CARO 2020 that on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date.
10.	CA Omkar is the statutory auditor of Sabhyata Ltd. for the FY 2022-23. The company is engaged in the business of manufacture of floor tiles. During the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Discuss as to how CA Omkar should deal with the situation in the auditor's report.
Ans.	SA 705 (Revised) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.
	The decision regarding which type of modified opinion is appropriate depends upon:

(a)	The nature of the matter giving rise to the modification, that is, whether the
	financial statements are materially misstated or, in the case of an inability to obtain
	sufficient appropriate audit evidence, may be materially misstated; and
(b)	The auditor's judgment about the pervasiveness of the effects or possible effects of
	the matter on the financial statements.
	Further, the auditor shall modify the opinion in the auditor's report when the auditor
	concludes that based on the audit evidence obtained, the financial statements as a
	whole are not free from material misstatement.
	In the present case, during the course of audit, CA Omkar obtained certain audit
	evidence which were not consistent with the affirmation made in the financial
	statements. Therefore, CA Omkar should modify his report in accordance with SA
	705- "Modifications to The Opinion in the Independent Auditor's Report.
	CA Omkar should issue either a qualified opinion or an adverse opinion depending upon
	the circumstances of the case:
(a)	CA Omkar shall express a qualified opinion when, having obtained sufficient appropriate
	audit evidence, he concludes that misstatements, individually or in the aggregate, are
	material, but not pervasive, to the financial statements
(b)	CA Omkar shall express an adverse opinion, when the auditor, having obtained sufficient
	appropriate audit evidence, concludes that misstatements, individually or in the
	aggregate, are both material and pervasive to the financial statements.
	Thus, since CA Omkar has obtained audit evidence which are inconsistent with the
	affirmations made in the financial statement, CA Omkar should modify his opinion as
	per the circumstances of the case.
❖	**INTEGRATED CASE SCENARIO**
	CA. Raghav is in midst of finalizing audit reports of five clients. On reviewing each
	file, it is noticed as under: -
[A]	In case of a company engaged in business of selling of agricultural products which are
	outside ambit of GST, engagement team has found that substantial part of revenues
	of the company (about 80%) is generated through cash sales. However, there is no
	proper system and internal control to verify accuracy of revenues generated through

	cash sales. Therefore, team has been unable to verify such revenues generated through cash sales.
[B]	TS Limited has been dragged to court by BS Limited for stealing its trade secrets using cyber theft and filed a claim for ₹50 crore. On reviewing audit file of TS Limited, CA Raghav finds that legal opinion of company's standing counsel is ambiguous. There are precedent case laws both in favour and against on such issue. The financial statements of TS Limited are silent on this litigation matter.
[C]	It is noticed on review of audit file of a client that net profit before tax was ₹2 crore on a turnover of ₹100 crore. There is an export receivable from a chain of stores outstanding in financial statements of ₹3 crore for which there is no chance of recovery. The said chain of stores has gone bankrupt. There is also no hope of recovering money through ECGC (Export credit Guarantee Corporation) due to certain technical issues. Debt has not been written off by the client despite being communicated to client.
[D]	On reviewing file of a small finance bank, it was noticed that team has drafted following para proposed to be included under Emphasis of Matter paragraph: "Concerns are raised regarding "Going Concern" status of the Bank. However, the Bank feels that it continues to remain a "Going Concern" in view of reasons stated in note 10. Our opinion is not modified in respect of this matter."
[E]	On reviewing file of a client, it is noticed that team was not informed about finished goods of ₹1 crore lying at a location taken on rent in February 2023. The said issue was flagged at time of reconciling inventories by the team. Hence, team could not attend physical inventory counting. The alternative procedures cannot be performed in absence of adequate records pertaining to above location. Total inventories reflected in financial statements is ₹ 8 crores. PBT of client is ₹10 crores.
	Based upon above answer the following questions:-
1.	**As regards description regarding revenues generated through cash sales of a company, which of the following statements is most appropriate in terms of SA 705?**
(a)	Qualified opinion will be issued and basis for qualified opinion will also be provided.
(b)	Adverse opinion will be issued and basis for adverse opinion will also be provided.
(c)	A disclaimer of opinion will be issued and basis for disclaimer of opinion will also be

	provided· Besides, statement in audit report will be changed from "financial statements have been audited" to "auditor was engaged to audit financial statements·"
(d)	A disclaimer of opinion will be issued and basis for disclaimer of opinion will also be provided· Besides, statement in audit report will be changed from "financial statements have been audited" to "financial statements have not been audited·"
2·	**Considering litigation matter of TS Limited, which of the following statements is most appropriate in this regard?**
(a)	Unmodified opinion needs to be expressed by auditor·
(b)	It amounts to non-disclosure of a material contingent liability by the company· Adverse opinion needs to be expressed by auditor·
(c)	It amounts to non-disclosure of a material contingent liability by the company· Qualified opinion needs to be expressed by auditor·
(d)	The company has not made a material provision resulting in material misstatement· Adverse opinion needs to be expressed by auditor·
3·	**Considering description of issue regarding non-recoverability of export receivable of ₹3 crore from a chain of stores, which type of opinion is appropriate to be issued in audit report?**
(a)	Disclaimer of opinion
(b)	Unmodified opinion
(c)	Qualified opinion
(d)	Adverse opinion
4·	**As regards matter of going concern in respect of a small finance Bank, which of the following statements is most appropriate?**
(a)	The para drafted by team is proper and in accordance with SA 570 since auditor has decided to give unmodified opinion·
(b)	The para drafted by team is proper and in accordance with SA 570 since matter has been disclosed in notes to accounts by bank management·
(c)	Instead of giving emphasis of matter paragraph, separate paragraph on 'Material Uncertainty Related to Going Concern' in report should be given in accordance with

	SA 570.
(d)	Separate paragraph on 'Material Uncertainty Related to Going Concern' under the heading "Emphasis of matter" paragraph in report should be given in accordance with SA 570.
5.	**Regarding issue of not informing team regarding inventory of finished goods lying at a location taken on rent in February 2023, which type of opinion is appropriate to be issued in case of this client?**
(a)	Modified opinion
(b)	Qualified opinion
(c)	Unmodified opinion
(d)	Either Modified or Qualified opinion
	ANSWERS

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

CHAPTER - 8

SPECIALISED AREAS

❖ TEST YOUR UNDERSTANDING

1. CA Lalita is auditor of a company. She is also offered professional work of audit of financial statements prepared specifically for meeting requirements of a loan agreement for the same period. She chooses to accept work and has made up her mind to disclose this fact in "Other matter Paragraph" in audit report to be issued by her for this specific engagement. Is her approach proper?

Ans. In the given situation, the approach of CA Lalita is proper. There is no bar upon accepting such an engagement even though she is the auditor of the company. Besides, she has intended to disclose this fact in "Other Matter Paragraph" of the audit report to be issued by her for such specific engagement.

2. CA Lakshmi has prepared a draft audit report for financial statements of X Ltd. prepared in accordance with financial reporting provisions of a contract with Y Ltd. She has drafted an unmodified opinion to be given in audit report. Besides, she has also drawn attention in draft audit report to Note "A "to the financial statements which describes the basis of accounting (under the heading "Basis of accounting"). How she should ensure that report would not be misused? Draft a suitable para to be included in the report for this purpose.

Ans. She may consider it appropriate to indicate that the auditor's report is intended solely for specific users. Depending on the law or regulation applicable, this may be achieved by restricting the distribution or use of the auditor's report. In these circumstances, the paragraph alerting the readers may be expanded to include these other matters and the heading modified accordingly. The draft para should read as under:-

Basis of Accounting and Restriction on Distribution and Use

Without modifying our opinion, we draw attention to Note A to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the company to comply with the financial reporting provisions of

	the contract referred to above. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for X Ltd. and Y Ltd. and should not be distributed to or used by parties other than X Ltd. and Y Ltd.
3.	CA M. Surya is auditor for financial statements of an entity prepared in accordance with financial reporting provisions of a contract. He is also offered audit of trade receivables appearing in above financial statements. Can he accept such engagement? Discuss brief outline of his audit approach in such a situation.
Ans.	The single financial statement or the specific element, account or item of a financial statement may be prepared in accordance with a general or special purpose framework. If prepared in accordance with a special purpose framework, SA 800 also applies to the audit.
	In the given case, financial statements of the entity are prepared in accordance with financial reporting provisions of a contract. It is a special purpose framework. The auditor of financial statements prepared in accordance with special purpose framework is also offered audit of trade receivables appearing in above financial statements which relates to audit of element of financial statements prepared in accordance with special purpose framework is also offered audit of trade receivables appearing in above financial statements which relates to audit of element of financial statements prepared in accordance with special purpose framework. Hence, his audit approach should include considering requirements of both SA 800 and SA 805.
4.	CA G is offered appointment for audit of trade payables of financial statements of a company. However, financial statements prepared under Companies Act, 2013 are audited by CA Jignesh. Discuss why it would be practically difficult for CA G to perform such an audit.
Ans.	Compliance with the requirements of SAs relevant to the audit of a single financial statement or of a specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete set of financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, including its internal control, as an auditor who

	also audits the entity's complete set of financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records.
	In the case of an audit of a specific element of a financial statement, certain SAs require audit work that may be disproportionate to the element being audited. If the auditor concludes that an audit of a single financial statement or of a specific element of a financial statement in accordance with SAs may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable.
5.	CA Madhur is auditor of a company and has issued audit report dated 15th June of a particular year. The audit report on summary financial statements derived from such audited financial statements is dated 15th July of that particular year. Discuss whether there exists any additional reporting responsibility for auditor in such a situation in respect of audit report on summary financial statements.
Ans.	The audit report on summary financial statements derived from audited financial statements is dated 15th July of that particular year. However, the audit report on audited financial statements is dated 15th June of that year.
	In the above situation, the auditor's report on summary financial statements should state that the summary financial statements and the audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements.
6.	Consider that the audit report on financial statements issued by CA Madhur for above said company contains qualified opinion. Can he issue an unmodified opinion on summary financial statements derived from audited financial statements? Discuss.
Ans.	If the auditor is satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, he can issue an unmodified opinion.
	However, when auditor's report on audited financial statements contains a qualified opinion, the auditor's report on the summary financial statements shall, also contain

	following:
(a)	State that the auditor's report on the audited financial statements contains a
	qualified opinion
(b)	Describe:
(i)	The basis for the qualified opinion on the audited financial statements, and that
	qualified opinion in the auditor's report on the audited financial statements; and
(ii)	The effect thereof on the summary financial statements, if any.
	Hence, above points should be included by CA Madhur.
❖	**THEORY QUESTIONS**
1.	CA P is auditor of a company responsible for auditing complete set of financial
	statements. He intends to express adverse opinion on complete set of financial
	statements considering conclusions drawn by him during course of audit. He is also
	auditing trade receivables of company for the same period in a separate engagement.
	Can he express unmodified opinion in respect of trade receivables? If so, discuss those
	circumstances.
Ans.	Refer to Para 3.6
2.	List out few factors affecting auditor's determination of the acceptability of the
	applied criteria before accepting audit of summary financial statements.
Ans.	Refer to Para 4.2
3.	SA 800 deals with special cosiderations applicable in respect of audit of financial
	statements prepared in accordance with special purpose framework. Explain, by giving
	examples, meaning of special purpose framework.
Ans.	Refer to Para 2.1
4.	CA Y is auditor of a company. He has expressed adverse opinion on audited financial
	statements. What additional points he has to keep in mind while expressing opinion
	on summary financial statements derived from such audited financial statements?
Ans.	Refer to Para 4.6

❖ INTEGRATED CASE SCENARIO

Given below is an extract of abridged financial statements of schemes of **"Smart Investment Mutual Fund"**. The abridged financial statements have been derived from audited financial statements of the schemes of **"Smart Investment Mutual Fund"** as at 31st March 20XX and for year ended 31st March,20XX.

Abridged Balance sheet as at 31st March 20XX **(in ₹ Lacs)**

Liabilities	Smart investment equity and debt fund	Smart investment equity savings fund
Unit Capital	20000.00	15000.00
Reserve and Surplus	160000.00	80000.00
Other current liabilities & provisions	100.00	100.00
Total	**180100.00**	**95100.00**
Assets		
Investments	170000.00	90000.00
Deposits	100.00	100.00
Other Current assets	10000.00	5000.00
Total	**180100.00**	**95100.00**

Abridged revenue account for year ended 31st March 20XX (In ₹ Lacs)

Income	Smart investment equity and debt fund	Smart investment equity savings fund
Income	34000.00	1000.00
Expenses and losses	3400.00	1500.00
Net realized gains	30600.00	(500.00)
Add: Change in unrealized appreciation in value of investments	2000.00	700.00
Net Surplus	32600.00	200.00
Dividend appropriation	3000.00	50.00
Retained Surplus	29600.00	150.00

The abridged financial statements of the Schemes of the Fund have been prepared by

	Board of Trustees of Fund pursuant to SEBI regulations and in accordance with format prescribed by SEBI. Previous year figures have been ignored for purpose of case.
	Unmodified opinion has been expressed by auditor in audited financial statements of the schemes of **"Smart Investment Mutual Fund"** as at 31st March 20XX and for year ended 31st March, 20XX.
	Keeping in view above, answer the following questions: -
1.	**Given the above extract of abridged financial statements and description, which the following statements is most appropriate?**
(a)	The auditor may presume that criteria applied by the Board of Trustees in the preparation of the abridged financial statements are acceptable.
(b)	The auditor cannot presume that criteria applied by the Board of Trustees in preparation of abridged financial statements are acceptable.
(c)	The abridged financial statements have been prepared by the Board of Trustees. The auditor cannot ordinarily accept criteria applied by them for the preparation of such abridged financial statements before detailed evaluation.
(d)	The auditor is duty bound to accept the criteria applied by the Board of Trustees in the preparation of abridged financial statements.
2.	**Which of the following statements in reference to abridged financial statements is not in accordance with the requirements of SA 810?**
(a)	The notes to accounts should specifically disclose that these abridged financial statements have been derived from audited financial statements.
(b)	The Board of Trustees has disclosed that audited financial statements are available on the website of the company.
(c)	It should be stated in the auditor's report that abridged financial statements have been compared with the related information in the audited financial statements to determine whether the abridged financial statements agree with or can be re- calculated from the related information in the audited financial statements.
(d)	It should be stated in auditor's report that reading the abridged financial statements is not a substitute for reading the audited financial statements of the Schemes of the Fund.

3.	**Which of the following paras is most appropriate to be included under heading "Auditor's responsibility" in the auditor's report?**
(a)	Our responsibility is to express an opinion on the A bridged financial statements based on our procedures, which were conducted in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India.
(b)	Our responsibility is to express an opinion on the Abridged financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.
(c)	Our responsibility is to express an opinion on the Abridged financial statements based on our procedures, which were conducted in accordance with Standards on Auditing adapted in circumstances including (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.
(d)	Our responsibility is to express an opinion on the Abridged financial statements based on our procedures, which were conducted in accordance with SEBI regulations and Standards on Auditing adapted in circumstances including (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.
4.	**Which of the following paras is most appropriate to be included under heading "Opinion" in auditor's report?**
(a)	In our opinion, the abridged financial statements, derived from the audited financial statements of the Schemes of the Fund as at March 31, 20XX and for the year ended March 31, 20XX are a fair summary of those financial statements, and are in accordance with the accounting policies and standards specified in SEBI regulations and generally accepted accounting principles in India to the extent applicable.
(b)	In our opinion, the abridged financial statements, as at March 31, 20XX and for the year ended March 31, 20XX are a fair summary of those financial statements.
(c)	In our opinion, the abridged financial statements, derived from the audited financial statements of the Schemes of the Fund as at March 31, 20XX and for the year ended March 31, 20XX are consistent with audited financial statements and are in

	accordance with the accounting policies and standards specified in SEBI regulations and generally accepted accounting principles in India to the extent applicable.
(d)	In our opinion, the abridged financial statements, derived from the audited financial statements of the Schemes of the Fund as at March 31, 20XX and for the year ended March 31, 20XX are consistent with audited financial statements.
5.	**Which of the following is usually not an element of audit report on abridged financial statements in accordance with SA 810?**
(a)	Emphasis of matter paragraph.
(b)	Other matter paragraph.
(c)	Management's responsibility for abridged financial statements.
(d)	Key audit matters.
	ANSWERS
1.	(a) 2. (c) 3. (b) 4. (a) 5. (d)

CHAPTER - 9

AUDIT - RELATED SERVICES

❖ **TEST YOUR UNDERSTANDING**

1. A company asks you to carry out process of confirmation of its accounts receivables having balances in excess of ₹10 lacs as per its books of accounts at the close of the year. The work to be performed only involves preparing and sending confirmation requests to such parties, analysis of variations on receipt of confirmations and submission of a report in accordance with professional standards. What points have to be kept in mind for inclusion in report specifically for such engagement?

Ans. The described engagement is an agreed-upon procedures engagement. Following points have to be kept in mind for being included in the report: -

- A statement that the procedures performed were those agreed-upon with the recipient
- A statement that the engagement was performed in accordance with the Standard on Related Services applicable to agreed-upon procedures engagements
- Identification of the purpose for which the agreed-upon procedures were performed
- A listing of the specific procedures performed
- A description of the auditor's factual findings including sufficient details of errors and exceptions found
- A statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed
- A statement that had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported
- A statement that the report is restricted to those parties that have agreed to the procedures to be performed
- A statement that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's financial statements taken as a whole

2. During the course of performing a compilation engagement in accordance with SRS

	4410, it becomes known to you that client had suffered a theft loss of ₹100 lacs of its inventories over a period of time at a storage location visited infrequently. A claim was lodged by the client with insurance company which was repudiated due to certain technical reasons relating to coverage of policy. The client has not preferred a complaint or an appeal against said repudiation. The amount is reflected under the head "current assets" in trial balance of the client. Discuss, how you should proceed to deal with the matter?
Ans.	In this instant case, amount of ₹100 lacs is reflected under the head "current assets" in trial balance. Since client's claim has been repudiated and no appeal has been preferred, it is a loss for the client and should be dealt accordingly. Therefore, amendments are required for the financial information not to be materially misstated.
	If the practitioner becomes aware during the course of the engagement that amendments to the compiled financial information are required for the financial information not to be materially misstated or the compiled financial information is otherwise misleading, the practitioner shall propose the appropriate amendments to management.
	If management declines, or does not permit the practitioner to make the proposed amendments to the compiled financial information, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing.
	If withdrawal from the engagement is not possible, the practitioner shall determine the professional and legal responsibilities applicable in the circumstances.
❖	**THEORY QUESTIONS**
1.	List out few intended purposes of a "compilation engagement."
Ans.	Refer to Para 3.
2.	A Chartered Accountant is offered appointment for a compilation engagement to be performed under SRS 4410. Is he required to comply with ethical requirements of Code of Ethics? Discuss briefly.
Ans.	Refer to Para 3.3

3.	How do "related services" differ from assurance engagements?
Ans.	Refer to Para 1.
4.	CA. P has been appointed to compile the financial information of X Limited. CA P is confused whether he should apply the same procedures which are required to be applied to conduct an audit or there are some other procedures to discharge the duties under such an engagement. Define the characteristics of Compilation Engagement. What should be the approach of CA P for performing the Engagement?
Ans.	Refer to Para 3 and Para 3.5
❖	**INTEGRATED CASE SCENARIO**
	KM Limited has engaged your firm for compilation of financial statements in accordance with requirements of SRS 4410. You also come to know that company is setting up a new unit in Rourkela, Odisha. The company management has provided you with draft trial balance and requires assistance in preparation and presentation of its financial statements for year ended 31st March, 2023. The management requires such a preparation and presentation for its internal use.
	During the course of engagement, it is noticed that: -
[1]	There are apparent errors in few opening balances brought forward from previous year relating to some outstanding incentives receivable from government authorities. These have been swapped with some other balances in trial balance. However, there are no credit transactions in such incentive accounts or accounts whose balances have been swapped during the year.
[2]	One of the team members suggests that it is one of the duties to ensure that revenue figures stated in trial balance, at least, are verified to ensure that all revenues required to be booked by the company have, in fact, been booked.
[3]	It is also suggested by this team member that even though it is a compilation engagement, quality control aspects like adhering to appropriate Standards needed to be followed.
[4]	Before signing and issuing report under SRS 4410, you once again read the financial information. It comes to your notice that figures relating to setting up of a new unit

	of the company coming up in Rourkela in Odisha have not been properly disclosed in compiled financial statements. The expenditure was incurred from a bank account maintained in Rourkela and was omitted to be shown under appropriate heads. You are vacillating regarding above considering scope of compilation engagement.
[5]	The team has prepared detailed documentation during the course of engagement.
	Keeping in view above, answer the following questions: -
1.	**In respect of errors in some of opening balances noticed as described in case, which of the following statements is most appropriate?**
(a)	Such errors should straight away lead to the qualification of a report to be issued.
(b)	Such errors should be brought to the knowledge of management.
(c)	Knowledge of such type of errors has no effect on compliance of ethical requirements by the firm.
(d)	The above said matter relates to SA 510 Initial Audit Engagements-Opening Balances and has no effect on reporting obligations in a compilation engagement.
2.	**As regards the suggestion of one of the team members regarding the verification of all revenues of the company, which of the following statements is most appropriate?**
(a)	Suggestion of team member is proper as such verification is part and parcel of such an engagement.
(b)	Suggestion of team member is proper as the absence of such verification may make financial statements misleading.
(c)	Suggestion of team member is not proper as verifying the accuracy or completeness of the information provided by management is not required in such engagement.
(d)	Suggestion of team member is not proper as compliance with qualitative requirements is not required in such engagement.
3.	**In view of the team member's suggestion relating to adherence to appropriate Standards for quality control, which of the following statements is relevant in the context of above said engagement?**
(a)	SA 220 is applicable in this engagement and has to be followed by the engagement partner meticulously.

(b)	SQC 1 is applicable in this engagement.
(c)	Both SA 220 and SQC 1 are applicable in this engagement.
(d)	SA 220 and SQC 1 are not applicable in this engagement. However, SRS 4410 lays down detailed quality control requirements for such type of engagement.
4.	**Which of the following statements is most appropriate as regards omission of expenditure under appropriate heads pertaining to the Rourkela unit in compiled financial statements?**
(a)	The above-noted omission can be misleading. By disregarding such an omission, the fundamental principle of integrity is violated and engagement cannot be performed in accordance with ethical requirements.
(b)	The above-noted omission can be misleading. By disregarding such an omission, the fundamental principle of objectivity is violated and engagement cannot be performed in accordance with ethical requirements.
(c)	The above noted omission has no effect on performing such compilation engagement.
(d)	The above-noted omission has no effect on performing and issuing reports under such compilation engagement.
5.	**The detailed documentation is maintained during the course of compilation engagement. Which of the following statements is most appropriate regarding the assembly of the final engagement file?**
(a)	Final engagement file should be assembled in not more than 60 days after the date of the report.
(b)	Final engagement file should be assembled in not more than 120 days after the date of the report.
(c)	Final engagement file should be assembled on a timely basis after the engagement report has been finalized in accordance with the time limits set by the firm.
(d)	There is no requirement of assembling of final engagement file in a compilation engagement.
	ANSWERS
1.	(b) 2. (c) 3. (b) 4. (a) 5. (c)

CHAPTER - 10

REVIEW OF FINANCIAL INFORMATION

❖ TEST YOUR UNDERSTANDING

1. Roma Limited has entered into a contract with Dorma Limited. There is a condition in the contract by virtue of which Roma Limited is required to get its financial statements reviewed for a year on a quarterly basis in accordance with the financial reporting provisions of the contract. Can Roma Limited get its financial statements reviewed from a professional accountant in practice?

Ans. The above financial statements are prepared in accordance with special purpose framework in accordance with requirements of a contract. Financial statements prepared in accordance with special purpose framework can also be reviewed by a professional accountant in practice and review report may be issued in accordance with SRE 2400.

2. You are conducting a review of the financial statements of a company. It is gathered upon inquiry that there is a possibility of material misstatements in financial statements. Discuss, how you would proceed further in the matter under SRE 2400.

Ans. If the practitioner becomes aware of matters that causes the practitioner to believe the financial statements may be materially misstated, the practitioner shall design and perform additional procedures sufficient to enable the practitioner to: -

(a) Conclude that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated or

(b) Determine that the matter(s) causes the financial statements as a whole to be materially misstated.

Additional procedures focus on obtaining sufficient appropriate evidence to enable the practitioner to form a conclusion on matters that the practitioner believes may cause the financial statements to be materially misstated. The procedures may be:

- Additional inquiry or analytical procedures, for example, being performed in greater detail or being focused on the affected items (i.e. amounts or disclosures concerning the affected accounts or transactions as reflected in the financial statements); or
- Other types of procedures, for example, substantive test of details or external

	confirmations·
3·	During review of quarterly results of a company of which you are auditor, it is gathered on inquiries made that there has been a major fire in fabric processing plant of the company during the quarter· It has resulted in massive disruption in operations of the company· Worse still, machinery and inventories of plant were uninsured due to carelessness of concerned staff leading to substantial losses· The matter has been disclosed in interim financial information appropriately· Discuss, how you would proceed to deal with the same in review report?
Ans·	Uninsured assets in a disaster are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption· As a result of fire, there is massive disruption in operations of the company· Besides, the company would have to bear losses as its damaged assets are uninsured·
	In accordance with SRE 2410, if, as a result of inquiries or other review procedures, a material uncertainty relating to an event or condition comes to the auditor's attention that may cast significant doubt on the entity's ability to continue as a going concern, and adequate disclosure is made in the interim financial information, the auditor modifies review report by adding an emphasis of matter paragraph·
	Therefore, Emphasis of matter paragraph should be added in review report·
4·	CA· Seerat is conducting review of the quarterly financial information of a company of which she is also auditor· She believes that it is necessary to make a material adjustment to the quarterly financial information for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework· She has communicated the matter to CFO and audit committee· However, no response was received even after waiting for a reasonable time· What are the options available to her?
Ans·	In such a case, options available to her in accordance with SRE 2410 are: -
(a)	Whether to modify the report or
(b)	The possibility of withdrawing from the engagement and
(c)	The possibility of resigning from the appointment to audit the annual financial statements·

❖	**THEORY QUESTIONS**
1.	Discuss why "inquiry" is important as an audit procedure in an engagement to review financial statements.
Ans.	Refer to Para 2.4
2.	CA. Aditya Jain is auditor of a listed company. He is also required to carry out quarterly review of financial statements of company in terms of regulatory requirements. He is already well-versed with business of company and has deep understanding of the company. Discuss, any five procedures, by which he can update his understanding of the company for carrying out quarterly review.
Ans.	Refer to Para 3.3
3.	What is significance of "date of report" in a review report?
Ans.	Refer to Para 2.4
4.	CA. Pankaj Chaturvedi has issued a review report dated 28.7.2022 for financial results of a company for quarter ending 30.6.2022. Describe his responsibility, if any, for events occurring from 1.7.2022 till date of review report in accordance with SRE 2410.
Ans.	The auditor should inquire whether management has identified all events up to the date of the review report that may require adjustment to or disclosure in the interim financial information.
❖	**INTEGRATED CASE SCENARIO**
	Below is given an incomplete draft text of the review report on the review of financial results of Fast Operations Limited, a listed company in accordance with SEBI regulations. The review is a compulsory requirement under SEBI (Listing Obligations and Disclosure Requirements) Regulations. The incomplete areas of the report have been marked as XXXX.
	INDEPENDENT AUDITOR'S REVIEW REPORT ON REVIEW OF INTERIM STANDALONE FINANCIAL RESULTS

	TO XXXX
1.	We have reviewed the accompanying Statement of Standalone unaudited financial results of Fast Operations Limited("the Company"), for the quarter and six months ended September 30, 2022 ("the Statement"), being submitted by the Company pursuant to the requirement of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended.
2.	This Statement, which is the responsibility of the Company's Management and approved by the Company's Board of Directors, has been prepared in accordance with the recognition and measurement principles laid down in the Indian Accounting Standard 34 "Interim Financial Reporting" ("Ind AS 34"), prescribed under Section 133 of the Companies Act, 2013 read with relevant rules issued thereunder and other accounting principles generally accepted in India. Our responsibility **XXXXXXXXXXX**.
3.	We conducted our review of the Statement in accordance with the Standard **XXXX**, issued by the Institute of Chartered Accountants of India (ICAI). A review of interim financial information consists of making inquiries, primarily of the company's personnel responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially **XXXXXXXXXXXXXXXXXXXXXXXXX**
4.	Based on our review conducted as stated in paragraph 3 above, **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**
	Using your knowledge, answer the following questions to complete the draft text of review report of Fast Operations Limited:-
1.	**The name of addressee is missing from text of draft review report. Identify the most appropriate option:**
(a)	Audit Committee
(b)	Board of Directors
(c)	CFO
(d)	Stock exchange on which shares of company are listed
2.	**Under para 2 of the case study, choose the appropriate sentence beginning with "Our responsibility XXXX":**
(a)	Our responsibility is to express an opinion on the Statement based on our review.

(b)	Our responsibility is to express a conclusion on the Statement based on our review.
(c)	Our responsibility is to provide a reasonable assurance on the Statement based on our review.
(d)	Our responsibility is to express a compliance statement on the Statement based on our review.
3.	**Given the description of case study, which of the following engagement standards is most appropriate to be stated in para 3?**
(a)	SRE 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity'.
(b)	SRE 2400 Engagements to Review Historical Financial Statements.
(c)	SA 700 Forming an Opinion and Reporting on Financial Statements.
(d)	SA 810 Engagements to Report on Summary Financial Statements.
4.	**Which of the following statements is most appropriate to be inserted in sentence beginning with "A review is substantially XXXX" in para 3?**
(a)	A review is substantially broader in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in a review. Accordingly, we do not express an audit opinion.
(b)	A review is substantially broader in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.
(c)	A review is substantially narrower in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in a review. Accordingly, we do not express an audit opinion.

(d)	A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.
5.	**Complete the paragraph 4 of case study from following options: -**
(a)	Nothing has come to our attention that causes us to believe that the accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has not disclosed the information required to be disclosed in terms of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it contains any material misstatement.
(b)	Nothing has come to our attention that causes us to believe that the accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has disclosed the information required to be disclosed in terms of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it does not contain any material misstatement.
(c)	The accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has disclosed the information required to be disclosed in terms of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it does not contain any material misstatement.
(d)	The accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has disclosed the information required to be disclosed in terms of Regulation 33 of the SEBI (Listing Obligations

and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it does not contain any material misstatement and gives a true and fair view of the state of affairs of the company as on date of interim financial statements.

ANSWERS

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

CHAPTER – 11

PROSPECTIVE FINANCIAL INFORMATION AND OTHER ASSURANCE SERVICES

❖ TEST YOUR KNOWLEDGE

1. A company has approached CA. Hemant for an assurance report in respect of prospective financial information of a project. Ongoing through the project details, it is noticed that depreciation reflected on proposed fixed assets to be acquired in prospective financial information has been calculated in accordance with provisions of the Income Tax Act. No disclosure is made in this respect too. How the matter should be proceeded with?

Ans. In such types of engagements, it is the duty of a professional accountant to see that prospective financial information is based on a consistent basis with historical financial statements using appropriate accounting principles.

In the case of a company, historical financial statements are prepared considering the requirements of the Companies Act, and depreciation is calculated accordingly. However, in the given situation, depreciation has been calculated in accordance with Income Tax Act which is not consistent with historical financial statements. Therefore, it is not proper.

The fact that the projection has not been prepared on a consistent basis with the historical financial statements, using appropriate accounting principles needs to be stated.

Further, when presentation and disclosure are not adequate, a qualified or adverse opinion should be given or withdrawal from engagement should be made as appropriate.

2. Bansi Group is a leading institution running prestigious post graduate courses in the field of management. Its financial statements are audited by an independent auditor. Before the start of this academic session, the Board of the institution had outsourced its entire process of inviting student applications, submission of applications, and collection of application fees including late fees and such matters to Easy Solutions Limited.

	The auditors of Bansi Group want to be sure about the design and operating effectiveness of controls at Easy Solutions Limited. What should be the nature of the report to be provided by auditors of Easy Solutions Limited specifically for use by Bansi Group and its auditors in this regard in terms of SA 3402?
Ans.	In such a case, the auditors of Bansi Group want to be sure about the design and operating effectiveness of controls at the organization which is providing services to their client. Type 2 report is a report on the description, design and operating effectiveness of controls operating at the service organization. Auditors of Easy Solutions Limited should provide such a report giving assurance on these matters. It should also include details of tests of controls performed and details of deviations, if any.
3.	The management of S Ltd. requests you to accept an engagement to report on the compilation of pro forma financial information to be included in a prospectus. In light of SAE 3420, what factors you will consider regarding the company acknowledging and understanding its responsibility in this matter before accepting engagement?
Ans.	The company's responsibility has to be acknowledged for the following matters:-
(i)	Adequately disclosing and describing the applicable criteria to the intended users if these are not publicly available
(ii)	Compiling the pro forma financial information on the basis of the applicable criteria and
(iii)	Providing the practitioner with:-
a.	Access to all information (including, when needed for purposes of the engagement, information of the acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria
b.	Additional information that the practitioner may request from the responsible party for the purpose of the engagement
c.	Access to those within the entity and the entity's advisors from whom the practitioner determines it necessary to obtain evidence relating to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria; and

d.	When needed for purposes of the engagement, access to appropriate individuals within the acquiree(s) in a business combination.
❖	**THEORY QUESTIONS**
1.	Ayurda Ltd. is a fast growing and award-winning SaaS software company which is headquartered in Mumbai. It also has offices in the UK and provides cloud-based professional services automation (PSA) software solutions to professional services organizations around the world. They want to engage you to provide an assurance report for one of its major clients over the controls it operates as a service organisation. Can you provide such an assurance report?
Ans.	Assurance report can be provided under SAE 3402. **Refer to Para 3.**
2.	Discuss the significance of Pro forma financial information included in prospectus of a company.
Ans.	Refer to Para 4.
3.	Discuss the term "Pro forma adjustment" under SAE 3420.
Ans.	Refer to Para 4.4.2
4.	Discuss, how, a Chartered Accountant can be associated with prospective financial information without violating relevant provisions of the Chartered Accountants Act, 1949.
Ans.	Refer to Para 2.3.
❖	**INTEGRATED CASE SCENARIO**
	Below is given draft text of the "Report on Examination of Prospective Financial Information" of Top Edge Limited in relation to the company's upcoming project prepared by a staff member in a CA firm unfamiliar with drafting such reports. The report has been drafted in a casual manner and may consist of omissions and errors.
	Report on Examination of Prospective Financial Information
	To

	The Board of Directors
	Top Edge Limited
	We have examined the projection of the upcoming project to come up at Ratnagiri of Top Edge Limited for the period from April 2023 to March 2030 as given in the Prospective Financial Information from page 1 to 250 in accordance with **Standard on Assurance Engagement 3400, "The Examination of Prospective Financial Information"**, issued by the Institute of Chartered Accountants of India.
	The preparation and presentation of the projection is the responsibility of the Management and has been approved by the Board of Directors of the company.
	Our responsibility is to examine the evidence supporting the assumptions (excluding the hypothetical assumption) and other information in the prospective financial information.
	The projection has been prepared using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur.
	We have carried out our examination of the prospective financial information thoroughly.
	Further, in our opinion the projection is properly prepared on the basis of the assumptions as set out in Note 1 to 50 to the Prospective Financial Information and on a consistent basis with the historical financial statements, using appropriate accounting principles. Even if the events anticipated under the hypothetical assumptions described above occur, actual results are still likely to be different from the projection since other anticipated events frequently do not occur as expected and the variation may be material.
	For PCK & Co.
	Chartered Accountants
	Signature
	Designation
	Membership Number
	Based on your knowledge and description of the case, answer the following questions:
1.	**Whose responsibility is to list out assumptions underlying prospective financial information?**

(a)	Professional Accountant issuing report on prospective financial information.
(b)	Auditor of Company issuing report on prospective financial information.
(c)	Management of company.
(d)	Banker of company.
2.	**Which of the following statements is most appropriate regarding "use of prospective financial information" to be included in such a report?**
(a)	Intended use of projection is required to be disclosed. It is further necessary to caution the users regarding inappropriateness of projections for other purposes.
(b)	It is discretionary to state intended use of projection in such a report.
(c)	Intended use of projection is required to be disclosed. It is not necessary to caution the users regarding inappropriateness of projections for other purposes.
(d)	It is prerogative of management to use report in the manner it deems fit.
3.	**What should be language of such an unmodified assurance report regard underlying assumptions?**
(a)	Positively worded to suggest assumptions are a reasonable basis.
(b)	Negatively worded to suggest assumptions are not on a reasonable basis.
(c)	Neither positively worded nor negatively worded about assumptions.
(d)	Depends upon the professional judgment of the Chartered Accountant
4.	**Which of the following statements is most appropriate regarding the examination of prospective financial information by a Chartered accountant in accordance with SAE 3400?**
(a)	Accuracy of projections is vouched for based upon performing procedures thoroughly.
(b)	Projections can go haywire; it depends upon the professional judgment of the Chartered Accountant to vouch for the accuracy of projections.
(c)	Accuracy of projections is not at all vouched for in an assurance report on prospective financial information.
(d)	The matter of accuracy of projections or otherwise is not domain of such an examination. Therefore, there is no reporting requirement under SAE 3400.

5.	**Which of the following statements is most appropriate regarding UDIN in context examination of prospective financial information by a Chartered Accountant?**
(a)	It is mandatory to state UDIN in such type of reports.
(b)	It is desirable to state UDIN in such type of reports.
(c)	It is not required to state UDIN in such type of reports as it is not an audit engagement.
(d)	It is not required to state UDIN in such type of reports as it is not an engagement related to historical financial information.
	ANSWERS
1.	(c) 2. (a) 3. (b) 4. (c) 5. (a)

CHAPTER - 12

DIGITAL AUDITING & ASSURANCE

❖ TEST YOUR UNDERSTANDING

1. Sukanya, a CA final student, is of the view that cyber risks are issues of IT and result only in information loss to an entity. She also feels that many cyber-attacks are not directly targeted at financial systems and do not pose risk of material misstatements to financial statements of an entity. Is her view proper?

Ans. The cyber risks are not an issue of IT alone. Rather, it is a business risk and has an effect on whole business organization. It affects entity's reputation and can lead to many other consequences which are listed below: -

- Regulatory costs
- Business interruptions causing an operational challenge for an organization.
- Data loss, reputational loss and litigation.
- Ransomware - more common these days where entire systems are encrypted
- Intellectual property theft which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
- Incident response cost which could be for investigations & remediation's.
- Breach of Privacy, if personal data of a consumer is hacked it could have a significant impact on the organization.
- Fines and penalties

It may happen that many cyber-attacks are not directly targeted at financial systems. However, the access gained by the attackers may provide them the ability to:

- Manipulate or modify financial records
- Modify key automated business rules
- Modify automated controls relied upon by the management.

Further, auditor should consider whether cyber risk (like other business risks) represents a risk of material misstatement to the financial statement as part of the audit risk assessment activities. Focus should be on understanding the cyber risks affecting the entity and the actions being taken to address these risks.

2.	CA Y is planning to use CAATs extensively in audit of a company-be it for compliance tests or substantive tests. Can you list out examples of few situations (in brief) of tests performed by him using CAATs?
Ans.	
(i)	Identify exceptions: Identify exceptional transactions based on set criteria. For example, cash transactions above ₹ 10,000.
(ii)	**Identify errors:** Identify data, which is inconsistent or erroneous. For e.g.: account number which is not numeric.
(iii)	**Verify calculations:** Re-perform various computations in audit software to confirm the results from application software confirm with the audit software. For e.g.: TDS rate applied as per criteria.
(iv)	**Existence of records:** Identify fields, which have null values. For example: invoices which do not have vendor name.
(v)	**Data completeness:** Identify whether all fields have valid data. For example: null values in any key field such as date, invoice number or value or name.
(vi)	**Data consistency:** Identify data, which are not consistent with the regular format. For example: invoices which are not in the required sequence.
(vii)	**Duplicate payments:** Establish relationship between two or more tables as required. For example, duplicate payment for same invoice.
(viii)	**Accounts exceeding authorized limit:** Identify data beyond specified limit. For example, transactions entered by user beyond their authorized limit or payment to vendor beyond amount due or overdraft allowed beyond limit.
3.	A company is planning to use Robotics process automation (RPA) to streamline its hiring process. Earlier, the company used to hire from campuses of various management institutes leading to high recruitment costs, inefficient hire yield and resultant lack of diversity. How RPA can be used to automate the hiring process? List out tentative few such steps. What could be likely benefits of using RPA in hiring process?
Ans.	RPA can be used to streamline hiring process in a company. The tentative steps could include: -
➢	Place advertisements on social media/career advice sites.

➢	Link redirects candidate to a career site.
➢	Career site pulls information of candidate.
➢	An algorithm scans applicants for desired and suitable roles.
➢	Selected candidates may be asked to play online games to assess their skills.
➢	A certain percentage of those applicants are called for a video interview using an
	interview software.
	The automated hiring process will reduce full time effort involvement, provide with
	a wider assessment range, reduce the impact of recruiter biases, increase the
	efficiency of mapping of interested candidates, reduce recruiting costs, increase hire
	yield, reduce time to hire, increase diversity.
❖	**THEORY QUESTIONS**
1.	Briefly describe the advantages and challenges of Auditing digitally.
Ans.	Advantages – Improved efficiency, better quality, lower costs, improved risk assessment.
	Challenges – Reluctance to change, challenges with data security and governance,
	choosing the right tool and automating the right process, ensuring standardisation
	and correct configurations to avoid error and bias, evaluating business benefits the
	organization wants to achieve with automation and the roadmap for digital strategy.
	For details refer Para 2.
2.	What are the stages involved in understanding the IT environment and what key
	considerations auditor should consider?
Ans.	The stages involved in understanding of IT environment are: Understand – Identify –
	Assess. Key considerations - Understand the flow of transaction, Identification of
	Significant Systems, Identification of Manual and Automated Controls, Identification
	of the technologies used and assessing the complexity of the IT environment.
	For details refer Para 3.
3.	Auditor should scope in ITGCs to tests when there are IT dependencies identified in
	the system briefly describe the types of IT dependencies.
Ans.	For details refer para 4.

4.	What does cyber risk explain it with some examples?
Ans.	For details refer para 5.1.
5.	Briefly describe the cyber security Framework.
Ans.	For details refer para 5.3.
6.	What are the advantages and disadvantages of remote audit?
Ans.	For details refer para 5.5
7.	In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for preparation of management information system (MIS) reports and electronic dashboards that give a high- level snapshot of business performance. In view of above you are required to briefly discuss the meaning of data analytics and example of such data analytics techniques.
Ans.	For details refer para 6
8.	Enterprises are adopting emerging technologies at a rapid pace to create synergies and harness the latest technologies. Give 3 examples of automated tools used as a part of emerging technologies along with the risk and audit considerations associated with these tools.
Ans.	For details refer para 7
9.	Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks Give some examples of technology risks of digital system and the control considerations to consider while assessing technology risk.
Ans.	For details refer para 8
10.	Give example of emerging technologies available for Next Generation Audit along with the risks associated with it.
Ans.	For details refer para 9

❖	**INTERGRATED CASE SCENARIO**
	Consider the following five situations: -
[A]	Safe Health Insurance Limited is a company working in field of health insurance sector. It is now using a claim management system where incoming claims can be immediately identified on the website itself. A form is issued to the customer who signs it. The details are verified by the system against data present in it. Such a system has allowed faster processing of claims, error-free data validation and increased customer satisfaction.
[B]	During the course of audit of a company, it is noticed that a cyber-attack took place on the data in which files were encrypted and computers got locked. The hacker then demanded a booty for decryption of files which was to be paid in bitcoins.
[C]	CA X, auditor of a company, is looking into cyber security risks of the company. He is making inquiries regarding processes and controls relating to privileged account access, patch management program, vendor risk management program. He has also performed external network penetration testing.
[D]	"Verificatory" is an entity which can stamp e-mails or any files. It simplifies certifying of e- mails by just e-mailing to them to an e-mail specifically created for each customer. Many law firms can use this service to certify documents. The information is secured by networks of thousands of computers distributed across the globe. It uses cryptographic algorithms. The information can be verified from anywhere in the world. Its hashing and time stamping is of significant evidentiary value.
[E]	CA X is planning for audit of an entity. The timelines are agreed in a meeting with key management person on an electronic meeting platform. The entity also agrees to provide data electronically. Video-conference meetings are to be held from time to time with the client.
	Keeping in view above situations, answer the following questions: -
1	**In respect of situation regarding working of insurance company in health insurance sector, which of following technologies has likely been used?**
(a)	Internet of things
(b)	Data analytics
(c)	Robotic process automation
(d)	Power BI

2.	**Which type of cyber-attack is referred to situation described in para [B]?**
(a)	Ransomware
(b)	Trojan
(c)	Denial of service attacks
(d)	Fileless Malware
3.	**In situation described at [C] above, which is not part of risk assessment procedures to assess cyber security risks?**
(a)	Making inquiries regarding processes and controls relating to privileged account access
(b)	Making inquiries regarding processes and controls relating to patch management program
(c)	Making inquiries regarding processes & controls relating to vendor risk management program
(d)	Performing external network penetration testing
4.	**The kind of services being provided by an entity described at [D] above, are example of use of: -**
(a)	Blockchain technology
(b)	Internet of things
(c)	Ethical hacking
(d)	Cyber attestation
5.	**Which of following is false in an audit described at para [E]?**
(a)	The opportunity to present doctored documents and to omit relevant information is decreased.
(b)	Remote access to sensitive IT systems may not be allowed.
(c)	It provides comfort and flexibility to the audit team as they would be working from their office/home environment.
(d)	Time zone issues could also affect the efficiency of audits.
	ANSWERS
1.	(c) 2. (a) 3. (d) 4. (a) 5. (a)

CHAPTER – 13

GROUP AUDITS

❖	**TEST YOUR UNDERSTANDING**
1.	CA. Mukund is in the second year of his term as statutory auditor of Style Marks Limited (Holding company), its subsidiaries and joint ventures. At the time of planning audit, he wants to be sure that all the components have been included in the consolidated financial statements. List out some procedures he should perform to verify completeness of this information.
Ans.	The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion. In respect of completeness of this information, the auditor should perform the following procedures:
(a)	review his working papers for the prior years for the known components
(b)	review the parent's procedures for identification of various components
(c)	make inquiries of management to identify any new components or any component which goes out of consolidated financial statements.
(d)	review the investments of parent as well as its components to determine the shareholding in other entities
(e)	review the joint ventures and joint arrangements as applicable
(f)	review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group
(g)	review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013
(h)	also identify the changes in the shareholding that might have taken place during the reporting period.
2.	CA. Kajal Gupta is nearing completion of audit of consolidated financial statements of Rubic Paints and Chemicals Limited. She requires written representations from the parent's management on matters material to the consolidated financial statements. What specific matters such written representations can include?

Ans·	The auditor of the consolidated financial statements should obtain written representations from parent's management on matters material to the consolidated financial statements· Examples of such representations include:
(a)	Completeness of components included in the consolidated financial statements;
(b)	Identification of reportable segments for segment reporting
(c)	Identification of related parties and related party transactions for reporting
(d)	Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions·
3·	CA·MV Chitale is auditor of consolidated financial statements of "D and D Limited" for year 2022-23· The consolidated financial statements consist of financial statements and financial information of 8 subsidiaries audited by other auditors· Such financial statements, financial information and auditor's reports of subsidiaries have been furnished by management of the "D and D Limited" to him· Following further information is also available in respect of these 8 subsidiaries for year 2022-23:-
	Total assets ₹ 1500 crore
	Total revenues ₹ 1000 crore
	Net cash outflows ₹ 10 crore
	Two of these subsidiaries are located outside India whose financial statements have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries·
	Where and how such information should be included in independent auditor's report on consolidated financial statements of company? Also draft a suitable para by making necessary assumptions·
Ans·	In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, then as prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditors· This may be done by stating aggregate rupee amounts or percentages of total assets,

revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

It should be included in Other Matter paragraph of independent auditor's report. The draft "Other Matter Paragraph" is as under: -

Other Matter Paragraph

We did not audit the financial statements and other financial information, in respect of eight (8) subsidiaries, whose financial statements include total assets of Rs.1500 crores as at March 31, 2023, and total revenues of Rs.1,000 crores and net cash outflow of Rs. 10 crores for the year ended on that date. These financial statements and other financial information have been audited by other auditors and such financial statements, other financial information and auditor's reports have been furnished to us by the management of the Holding Company.

Our opinion on the consolidated financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and joint ventures, and our report in terms of sub-sections (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries is based solely on the reports of such other auditors.

Two of these subsidiaries are located outside India whose financial statements and other financial information have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries. The Holding Company's management has converted the financial statements of such subsidiaries from accounting principles generally accepted in their respective countries to accounting principles generally accepted in India.

We have audited these conversion adjustments made by the Holding Company's management. Our opinion in so far as it relates to the balances and affairs of such subsidiaries is based on the report of other auditors and the conversion adjustments prepared by the management of the Holding Company and audited by us. Our opinion on the consolidated financial statements, and our report on Other Legal and Regulatory Requirements is not modified in respect of the above matters with respect to our reliance on the work done and the reports of the other auditors and the financial statements and other financial information certified by the Management.

❖	**THEORY QUESTIONS**
1.	Whether preparation of consolidated financial statements is mandatory? If yes, please elaborate on the requirements under the statute.
Ans.	Refer Para 1.1
2.	Please elaborate on the situations wherein the requirement related to preparation of consolidated financial statements may not apply.
Ans.	The requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:
(i)	it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
(ii)	it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
(iii)	its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.
3.	While doing the audit of Consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?
Ans.	Refer Para 6.2
4.	Write a short note on:
(a)	Responsibility of holding company for preparation of Consolidated Financial Statements.
(b)	Permanent Consolidated Adjustments.
Ans.	(a) Refer Para 2
	(b) Refer Para 6.1

5.	R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?
Ans.	**Consolidation of Financial Statement:** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee". However, as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act. In the given case, R Ltd's intention is to dispose off the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is temporary, Therefore, R Ltd. is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110.
6.	A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd., what factors would be considered by you as the statutory auditors of A Ltd. for the audit of its consolidated financial statements prepared under Ind AS?
Ans.	**10% Voting Power and Control over the composition of Board of Directors:** In this case, A Ltd. holds only 10 percent of the voting power but has control over the composition of the Board of Directors of B Ltd. In such a case, A Ltd shall be considered as a parent of B Ltd and, therefore, it would consolidate B Ltd in its consolidated financial statements as a subsidiary.

	The auditor should verify A Ltd's management's assessment of having control in B Ltd despite having only 10% voting power as per the requirements of Ind AS 110. Auditor would need to verify as to how A Ltd controls the composition of the Board of Directors or corresponding governing body of B Ltd. There can be various means by which such kind of control can be established. In this regard, the auditor may verify the minutes of Board meetings, shareholder agreement entered into by the parent, agreements with B Ltd to which the parent might have provided any technology or know how, enforcement of statute, etc. Further, the auditor should verify that the adjustments warranted by Ind AS 110 have been made wherever required and have been properly authorised by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments. The auditor should make plan, among other things, for the understanding of accounting policies of the A Ltd and B Ltd and determining and programming the nature, timing, and extent of the audit procedures to be performed etc. Further, the duties of an auditor with regard to reporting of transactions with any other related parties are given in SA 550 on Related Parties. As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity are considered as Related Party. In forming an opinion on the financial statements, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with Ind AS 110 and Schedule III and whether the effects of the related party relationships and transactions prevent the financial statements from achieving true and fair presentation (for fair presentation frameworks) or cause the financial statements to be misleading (for compliance frameworks).
7.	You are appointed as an auditor of Nawab Limited, a listed company who is a main supplier to the UK building and construction market. With a turnover of ₹2.9 billion,

	the company operates through 11 business units and has nearly 180 branches across the countries.
	As an auditor, how will you draft the report in case:
a.	When the Parent's Auditor is also the Auditor of all its Components?
b.	When the Parent's Auditor is not the Auditor of all its Components?
c.	When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent?
d.	When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?
e.	Where the financial statements of one or more components is not audited?
Ans.	Refer Para 8
8.	M Ltd. acquired 51 % shares of S Ltd. on 01-04-2019 and sold 25% of these shares during the financial year 2019-20. M Ltd. did not prepare Consolidated Financial Statements for the financial year 2019-20 on the plea that the control was only temporary. Do you agree with the view of M Ltd.? Decide, assuming, that M Ltd. is required to prepare its financial statements under Ind AS.
Ans.	**Consolidation of Financial Statement:** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operating under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.
	Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".
	In the given case, M Ltd acquired 51% shares of S Ltd on 01.04.2019 and sold 25% shares during the year ended 2019-20. M Ltd did not consolidate the financial statements of S Ltd for the year ended 31.03.2020 on the plea that control was only temporary. The intention of M Ltd. is quite clear that the control in S Ltd. is temporary as the former company disposed off the acquired shares in the same year of its purchase.
	However, even though the intention of M Ltd. is for temporary holding of shares in

	S Ltd· as per Ind AS, M Ltd is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110· However, "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee"· Here, due to sale of investment in S Ltd· up to 25%, M Ltd· loses control of S Ltd· Accordingly, M Ltd·, is required to prepare consolidated statement till the date of disposal of the 25% shares to comply with the same·
9·	H Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS· The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors· During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd·, 50% in S2 Ltd· and 60% in S3 Ltd· of the respective share capitals of the Investee Companies· When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation· Analyse the issues involved and give your views·
Ans·	**Consolidated Financial Statements:** According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own· Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards· However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act· However, an investment entity need not present consolidated financial statements if

	it is required, in accordance with Ind AS 110'Consolidated Financial Statements', to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.
	(An investment entity is an entity that(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.)
	In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.
	Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated, then list should be disclosed in notes to accounts with reason.
10.	Venus Ltd. is a company engaged in the manufacture of stainless steel items. The company operates through 5 business units and has 35 branches across India. Manglam & Associates are being appointed as the principal auditor of the company. While accepting the audit assignment as the principal audit or, what will be the points of consideration for the principal auditor of the company?
Ans.	**Acceptance as Principal Auditor:** The principal auditor, Manglam & Assocaites, should consider whether their own participation is sufficient to be able to act as the principal auditor. For this purpose, the auditor would consider:
(a)	the materiality of the portion of the financial information which the principal auditor audits;
(b)	the principal auditor's degree of knowledge regarding the business of the components;

(c)	the risk of material misstatements in the financial information of the components audited by the other auditor; and
(d)	the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.
11.	Venus Ltd. is a curtain manufacturing company having its corporate office in Punjab. The company is in the process of expansion and has acquired four companies during the year. Pradyuman & Co.is the principal auditor of the company while the audit of all the companies acquired during the year is being conducted by Jha & Jha Associates. During the course of audit, CA Pradyuman, the engagement partner asked the management of Venus Ltd. at the corporate office that in order to conduct the audit of the consoaltiedd financial statements, his audit firm is required to conduct audit of the financial statements oaf ll the components also(Companies acquired during the year) to this, the management asked CA Pradyuman to consider the audit reports of the component auditor already provided to his audit team and to communicate with the component auditor for any discussion they wish to have. CA Pradyuman contended that for the purpose of audit of consolidated financial statements either his firm is required to conduct an audit of all the component's financial statements or he needs the working papers of the component auditors. Is the contention of CA Pradyuman correct?
Ans.	As per SA 600, "Using the work of Another auditor", the principal auditor is normally entitled to rely upon the work of component auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

	The principal auditor should consider the significant findings of the other auditor.
	The principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor.
	Accordingly, CA Pradyuman, can perform the above mentioned audit procedures. However, the audit of the component's financial statements by the principal auditor is not required.
	So, the contention of CA Pradyuman that for the purpose of audit of consolidated financial statements he is required to conduct an audit of the components financial statements is not correct.
	Further, SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.
	Accordingly, it is the discretion of the component auditor as the working papers with respect to the components examined by the component auditor are the property of the component auditor.
	So, the contention of CA Pradyuman is not correct.
12.	Kukreja & Associates is the principal auditor of MN Ltd. The company is engaged in the manufacture of sports items and operates through its 14 branches all over India. With respect to the audit of branches, the company has appointed seven Chartered Accountant firms, each firm conducting the audit of two branches. The audit reports in respect of accounts of branches have already been sent to the principal auditor. While analysing the work of the branch auditors, CA Kukreja, the engagement partner, asked the branch auditors to share with him a summary of the audit procedures and

findings in respect of the accounts of the branches examined by them. CA Kukreja also asked one of the branch auditor to share his working paper with respect to the two branches examined by that branch auditor for his review and return. Is the principal auditor correct in asking the branch auditors for sharing the summary and the working papers for his review.

Ans. In terms of SA 600 "Using the Work of Another auditor", where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India.

The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.

Accordingly, CA Kukreja is correct in asking the branch auditors to share with him the summary of their audit procedures and findings in respect of the accounts of the branches examined by them.

Further, CA Kukreja has asked one of the branch auditors to share with him the working papers with respect to the branches examined by such branch auditor for the former's review and return.

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

	Accordingly, it is the discretion of the branch auditor as the working papers with respect to the branches examined by the branch auditor are the property of the branch auditor.
	So, CA Kukreja is not correct in asking the branch auditor to share with him the working papers with respect to the branches examined by the branch auditor.
❖	**INTERGRATED CASE STUDY**
	While auditing consolidated financial statements of YK Industries Limited for the year 2022-23, a manufacturing company whose financial statements are required to be prepared in accordance with Division II of Schedule III of Companies Act, 2013, CA. Palash Shah notices as under: -
(A)	The notes to accounts in respect of consolidated financial statements disclose additional information pertaining to the holding company and its subsidiaries. It provides disclosure regarding percentages of consolidated net assets, of consolidated profit and loss and of total comprehensive income along with their respective amounts pertaining to holding company and its subsidiaries.
(B)	It is noticed by him that financial statements of one foreign subsidiary included in consolidated financial statements are drawn up to 31st December, 2022 in accordance with legal requirements in US. He feels it to be weird and is of the view that consolidated financial statements of group could present a distorted picture. The management, in turn, informs him that it is not practicable to draw the financial statements of foreign subsidiary to 31st March, 2023.
(C)	During the year 2022-23, goodwill of ₹50 crore had arisen on account of the acquisition of a subsidiary during the year and there is no impairment loss as on the balance sheet date. Besides, adjustments have been made in consolidated financial statements with respect to intra-group indebtedness and those related to harmonizing different accounting policies being adopted by parent and its subsidiaries.
(D)	It is noticed by him that one subsidiary was acquired on 15.6.22. He is in a dilemma as regards to the correctness of consolidation of its financial statements in group financial statements.
	Besides, he is also in the process of finalising audit report including matters to be

	reported under CARO, 2020 in respect of consolidated financial statements. However, he is in a fix in respect of manner of reporting under CARO,2020 relating to consolidated financial statements.
	Based upon above information and description, answer the following questions:-
1.	**Considering disclosure of additional information in consolidated financial statements as stated in para (A) of case study, which of the following statements is correct?**
(a)	The said disclosure is not proper as percentage of consolidated revenue from operations along with respective amount pertaining to holding company and its subsidiaries is also required.
(b)	The said disclosure is not proper as percentage of other comprehensive income along with respective amount pertaining to holding company and its subsidiaries is also required.
(c)	The said disclosure is not proper as percentages of consolidated revenue from operations as well as other comprehensive income along with their respective amounts pertaining to holding company and its subsidiaries are also required.
(d)	The said disclosure is proper.
2.	**What should be auditor's proper course of action pursuant to situation highlighted in para [B] relating to financial statements of a foreign subsidiary?**
(a)	The auditor should insist for drawing up of financial statements of foreign subsidiary to 31st March, 2023. The reason for impracticality is a mere excuse. In case of failure to redraw, he can modify his opinion in accordance with SA 705.
(b)	The auditor can accept management's version.
(c)	The auditor can accept management's version. However, it is his duty to verify adjustments made for effects of significant transactions or events occurring between 1st January 2023 and 31st March, 2023.
(d)	The auditor should modify his opinion by quantifying the financial effects of such an inconsistency.
3.	**Which of the following statements is correct in respect of goodwill and other matters described in the case scenario?**
(a)	Goodwill represents current period consolidation adjustments. Adjustments relating to

	intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent permanent consolidation adjustments.
(b)	Adjustments relating to goodwill, intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by parent and its subsidiaries represent current period consolidation adjustments.
(c)	Goodwill represents permanent consolidation adjustments. Adjustments relating to intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent current-period consolidation adjustments.
(d)	Goodwill and adjustments relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent permanent consolidation adjustments. Adjustments relating to intra-group indebtedness represent current-period consolidation adjustments.
4.	**Which of the following statements is most appropriate regarding consolidation of financial statements of a subsidiary acquired on 15.6.22?**
(a)	The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements from the date it gains control of subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the acquisition date.
(b)	The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements for the complete financial year and further such income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the preceding reporting date.
(c)	The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements from the date it gains control of subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the preceding reporting date.
(d)	The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements for the complete financial year and further such

	income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the acquisition date.
5.	***As regards reporting under reporting CARO, 2020 in respect of consolidated financial statements, which of the following is in accordance with requirements of law?***
(a)	*A separate report providing Clause by Clause reporting under CARO, 2020 is required in respect of specified matters pertaining to parent and all subsidiaries incorporated in India.*
(b)	*It would be sufficient if report under CARO, 2020 in respect of standalone financial statements is supplemented with additional information in respect of all subsidiaries incorporated in India.*
(c)	*A separate report under CARO, 2020 in respect of all subsidiaries incorporated in India together is required. It should be annexed with report under CARO, 2020 in respect of standalone financial statements.*
(d)	*Reporting of details of subsidiaries together with paragraph numbers of reports under CARO, 2020 of auditors of such companies incorporated in India containing qualifications or adverse remarks would serve the purpose.*

CHAPTER - 14

AUDIT OF BANKS & NON-BANKING

❖ **TEST YOUR UNDERSTANDING**

BANKS

1. CA. Harshit is conducting statutory audit of branch of a public sector bank. On examining 20 large advances of the branch, he finds that in 5 examined cases, loan applications have been filled up scantily with important details left out. In these cases, it is also noticed that cash credit limits to the borrowers were enhanced during the year but there are no records pertaining to assessment of enhanced working capital requirements in respective borrower files. The branch is unable to show such assessments/workings in system either.

However, all the five accounts are operating satisfactorily. These accounts have been classified as standard assets by branch. Would above information prompt auditor to suggest change in asset classification of above accounts? What does depicted situation reflect?

Ans. An account becomes NPA when it ceases to generate income for bank. In the given situation, all the examined five accounts are operating satisfactorily. There is no reason for suggesting changes in their classification.

The matter of scantily filling up loan applications and lack for record for assessment of enhanced working capital requirements shows that internal control over advances in branch is not proper. The above said situation shows deficiencies in "credit appraisal" at branch level. Such deficiencies need to be highlighted by auditor in LFAR.

2. You are conducting concurrent audit of branch of a public sector bank. It is a large branch having advances of about ₹ 500 crores including export advances of ₹ 300 crores. Some borrowers also get LCs issued from branch for importing raw diamonds from diamond hubs of Belgium. You want to be sure that there is no revenue leakage in branch. For the time being, you are focusing upon advances. Discuss any five areas pertaining to advances of the branch which you would verify to ensure no revenue leakage.

Ans·	The areas of advances which need to be verified are as under:-
i·	Interest rates fed in the system need to be verified with respect to corresponding sanction letters· It would help ensure that correct rate of interest is fed into the system and interest is applied properly at stipulated intervals on advances·
ii·	Processing fees in respect of freshly sanctioned advances and renewed limits need to be levied in accordance with bank guidelines and these need to be verified· Any revision in processing fees from time to time has to be given effect to in accordance with circulars/manual of bank·
iii·	Sanction of cash credit limits is generally accompanied with stipulation to submit stock statements· Non-submission of stock statements can involve levying of penal interest· Verification of this aspect is required·
iv·	Verification of overdue interest on export bills purchased and packing credit facilities for overdue period·
v·	Verification of charges/commission in respect of letters of credit issued in accordance with Bank's circulars/manual·
3·	CA· Seema is appointed as stock auditor of Bhawani Rice Mills Pvt· Ltd· availing credit facilities from R·K· Puram Branch, Near Tamil Educational Society, New Delhi· The borrower is enjoying cash credit limit of ₹ 12 crore from branch against security of paid stocks and debtors up to 90 days against margin of 25%· She proceeds to visit premises of Bhawani Rice Mills Pvt· Ltd· located on outskirts of Delhi· She verifies books of accounts and stock records of the company and also test checks quantity of paddy and rice of 20000 quintals and 8000 bags lying in premises of the company· Drawing power of ₹ 12·05 crore is computed in stock audit report and report stands submitted to bank·
	After about a week, regular internal inspector appointed by Inspection department of bank also happened to visit premises of the borrower and found that rice contained in about 5000 bags included in stocks having approx· value of ₹ 1·50 crore was fungus ridden· The company was holding this stock for last 15 months·
	How do you view the above situation? Discuss·
Ans·	The above situation reflects that professional work of stock audit was not performed

	diligently by stock auditor. It is one of the important responsibilities of stock auditor to verify condition of stocks. The auditor's role is not limited to verify physical quantities only.
	In given case, she should have got opened rice bags on test check basis. In the process, she could have come to know about fungus ridden condition of rice. Value of such rice should have been excluded while arriving at value of stocks for purpose of computation of drawing power. It shows that she has failed to perform her work diligently and drawing power calculated in the report submitted to bank is not proper.
	NON - BANKING
4.	"Fin crazy" is a P2P online platform owned by Future Technologies Pvt Limited which is registered with RBI as NBFC. Peer to Peer Platform (P2P) means an intermediary providing the services of loan facilitation via online medium or otherwise to the participants.
	Participants have to enter into an arrangement with NBFC-P2P to lend on its platform or avail loan facilitation services provided by it. It provides only as a medium connecting lenders and borrowers. It also carries out the credit assessment and risk profiling of the participants on the platform. It also provides services relating to loan documentation and loan recovery. The company falls outside purview of upper layer.
	Where does such NBFC fit into in accordance with scale-based regulations? Suggest few audit procedures for above NBFC-P2P
Ans.	NBFC-P2P falls in base layer in accordance with scale-based regulations of RBI. Few audit procedures for NBFC-P2P are as under: -
➢	Gaining an understanding of business conducted by NBFC-P2P. It should be verified that company undertakes only permissible activities applicable to such type of NBFCs like providing online marketplace to participants for lending and borrowing. It should not be engaged in business of lending funds on its own.
➢	Verifying certificate of registration obtained from RBI for carrying business of P2P platform.
➢	Verifying Board approved policy setting out eligibility criteria for participants i.e lenders and borrowers.

➢	Verifying board approved policy for pricing of services provided by P2P platform
➢	Verification of adherence to lending and borrowing guidelines prescribed by RBI
➢	Verifying appropriate arrangements have been entered into among participants and NBFC-P2P.
➢	Compliance with reporting requirements of RBI
➢	Verifying board approved policy for grievance redressal and complaints
5.	Sugam Housing Finance Limited is in the business of housing finance activities having asset size of ₹ 800 crores. Its principal business is of providing finances for housing mainly to individuals. It is not identified by RBI in upper layer. Under scale-based regulations introduced by RBI, what should be appropriate classification for such a company?
	Is there any specific reporting requirement under CARO, 2020 for statutory auditor of a company engaged in housing finance activities?
Ans.	The said company is not identified in upper layer by RBI. Under scale based regulations introduced by RBI, NBFCs undertaking housing finance activities constitute "middle layer". The asset size is not relevant in such a case. All housing finance companies not identified in upper layer would constitute middle layer due to nature of such activities undertaken by them.
	There is specific reporting requirement under CARO, 2020 under clause 3 (xvi)(b) which requires auditor to report whether the company has conducted any non-Banking financial or housing finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.
6.	You are auditor of a deposit taking NBFC (NBFC-D). The NBFC is identified by RBI in its upper layer and its financial statements are required to prepared in accordance with requirements of Ind AS. The following is extract of statement of profit and loss for year ending 31st March, 2023 in accordance with Division III of Schedule III of Companies Act, 2013. Previous year figures are ignored.
Ans.	An NBFC is preparing financial statements in accordance with requirements of Division III of Schedule III of Companies Act, 2013 has to separately disclose by way of note any item of "other expenditure" exceeding 1% of total income.

	The said expenditure of ₹99·50 crore does not exceed 1% of total income· Hence, it meets requirements of Division III of Schedule III of Companies Act, 2013·
❖	**THEORY QUESTIONS**
	BANK
1·	Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank· The Bank follows financial year as accounting year· Your Audit Manager informed that the bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year· The dividends on securities and Units of Mutual Funds were declared after the end of financial year Comment·
Ans·	Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established· This is also in accordance with AS 9· In this case the dividends have been declared after the financial year end· Therefore, the recognition of income by the bank on accrual basis is not in order·
	In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly and as such is not in arrears· It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government·
2·	As statutory central auditors of a Nationalized bank, what special points are to be borne in mind in the audit of compliance with "Statutory Liquidity Ratio" (SLR) requirements?
Ans·	Refer Para no 6·
3·	Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India guidelines·

Ans.	Refer Para no. 10.1
4.	In course of audit of Good Samaritan Bank as at 31st March, 23 you observed the following:
(a)	In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government?
Ans.	**Government Guaranteed Advance:** If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.
	Since the bank has not invoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed. The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days. In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.
(b)	The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.
Ans.	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.
5.	Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The bank is a consortium member of Cash Credit Facilities of ₹50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹1.75 crores towards interest the credits in X Ltd's account are to the tune of ₹1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing. The Bank follows financial year as accounting year Advise your views on the issue which were brought to your notice by your Audit Manager.
Ans.	The bank is a consortium member of cash credit facilities of ₹ 50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹ 1.75 crores towards interest, the credits in X Ltd.'s account are to the tune of ₹ 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.
6.	You have been appointed as an auditor of LCO Bank, a nationalized bank. LCO Bank also deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over storage and issue of credit cards.

	How will you evaluate the Internal Control System in the area of Credit Card operations of a Bank?
Ans.	Refer Para 5.
7.	You have been appointed as Concurrent Auditor of a nationalized bank branch. The main business at the branch is dealing in foreign exchange. Suggest the main areas of coverage with regard to foreign exchange transactions of the said branch under concurrent audit.
Ans.	Refer Para 10.4.
8.	While auditing FAIR Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks. Kindly guide.
Ans.	Refer Para 8 - Part (VI)
9.	ABC Chartered Accountants have been appointed as concurrent auditors for the branches of Effective Bank Ltd. for the year 2022-23. You are part of the audit team for Agra branch of the bank and have been instructed by your senior to verify the advances of the audit period. You are required to guide your assistant about the areas to be taken care while doing verification during the concurrent audit.
Ans.	Refer Para 7 sub heading III
10.	In the course of audit of Skip Bank Ltd., you found that the Bank had sold certain of its non-performing assets. Draft the points of audit check that are very relevant to this area of checking.
Ans.	Refer Para 7 sub heading III
11.	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?

Ans·	Refer Para 1
12·	ABC Bank had sanctioned credit limits of ₹100 lakh to M/s Volkart Ltd on 1st September 2021· The renewal of limits was due on 1st September 2022· While doing The statutory branch audit for the year ended 31st March 2023, you find that the renewal has not been done even though 180 days are over· The bank says that the renewal process has been initiated on time and most of the document are received· The account is operated regularly and is in order; balance is maintained within drawing power· It also shows a letter from Volkart starting that due to a sudden death of their auditor, a new auditor had to be appointed· Procedure for appointment took some time and the new auditor was doing the audit all over again· The limit was not renewed till 31/3/2023· However, the audited financials are received on 10th April 2023 and the renewal letter was issued immediately· Your assistant is insisting that the account must be classified as NPA since the limit was not renewed as on 31/3/2023· What is your opinion?
Ans·	As per Guidelines of Reserve Bank of India the account should be classified as NPA if renewal is not done in 180 days· However, in the present case, operations in the account are excellent· The bank has shown a letter from that company that due to certain reasons the audited financial statements are delayed· Further, the limit has been renewed before signing the audit report· Thus, even if the sanction was issued after the balance sheet date, it relates to the position as on the balance sheet date· Therefore, it is an adjusting event under AS 4, Contingencies and Events Occurring after the Balance Sheet Date· It is also a matter of substance over form· The auditor would consider classifying the account as a standard asset·
13·	You are auditing a small bank branch with staff strength of the manager, cashier and three other staff S1, S2 and S3· Among allocation of work for other areas, S1 who is a peon also opens all the mail and forwards it to the concerned person· He does not have a signature book so as to check the signatures on important communications· S2 has possession of all bank forms (e·g· Cheque books, demand draft/pay order

	books, travelers' cheques, foreign currency cards etc.) He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.
Ans.	Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. Given below are examples of internal controls that are violated in the given situation: In the instant case, S1 who is a peon opens all the mail and forwards it to the concerned person. Further, he does not have a signature book so as to check the signatures on important communications is not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book. All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery. In the given case, S2 has possession of all bank forms (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis. Further, contention of bank that being a small branch with shortage of manpower they are not able to check the work and records on regular basis, is not tenable as such lapses in internal control pose risk of fraud. The auditor should report the same in his report accordingly.
	NON - BANKING
14.	Define NBFC. Also give a brief description about types of NBFCs covering any five NBFCs.
Ans.	Refer Para 1 - Definition and Types of NBFCs.
15.	Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the

	requirements related to registration and regulation of NBFCs which an auditor needs to keep his in mind while planning the audit of NBFC which would help this firm.
Ans.	**An auditor should know following points regarding registration and regulation of NBFCs:**
	Under Section 45-IA of the RBI Act, 1934, no NBFC shall commence or carry on the business of a non-banking financial institution without
➢	obtaining a certificate of registration issued by the RBI; and
➢	having a net owned fund (NOF) of ₹ 25 lakhs (₹ Two crore since April 1999) not exceeding two hundred lakhs rupees, as the RBI may, by notification in the Official Gazette, specify.
	(The RBI (Amendment) Act (1997) provided an entry point norm of ₹ 25 lakh as the **minimum NOF** which was revised upwards to ₹ 2 crore for new NBFCs seeking grant of certificate of registration (CoR) on or after 21 April 1999).
	A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45-IA of the RBI Act, 1934 can apply to the RBI in prescribed form along with necessary documents for registration. The RBI issues CoR after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.
	However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock Broking Companies registered with SEBI, Insurance Company holding a valid CoR issued by IRDA, Nidhi Companies as notified under Section 406 of the Companies Act, 2013, Chit Companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank.
	The RBI has issued directions to NBFCs on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.
	Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders.

16.	Satyam Pvt. Ltd is a company engaged in trading activities, it also has made investments in shares of other Companies and advanced loans to group companies amounting to more than 50% of its total assets. However, trading income constitutes majority of its total income. Whether the Company is an NBFC?
Ans.	In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by Reserve Bank of India. In the given case, though Satyam Pvt. Ltd is fulfilling the criteria on the asset side, but however is not fulfilling the criteria on the income side, the company cannot be classified as a deemed NBFC.
17.	Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to audit of NBFC- Investment and Credit Company (NBF-CICC).
Ans.	Refer Para 6
18.	You are appointed as the auditor of a NBFC registered with the RBI and which is accepting and holding public deposits. You are considering your reporting requirement addition to your report made under Section 143 of the Companies Act, 2013 on the accounts of this NBFC as per the prescribed Directions. Please explain what points are required to be known in respect of separate report to be given by you to the Board of Directors of this NBFC.
Ans.	Refer Para 7.1(3), (4)

19.	Kamna & Co LLP, a firm of Chartered Accountants, was appointed as auditor of an NBFC. The audit work has been completed. The audit team which was involved in the fieldwork came across various observations during the course of audit of this FBNC and have also limited understanding about the exceptions which are required to be reported in the audit report. They would like to understand in detail regarding the obligations on the part of an auditor in respect of exceptions in his respect to that they can conclude their work. Please explain.
Ans.	Refer Para 7.1(5)
20.	The Statutory Auditor of the NBFC company is required to give are port to the Board of Directors. What shall be the content of the Auditor's Report to the Board.
Ans.	Ref Para 7.1
	The statutory auditor of Karma Pvt Ltd, being a Non-Deposit Taking Non-Systemically Important NBFC is required to submit separate report to the Board of Directors on the matters as specified as below:
I.	Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the RBI's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI.
II.	In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.
III.	Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction - Non-Banking Financial Company - Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

	Apart from the aspects enumerated above, the auditor shall include a statement on the following matters, namely: -
(i)	Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;
(ii)	Whether the company has accepted any public deposits during the relevant period/year;
(iii)	Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of Non-Banking Financial Company - Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016;
	Where, in the auditor's report, the statement regarding any of the items referred to matters specified above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred above, his report shall indicate such fact together with reasons thereof.
21.	Krishna Pvt. Ltd is primarily into the business of selling computer parts. However, the company is fulfilling the Principal Business Criteria as at the balance sheet date i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50% of Gross Income. What shall be the obligation of the Statutory Auditor in such a scenario?
Ans.	Ref Para 7.1
	In the given case, Krishna Pvt. Ltd is fulfilling the Principal Business Criteria i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50 % of Gross Income. The company which fulfils both these criteria shall qualify as an NBFC and hence is required to obtain Certificate of Registration (CoR) with Reserve Bank of India. In such a scenario, the statutory auditor has an obligation to submit exception report to the RBI on the following matters:
(I)	Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 of the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016, is unfavourable or qualified, or in

	the opinion of the auditor the company has not complied with:
(a)	the provisions of Chapter III B of RBI Act (Act 2 of 1934); or
(b)	Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
(c)	Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.
(II)	The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.
22.	Mr. G. has been appointed as an auditor of LMP Ltd., a NBFC company registered with RBI. Mr. G is concerned about whether the format of financial statements prepared by LMP Ltd. is as per notification issued by the Ministry of Corporate Affairs (MCA) dated October 11, 2018. The notification prescribed the. format in Division III under Schedule III of the Companies Act, 2013 applicable to NBFCs complying with Ind-AS. Mr. G wants to know the differences in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Help Mr. G.
Ans.	Refer Para 8.3
23.	Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of ₹1,50,00,000/-(one crore fifty lakhs) and was not having registration certificate from RBI and applied for it on 30th March 2023. The company appointed Mr. Kabra as its statutory auditors for the year 2022-23. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?
Ans.	As per Clause (xvi) of Paragraph 3 of CARO 2020, the auditor is required to report

	that "whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained."
	The auditor is required to examine whether the company is engaged in the business which attract the requirements of the registration. The registration is required where the financing activity is a principal business of the company. The RBI restrict companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.
	Audit Procedures and Reporting:
(i)	The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
(ii)	The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
(iii)	Whether the company has net owned funds as required for the registration as NBFC.
(iv)	Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.
(v)	The auditor should report incorporating the following:-
(1)	Whether the registration is required under section 45-IA of the RBI Act, 1934.
(2)	If so, whether it has obtained the registration.
(3)	If the registration not obtained, reasons thereof.
	In the instant case Abhimanyu Finance Ltd. is a Non Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of ₹ 1,50,00,000/-(one crore fifty lakhs) which is less in comparison to the prescribed limit i.e. 2 crore rupees and was also not having registration certificate from RBI (though applied for it on 30th March 2021). The auditor is required to report on the same as per Clause (xvi) of Paragraph 3 of CARO 2020.
❖	**INTERGRATED CASE STUDY**

1.	CA. Madhusudan is conducting concurrent audit of a branch of a nationalized bank. It is a large branch having deposits of ₹ 350 crore and advances of ₹ 600 crore respectively. The deposits of branch consist of term deposits apart from CASA deposits. It is an old branch in operation since late 70s. Therefore, there are many dormant deposit savings, current and term deposit accounts at the branch. Of late, the top management of the bank has been pushing for aggressive targets in opening of CASA deposits. He wants to ensure that CASA deposit accounts opened by the branch during his term comply with KYC norms. During the course of concurrent audit of a particular month, he finds that temporary over limits are granted to few borrowers availing cash credit facilities up to 10% of their respective sanctioned limits. Granting of such over limits falls within the powers of Chief Manager of the said branch. It is also noticed by him that temporary overdrafts are allowed to few customers in their current accounts. However, granting of these temporary overdrafts also falls in Chief Manager's delegated powers. Temporary over limits and overdrafts as discussed above have been adjusted and paid before the end of the month. It is further noticed by him during the same month that branch has sanctioned 5 fresh advances falling within Chief Manager's powers and conforming to bank norms aggregating to ₹ 10 crore. All these sanctioned advances pertain to same industry i.e., jute mills manufacturing jute sacks. He feels that branch's approach is not proper and sanction of 5 advances to the same industry lacks diversity and lending decision of branch is not proper. He further notices that during the month, one borrower of branch falling under definition of "small enterprise" in MSME sector has shifted its credit facilities from the branch to a bank in private sector. The branch has levied foreclosure charges on outstanding credit facilities pertaining to borrower by disregarding "Code of Bank's Commitment to Micro and Small Enterprises". The borrower is still having current account with branch. Reversal of such charges would lead to revenue loss for branch. He is in a fix as far as reporting is concerned. **Keeping in view above, answer the following questions: -**
1.	**As regards dormant deposit accounts in the branch, which of the following is not part**

	of duty of concurrent auditor?
(a)	Verifying that dormant accounts are revived with appropriate authority
(b)	Examining authorisation for withdrawals
(c)	Following up with account holders to ensure status of accounts remains active
(d)	Verifying that dormant accounts at the branches ageing more than 10 years have been transferred to Deposit Education and Awareness Fund (DEAF)
2.	**The concurrent auditor wants to ensure that fresh CASA accounts opened in the branch are KYC compliant. Which of the following best sums up scope of KYC guidelines prescribed by RBI?**
(a)	The basic purpose of such guidelines is to weed out duplicate customers at the same branch.
(b)	Such guidelines contain detailed requirements for banks to enable them to draw a 360- degree credit profile of the customers by monitoring of transactions. Its primary purpose is assisting banks in making prudent credit decisions.
(c)	Such guidelines have a basic objective of ensuring credit of Direct benefit transfers (DBT) in accounts of deserving account holders.
(d)	Such guidelines contain detailed requirements in respect of customer acceptance policy, customer identification procedures, monitoring of transactions and risk management.
3.	**Which of the following statements is most appropriate as regards reporting of matters relating to temporary over limits in cash credit accounts and temporary overdrafts in current accounts?**
(a)	The said instances cannot be reported as these fall in powers of Chief Manager.
(b)	The said instances can be reported in monthly concurrent audit report. No discussion is necessary with Chief Manager in this respect to ensure sanctity of report.
(c)	The said instances can be reported in monthly concurrent audit report. However, a discussion is necessary with Chief Manager in this respect.
(d)	The said instances cannot be reported as these fall in powers of Chief Manager and have been adjusted and paid before the end of the month.
4.	**Which of the following statements is most appropriate regarding sanction of fresh**

	advances to borrowers in the same industry in a month from concurrent auditor's perspective?
(a)	Such a lending lacks diversity and needs to be reported without fail.
(b)	Such a lending increases credit risk for branch and needs immediate attention of higher authorities of bank.
(c)	Lending has been made within Chief Manager's powers. It does not fall in concurrent auditor's domain to question wisdom of lending decision conforming to bank norms.
(d)	Although lending has been made within Chief Manager's powers, branch should have reported to higher authorities flagging sanction of fresh advances to same industry. Only this aspect should be reported in concurrent auditor's report.
5.	**As regards matter of levying of foreclosure charges described in case scenario, what is appropriate course of action for concurrent auditor?**
(a)	The matter should be reported even though it would lead to revenue loss for branch.
(b)	The matter should not be reported as it is part of duties of concurrent auditor to safeguard branch's revenue interests.
(c)	The matter should be reported only for its disregard of Code without highlighting revenue impact.
(d)	The matter concerns branch management's decision. It does not fall in purview of concurrent audit.
	ANSWERS
1.	(c) 2. (d) 3. (c) 4. (c) 5. (a)
2.	CA. Parampara is statutory auditor of "Lohit Finance Limited" a micro finance institution, working pre-dominantly in states popularly described as "seven sisters of North East", West Bengal, Odisha and Andhra Pradesh. It is a non-deposit taking NBFC catering to credit requirements of rural and semi-urban households and provides small ticket loans. She has performed audit procedures for year 2022-23 and following further information is given as under:-
(A)	The Board of Directors of the company has passed a resolution in its meeting held on

	1·5·22 for non-acceptance of public deposits during year ended 31st March, 2023·
(B)	The company has obtained certificate of registration dated 15th March, 2012 from RBI in pursuance of section 45-IA of RBI Act, 1934 and it is entitled to hold such certificate of registration in terms of its financial assets/income pattern for year ended 31st March, 2023·
(C)	The company has identified instances of cash embezzlement by the employees during the year· Such instances relate to employees fleeing after collection of instalments from customers at some centres· The total amount involved is ₹15 lacs and ₹ 5 lacs have been recovered subsequently· The matter has also been reported in note 35 of financial statements·
(D)	It falls in middle layer of scale-based regulations and regulations for a systemically important non-deposit taking NBFC are applicable to it· Its capital adequacy ratio is stated in note 36 of financial statements·
(E)	Audit procedures performed by her included testing design and operating effectiveness of controls relating to allowances for loan losses using Expected credit loss model (ECL) in accordance with Ind AS 109· Tests of details performed by her included verifying assumptions affecting ECL calculations·
	Keeping in view above information, answer the following questions: -
1·	**The Board of Directors has passed a resolution for non- acceptance of public deposits during year 2022-23· Which of the following statements is most appropriate in this regard as regards reporting obligations of auditor are concerned?**
(a)	Passing of board resolution for non-acceptance of public deposits, being an internal governance matter, is not required to be reported by auditor·
(b)	Matter of passing of board resolution for non-acceptance of public deposits is a specific reporting requirement for auditor under CARO, 2020·
(c)	Matter of passing of board resolution for non-acceptance of public deposits is a specific reporting requirement in auditor's additional report to the Board of Directors of the company·
(d)	Matter of passing of board resolution for non-acceptance of public deposits is a specific reporting requirement in auditor's additional report to the Board of Directors of the company as well as under CARO, 2020·

2.	**Which of the following statements is most appropriate in respect of reporting requirements relating to certificate of registration of the company obtained from RBI as described in para [B] of the case?**
(a)	It is the duty of auditor to report whether company has obtained certificate of registration as required under section 45-IA of RBI Act, 1934 in auditor's additional report to the Board of Directors of the company.
(b)	It is the duty of auditor to report whether company has obtained certificate of registration as required under section 45-IA of RBI Act, 1934 in auditor's additional report to the Board of Directors of the company as well as under CARO, 2020.
(c)	It is the duty of auditor to report whether company has obtained certificate of registration as required under section 45-IA of RBI Act, 1934 under CARO, 2020.
(d)	It is the duty of auditor to report whether company has obtained certificate of registration as required under section 45-IA of RBI Act, 1934 in auditor's additional report to the Board of Directors of the company as well as under CARO, 2020. Further, it is also required to be reported in auditor's additional report to Board of Directors whether company is entitled to hold such certificate in terms of its financial assets/income pattern.
3.	**Regarding instances of cash embezzlement identified by the company during the year, which of the following statements best fits into reporting requirements of an auditor?**
(a)	Such instances are required to be reported under CARO, 2020 under relevant clause.
(b)	Cash embezzled amount is less than ₹1 crore. No reporting under CARO, 2020 is required of such instances.
(c)	Such instances are required to be reported under CARO, 2020 as well as in auditor's additional report to Board of Directors of company.
(d)	Such instances are to be specifically reported in auditor's report under Section 143(3) of Companies Act, 2013.
4.	**As regards description of capital adequacy ratio as described in para [D] of case, which of the following statements meets regulatory reporting requirements?**
(a)	Auditor has to ascertain and verify whether such ratio has been disclosed in financial

	statements in notes to accounts.
(b)	Auditor has to ascertain and verify whether such ratio as disclosed in NBS-7 has been correctly arrived at.
(c)	Auditor has to ascertain and verify whether such ratio as disclosed in NBS-7 has been correctly arrived at and whether such ratio is in compliance with minimum CRAR prescribed by RBI.
(d)	Auditor has to ascertain and verify whether such ratio has been disclosed in financial statements in notes to accounts and has been correctly arrived at and is in compliance with minimum CRAR prescribed by RBI.
5.	**The auditor has performed audit procedures relating to allowances for loan losses using ECL in accordance with Ind AS 109. As these allowances involve significant judgment and estimates, she wants to state how it was addressed by her. How she can do that?**
(a)	By stating it in Auditor's additional report to Board of Directors.
(b)	By stating it in matters as required under Section 143(3) of Companies Act.
(c)	By incorporating Emphasis of Matter Paragraph in Independent auditor's report.
(d)	By identifying it as Key audit matter in Independent auditor's report.
	ANSWERS:
1.	(c) 2. (d) 3. (a) 4. (c) 5. (d)

CHAPTER - 15

OVERVIEW OF AUDIT OF PUBLIC SECTOR UNDERTAKINGS

❖ TEST YOUR UNDERSTANDING

1. PGC & Associates are statutory auditors of BNPC Limited, a PSU in power sector. It is engaged in building large sized thermal power stations to accelerate development of power sector in the country. One of the financial committees of Parliament has decided to examine its physical and financial performance. It has also examined audit findings of C&AG in respect of which action is yet to be taken by the said PSU. The committee also proposes to include in its report performance of the company in various operational matters.

Which financial committee of Parliament deals with such matters? Outline its main functions.

Ans. The said matters are dealt by Committee on Public Undertakings (COPU). The functions of the Committee are-

(i) to examine the reports and accounts of public undertakings.

(ii) to examine the reports of the C & AG on public undertakings.

(iii) to examine the autonomy & efficiency of public undertakings & to see whether they are being managed in accordance with sound business principles & prudent commercial practices.

(iv) to exercise such other functions vested in the PAC and the Estimates Committee as are not covered above and as may be allotted by the Speaker from time to time.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

2. PS & Associates are statutory auditors of a Central government owned company for a particular year. The statutory auditors were required to examine the following areas mandatorily, provide their specific replies and also their impact on financial statements for that particular year in their audit report.

♦	Whether the company has system in place to process all the accounting transactions through IT system? If yes, the implications of processing of accounting transactions outside IT system on the integrity of the accounts along with the financial implications, if any, may be stated.
♦	Whether there is any restructuring of an existing loan or cases of waiver / write off of debts / loans/ interest etc. made by a lender to the company due to the company's inability to repay the loan? If yes, the financial impact may be stated. Whether such cases are properly accounted for?
♦	Whether funds (grants/subsidy etc.) received / receivable for specific schemes from Central government or its agencies were properly accounted for / utilized as per its term and conditions? List the cases of deviation.
	Can you gauge likely nature of such responsibility thrust upon auditors of above PSU?
Ans.	The above areas for which statutory auditors of PSU were required to examine, report and indicate impact of these matters in financial statements are likely to relate to directions issued by C&AG to statutory auditors under section 143(5) of Companies Act, 2013.
	In terms of section 143(5), in case of a government company, the C&AG has the power to direct the auditor the manners in which accounts of company are required to be audited and auditor shall submit audit report which among other things, include the directions, if any, issued by the C&AG the action taken thereon and its impact on the accounts and financial statements of the company.
❖	**THEORY QUESTIONS**
1.	The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG.
Ans.	Refer Para 9.
2.	ABG & Co., a Chartered Accountant firm has been appointed by C & AG for performance audit of a Sugar Industry. What factors should be considered by ABG & Co., while planning a performance audit of Sugar Industry?

Ans· Factors to be considered while planning the Performance Audit: Refer Para 6·2

3· Sunlight Limited is a public sector undertaking engaged in production of electricity from solar power· It had commissioned a new project near Goa with a new technology for a cost of ₹ 5,750 crore· The project had seen delay in commencement and cost overrun· State the matters that a Comprehensive Audit by C & AG may cover in reporting on the performance and efficiency of this project·

Ans· Refer Para 7

4· "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·

Ans· Refer Para 6

5· BT Ltd·, a company wholly owned by central government was disinvested during the previous year, resulting in 40% of the shares being held by public· The shares were also listed on the BSE· Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the BSE etc·

Sam, the FM of the company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the company and the C & AG will not have any role to play· Comment·

Ans· Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company· The auditors

	of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them. The listing of company's shares on a stock exchange is irrelevant for this purpose and hence Sam's opinion is not correct.
6.	You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task?
Ans.	Refer Para 6.2
7.	Comptroller & Auditor General appointed Verma & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C & AG.
Ans.	In the given scenario, C&AG appointed Verma & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit.
	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.
	Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.
	Therefore, the objectives of performance auditing are evaluation of economy, efficiency,

	and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.
	Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.
	Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.
	Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is not performance audit in all aspects.
8.	The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:
(i)	total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;
(ii)	tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;
(iii)	metering, billing and collection was managed efficiently and effectively;
(iv)	monitoring and internal controls were efficient.
	What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.
Ans.	In the given scenario, in view of the objectives discussed, performance audit is being referred. Refer Para 6.2.

❖	**INTEGRATED CASE SCENARIO**
	SRM & Associates are refreshening up their knowledge on functions of various Parliamentary financial committees and on the varied functions and duties of Comptroller & Auditor General of India in relation to audit of government institutions and government companies. They feel that unless they have understood scope of duties of C&AG, they would not be in a position to do justice to audits and professional work in this area.
	In the process, they have gone through various materials both offline and online. The summarized information derived from some of such materials including website of C & AG are stated below:
[A]	The C & AG report for a particular year contained results of the compliance audit of Department of Revenue-Direct Taxes of the Union Government dealing with "Assessments relating to Agricultural Income". It included certain observations relating to allowing of claim for exemption of agricultural income without supporting documents, use of this area by non-agriculturists as a conduit to avoid taxes etc., in scrutiny assessments performed by the Department.
[B]	The C&AG in one of its reports in respect of a state government owned industrial development corporation pointed out non-adherence of One-time settlement (OTS) guidelines of state government by the corporation resulting in acceptance of a below par OTS proposal thus foregoing recovery of loan amounting to ₹ 6.87 crores. The said corporation was providing loans to industrial units.
[C]	Annual report of a listed public sector company which is a "mini-ratna" PSU was also gone through. The said company is engaged in providing diversified services to Indian Railways.
[D]	A state government owned PSU was involved in setting up of a thermal power plant in the state. The C&AG, in its audit report, pointed out delay in completion of work due to failure to decide on the type of water treatment in the cooling plant on a timely basis. Besides, other reasons leading to delay like frequent changes in lay-out and re-testing of soil by the company were pointed out.
	Answer the following questions based upon above information:
1.	**Based on description provided at para [A] of case, which Parliamentary financial**

	committee is likely to examine above report of C & AG and make its recommendations?
(a)	Estimates Committee.
(b)	Public Accounts Committee.
(c)	Committee on Public Undertakings.
(d)	Committee on Commerce.
2.	**Considering the description stated in para [B] of case, the above audit finding is likely to fall in which areas?**
(a)	Compliance audit.
(b)	Performance audit.
(c)	Propriety audit.
(d)	Comprehensive audit.
3.	**As regards listed PSU described in para [C] of case, which of the following statements is most appropriate?**
(a)	The statutory audit of above PSU is to be conducted by a firm of auditors appointed by shareholders in AGM. C & AG cannot give directions to such firm of auditors. However, its office is empowered to conduct a supplementary audit.
(b)	The statutory audit of above PSU is to be conducted by C & AG.
(c)	The statutory audit of above PSU is to be conducted by a firm of auditors appointed by C &AG. Further, C&AG can give directions to the firm of auditors.
(d)	The statutory audit of above PSU is to be conducted by a firm of auditors appointed by shareholders in AGM. However, C&AG can give directions to the firm of auditors.
4.	**Considering nature of audit finding described at para [D] of case concerning delay in completion of work of thermal power plant, the said audit finding is likely to fall in domain of:**
(a)	Propriety audit
(b)	Performance audit
(c)	Financial audit
(d)	Compliance audit

5.	**PSU engagements are generally attestation engagements or direct reporting engagements. Which of the following statements is correct in this regard?**
(a)	Performance audits and compliance audits are generally attestation engagements.
(b)	Performance audits and compliance audits are generally direct reporting engagements.
(c)	Performance audit is a direct reporting engagement whereas compliance audit is an attestation engagement.
(d)	Performance audit is an attestation engagement whereas compliance audit is a direct reporting engagement.
	ANSWERS:
1.	(b) 2. (a) 3. (c) 4. (b) 5. (b)

CHAPTER - 16

INTERNAL AUDIT

❖ TEST YOUR UNDERSTANDING

1. After an illustrious career in Indian Audit & Accounts Service for about 25 years, Prateek, a post graduate in law, has taken voluntary retirement from government service. Being in fine spirits, he wants to take responsibilities in corporate sector as Chief internal auditor. On looking at attractive compensation packages, he applied for such position in a leading listed company engaged in oil refining business. The Board of company is keen on him due to his impressive credentials.

Can he be appointed in this leading position of said company?

Ans. As per section 138 of Companies Act, 2013 the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

The Board can appoint any professional as may be decided by it. The applicant in question is a law post graduate and he has spent 25 years of his career in Indian Audit & Accounts Service. Therefore, he has got the necessary experience and skills required for the said vacancy. The Board would be in a position to appoint such a competent and experienced person in the field of auditing as its Chief Internal auditor.

2. CA Deva is internal auditor of a listed company. The company wants to make sure that it is in compliance with SEBI requirements at all times and it is never on the wrong side of law. It asks its internal auditor to manage its compliance tracking system including directly corresponding with regulator in this regard. The profile and scope of internal audit agreed at time of appointment included "compliance with laws and regulations."

Can he perform such type of activities in capacity of internal auditor of company?

Ans. The Internal Auditor does not assume any responsibility to manage or operate the compliance framework or to take compliance related decisions. It is not responsibility of the Internal Auditor to execute or resolve compliance related risks (e.g., engaging

	directly with regulators, etc.).
	Although internal audit function provides independent assurance to enhance governance (which includes compliance with laws and regulations), it does not assume operational responsibility of its compliance framework. It is the responsibility of the management. He is responsible for auditing the compliance framework and not managing it. Similarly, he does not accept compliance related risks like directly engaging with regulator.
3.	Up Down Limited is in doldrums since last two years. The demand for its products has declined drastically. The statutory auditor is of the view that situation has put into question going concern assumption of the company. Its internal auditor has helped management in devising a strategy to deal with such risks and come out of the situation. The plan includes venturing into different product lines using same plant with minor modifications. Further, internal auditor has also prepared estimates of revenue generation along with cash flows.
	Can statutory auditor place total reliance on work performed by internal auditor in this regard?
Ans.	The greater the judgment needed to be exercised in planning and performing the audit procedures and evaluating the audit evidence, the external auditor will need to perform more procedures directly because using the work of the internal audit function alone will not provide the external auditor with sufficient appropriate audit evidence.
	The appropriate use of going concern assumption requires significant judgment on part of statutory auditor.
	Therefore, statutory auditor cannot place total reliance on internal auditor's work in this regard and he should perform more procedures directly.
❖	**THEORY QUESTIONS**
1.	Write a short note on Internal Audit Report.
Ans.	Refer para 6.
2.	State the important aspects to be considered by the External auditor in the evaluation of the Internal Audit Function.

Ans·	**Evaluation of Internal Audit Functions by External Auditor:** The external auditor's general evaluation of the internal audit function will assist him in determining the extent to which he can place reliance upon the work of the internal auditor· The external auditor should document his evaluation and conclusions in this respect· The important aspects to be considered in this context are:
(a)	**Organisational Status** - Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself, the internal auditor reports to the management· In an ideal situation, his reports to the highest level of management and are free of any other operating responsibility· Any constraints or restrictions placed upon his work by management should be carefully evaluated· In particular, the internal auditor should be free to communicate fully with the external auditor·
(b)	**Scope of Function** - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management· He should also ascertain to what extent the management considers, and where appropriate, acts upon internal audit recommendations·
(c)	**Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency· This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work·
(d)	**Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented· An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers·
3·	AB Pvt· Ltd· Company has outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint an internal auditor· Please guide him for the applicability of the same and who can be appointed as an internal auditor and what work would be reviewed by him·
Ans·	**Applicability of Internal Audit:** Section 138 of the Companies Act, 2013 states that every private limited company is required to conduct internal audit if its outstanding

	loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.
	In view of above provisions, AB Pvt. Ltd. is under compulsion to conduct internal audit as its loans or borrowings are falling under the prescribed limit.
	Who can be appointed as Internal Auditor- The internal auditor shall either be a chartered accountant or a cost accountant, whether engaged in practice or not, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.
	The internal auditor may or may not be an employee of the company.
	Work to be reviewed by Internal Auditor- Refer Para 2.
4.	Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.
Ans.	Refer Para 6
5.	Mr. A is appointed as a statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.
(a)	Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.
(b)	Will your answer be different if Mr. A asks direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?
Ans.	
(a)	**Direct Assistance from Internal Auditor:** As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct

	assistance to perform procedures that Involve making significant judgments in the audit.
	Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.
	Significant judgments include the following:
•	Assessing the risks of material misstatement;
•	Evaluating the sufficiency of tests performed;
•	Evaluating the appropriateness of management's use of the going concern assumption;
•	Evaluating significant accounting estimates; and
•	Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.
	In view of above, Mr. A cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.
(b)	**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.
6.	The XYZ Ltd has to appoint Mr. A as Chief Internal Auditor to lead the internal audit function for the Company. The Managing Director of the Company has asked the HR head to define the reporting structure of the Chief Internal Auditor, so that

	he can discharge his duties objectively? Suggest the ideal reporting structure of the Chief Internal Auditor that HR head may propose to the Managing Director?
Ans.	HR Head need to evaluate multiple options and identify most suitable option in light of the relevant provisions, guidance and overall governance of the organization. HR head also need to evaluate different option for his administrative reporting and various options for functional reporting of Chief Internal Auditor. The possible options to be considered and evaluated include Board of Directors, Audit Committee, Managing Director of the Company, Chief Executive Officer or Chief Financial Officer.
	As per section 138 of the Companies Act 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.
	As per the revised definition of the term 'Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, "Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives".
	Refer para 3.1, The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.
	As per the requirement of the above stated provision, Chief Internal Auditor need to be independent of the operational activities and report of Audit Committee / Board of Directors to enjoy his true status of independent auditor. He may administratively report to CEO or Managing Director for his administrative reporting purpose or any other similar authority till the time it is approved by Board of Directors and it does not impact his independence to be able to perform his duties and report to audit committee / Board of Director independently.
7.	The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their Internal Audit plan for

	next financial year? What approach would Mr. A follow to prepare the internal audit plan for next year?
Ans.	Refer para 2
	The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner. Internal audit plan should be developed in such a manner that all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle. Also, ensuring that appropriate consideration is made and adequate balance is ensured to the following:
➢	Risk underlying the business process
➢	Value that the internal audit can provide to the organization
➢	Effort involved in conducting the internal audit for a particular business process
➢	Risk Appetite of the organization
➢	Coverage of all auditable areas within the defined time range
8.	The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. to perform detailed analysis of their expenses in previous year and report all risks and underlying gaps? What audit approach should Internal Auditor follow to identify such gaps?
Ans.	Refer para 5
9.	The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. to present detailed report on their finding and areas where immediate action is needed to mitigate critical risks? What should be the content of internal audit report to address this requirement of the Audit Committee?
Ans.	Refer para 6
	As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:
➢	**At the end of a particular audit assignment**, an "Internal Audit Report" covering a

	specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.
➢	**On a periodic basis, at the close of a plan period**, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.
	Accordingly, a typical internal audit report should include the following:
•	Audit Scope performed;
•	Audit period Covered;
•	Executive Summary;
•	Summary of the critical findings;
•	Detailed audit findings with elaboration on business impact and root cause of such issues;
•	Rating of the highlighted issues (E.g High / Medium / Low) in accordance to the rating criteria approved by Audit Committee;
•	Audit recommendation to improve control environment and address the highlighted finding;
•	Response received from the responsible functional authority containing action plan and target timelines for action.
10.	The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their analysis on the implementation of recommendation of previous audit report and highlight critical areas which need immediate attention of Audit Committee? What should be the steps followed by internal auditor to address this requirement of Audit Committee?

Ans·	Refer para 6·1
	As per SIA 390 Monitoring and Reporting of Prior Audit Issues, the Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits· This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance· The responsibility to implement the action plans remains with the management·
	In monitoring and reporting of prior audit issues, the responsibility of the Internal Auditor is usually in the form of an "Action Taken Report (ATR) of previous audits"·
	To address the requirement of Audit Committee in the given situation, Internal Auditor should assess the action taken against the previous audit findings and report a summary of the action taken by the management· Typical Action Taken Report may include the following:
➢	Reference to the previous audit reporting containing the reported issues
➢	Implementation Action agreed by the management along with target implementation date
➢	Status of action taken by management· The same may be classified under Implemented / Not Implemented
➢	Residual risk and rating for any unimplemented action
➢	Audit findings not implemented for long period of time
➢	Any critical audit finding that require immediate action for action or implementation
❖	**CASE STUDY**
	JKT Pvt· Ltd· having ₹ 40 lacs paid-up capital, ₹9·50 crores reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being ₹ 49 crores, ₹ 145 crores and ₹ 260 crores, but does not have any internal audit system· In view of the management, the internal audit system is not mandatory· Comment·
Ans·	**Applicability of Provisions of Internal Audit:** As per section 138 of the Companies Act, 2013, read with rule 13 of Companies (Audit and Auditors) Rules, 2014, every

	private company shall be required to appoint an internal auditor or a firm of internal auditors, having
(i)	turnover of two hundred crore rupees or more during the preceding financial year; or
	outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.
	Conclusion: In the instant case, JKT Pvt. Ltd. is having a turnover of ₹ 260 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the company has the statutory requirement to appoint an Internal Auditor and mandatorily conduct an internal audit.

CHAPTER - 17

DUE DILIGENCE, INVESTIGATION & FORENSIC AUDIT

❖ TEST YOUR UNDERSTANDING

1. CA. Y is employed with a leading private sector BDFP Bank posted in NOIDA branch. One of the existing borrowers has approached branch with a proposal to sanction fresh term loan of ₹5 crore with commensurate increase in working capital credit facilities relating to expansion of its garment manufacturing unit. While performing due diligence, he notices that company was formed just two years ago and had availed term loan of ₹ 10 crore and cash credit facilities of ₹5 crore respectively. Its sales have increased from ₹ 25 crores in first year to ₹45 crores in year just ended. It is generating cash profits and is timely servicing its debts.

The borrower was earlier catering to domestic market. However, now it is in process of procuring export orders and working assiduously in this regard. The expansion plans are in line with development in area of marketing relating to exports.

However, there are a large number of units catering to domestic and export market of garments in NOIDA, Delhi and surrounding areas. There is also demand slump in biggest US market.

Besides, the unit is family-based and relies upon marketing skills of its main promoter. There is lack of well-paid qualified staff with the borrower to deal effectively with its customers both domestic as well as foreign.

He starts jotting down and elaborating above points. Identify what he is trying to do as part of due diligence.

Ans. As part of due diligence exercise, he is performing SWOT analysis of borrower. He is making analysis of strengths, weaknesses, opportunities and threats (SWOT) pertaining to borrower. Features such as rise in sales, generation of cash profits and timely service of debts represent borrower strengths. Lack of well-paid qualified staff to deal effectively with its domestic and foreign customers is an area of weakness. Entering into export market presents opportunity for borrower and presence of large number of competitors and demand slump in US market reflect threats.

2.	A company has installed an Effluent treatment plant (ETP) in compliance with pollution control regulations of the state government. The authority structure in the company is fairly decentralized and top management of the company has given considerable leeway to different departments for meeting their manpower requirements in accordance with emerging and changing needs from time to time. Of late, the top management has grown suspicious over manpower expenditure in section maintaining and beautifying area around ETP. There is a system in the company where time cards are punched by all employees to mark attendance.
	Suggest any one procedure you would perform as an investigator to bring out the facts.
Ans.	The attendance record of employees pertaining to that section can be analysed with regards to in and out time. Further, surprise visit to the site can be conducted to see the actual number of workers at a point of time. It may reveal ghost workers. Discrepancies in attendance records vis-à-vis actual number of workers present could reveal dummy workers. Such a visit would also give indication of actual work done in the area and give an inkling of productivity of employees.
3.	X Limited engaged in manufacturing of floor coverings has taken a Product Liability Insurance policy (PLI). Such a policy covers risk of liabilities for damages for bodily injury resulting from sale and distribution of floor coverings by vendors of X Limited's products. The policy is also subject to "claim series" clause. A Claims Series event is a series of two or more claims arising from one specific common cause which are attributable to the same fault in design or manufacture of products or to the supply of the same products showing the same defect. A claim series event is deemed to be one claim under the terms & conditions of PLI policy.
	The company has been asked to shell out damages of ₹5 crore due to supply of faulty products to one of its vendors. The vendor had sold floor coverings to a 5 -star hotel which has alleged that harmful chemicals used in dyeing of floor coverings have resulted in skin ailments to some of its guests.
	Being in capacity of forensic accountant Professional appointed by insurance company, what special issues you would keep in mind while dealing with claims involving PLI policy covering such matters?

Ans·	
(i)	In claims involving product liability insurance policies, many documents are required from third parties· The third party may be unwilling to provide relevant documents to forensic accountant concerning the very organization responsible for causing damages·
(ii)	Independence of forensic accountant become paramount in such types of assignments because it involves engagement with parties who are not directly claiming from insurance company· Forensic accountant needs to resist any pressure or interference in establishing the scope of the assignments or the manner in which the work is conducted and reported·
(iii)	The company might be willing to negotiate it to salvage its reputation· It can lead to additional complexities·
(iv)	Quantification of legal liability under the policy can prove to be a challenging task and it has to be determined in accordance with policy terms & conditions·
(v)	Careful analysis of date of loss when first claim occurred in accordance with "claim series" clause and whether the same falls under the policy
❖	**THEORY QUESTIONS**
1·	Sri Rajan is above 80 years old and wishes to sell his proprietary business of manufacture of specialty chemicals· Ceta Ltd· wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business· What procedures you would adopt before you could render any advice to Ceta Ltd·?
Ans·	Refer Financial Due Diligence given in Para 3·
2·	An American Company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of more than 65% of the industrial gas business in India· It requests you to conduct a "Due Diligence" of this Indian Company and submit your Report· List out the contents of your Due Diligence Review Report that you will submit to your USA based Client·
Ans·	Refer Para 6·

3.	KDK Bank Ltd., received an application from a pharmaceutical company for takeover of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. KDK Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.
Ans.	Refer Over-Valued Assets Part given in Para 3.
4.	"Due diligence is different from audit" - Explain the difference between due diligence and audit.
Ans.	Refer Para 1.
5.	PB Ltd. entered into a deal with SV Ltd. for buying its business of manufacturing wooden products/ goods. PB Ltd. has appointed your firm for conducting due diligence review and they want to know the cash generating abilities of SV Ltd. What points will you check in order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally?
Ans.	In order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally, one is required to verify:
(a)	Is the company able to honor its commitments to its trade payables, to the banks, to the government and other stakeholders?
(b)	How well is the company able to convert its trade receivables and inventories?
(c)	How well the Company deploys its funds?
(d)	Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
(e)	What is the investment pattern of the company and are they easily realizable?
	Refer Cash Flow in Para 3.
6.	CA. Sanjana is acting as Credit manager in branch of DFC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth ₹10 crore for meeting usual business requirements. It is a prospective new client. She checks

	past history of the company, back ground of promoters & directors, shareholding pattern and nature of business. Assessment of financial results of past years and future projections is also undertaken. She also carries out SWOT analysis of the company. Besides, assessment of net worth of directors is also undertaken. Status of CIBIL score and position of name of promoters/directors in RBI defaulter list is also verified. She also makes discreet inquiries from few clients of the branch engaged in similar line of activity regarding credit worthiness of company, its promoters and directors.
	Based on above-
(a)	Identify activity being performed by CA Sanjana and discuss its nature.
(b)	Would your answer be different if this activity was to be performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.
(c)	Name any three other areas where identified activity can be undertaken.
Ans.	
(a)	The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.
	Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.
	Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

(b)	There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.
(c)	The areas where due diligence may be undertaken are: -
(i)	Corporate restructuring
(ii)	Venture capital financing
(iii)	Public offerings
7.	A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.
	List out the points you will cover in your investigation before submitting your report to the General Manager.
Ans.	Refer Para 11.3.
8.	What are the important steps involved while conducting Investigation on behalf of an Incoming Partner?
Ans.	Refer Para 11.1.
9.	Mr. Clean who proposes to buy the proprietary business of Mr. Perfect, engages you as investigating accountant. Specify the areas which you will cover in your investigation.
Ans.	Refer Para 10 and 11.5.
10.	In a Company, it is suspected that there has been embezzlement in cash receipts. As an investigator, what are the areas that you would verify?
Ans.	Refer Cash Receipts embezzlement in Para 11.4.1.

11.	J Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd., what factors would you consider in assessing the future maintainable turnover?
Ans.	In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:
(i)	**Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
(ii)	**Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
(iii)	**Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
(iv)	**Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?
12.	MF. Ltd., engaged in the manufacturing of various products in its factory, is concerned with shortage in production and there arose suspicion of inventory fraud. You are appointed by MF Ltd. To evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory?
Ans.	Refer Inventory Fraud in Para 11.4.1.
13.	In a Public Limited Company, it is suspected by the Management that there has been embezzlement in supplier's ledger. As an auditor of the Company, you have been asked to investigate the matter. What are the major areas that you would verify in this regard?
Ans.	Refer Areas to be verified in case of embezzlement in supplier's ledger in Para 11.4.1.

14. General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose.

In view of the above, you are required to brief out the difference between Audit and Investigation.

Ans. Refer Para 7.1.

15. Enumerate the steps to be undertaken in case of forensic accounting process.

Ans. Refer Para 14

16. Briefly discuss the key content of Forensic Accounting and Investigation Report.

Ans. Refer Para 15

17. ABC Ltd. is a listed company having turnover of ₹ 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of ₹ 20 crore.

Rupees (In crore)	Purpose
10.0	- for Building
8.5	- for Machinery
1.5	- for Working Capital
20 Crore	**Total**

Project gets implemented in 2022-23 and one of the accountants report to the Managing Director that some suspicious transactions are noticed in the purchase of building material. But the Management is confused as to whether they should get an audit or Forensic Accounting done for the same. Advise Management about the difference in forensic accounting and audit.

Ans. Refer Para 12

CHAPTER - 18

EMERGING AREAS SUSTAINABLE DEVELOPMENT GOALS (SDG) & ENVIRONMENT

❖ **TEST YOUR KNOWLEDGE**

1. You have recently joined a listed company after qualifying CA final exams through campus placement programme conducted by CMI&B at ICAI. Although the company you have joined in is not amongst top 1000 listed companies in the country, it wants to include "Sustainability reporting" in accordance with Global Reporting Initiative framework (GRI) in its annual report on voluntary basis. "Sustainability reporting" seems to be new buzzword in corporate circles and you are assigned responsibility for collating all the information required for such reporting.

In above context, dwell upon what is your understanding of "Sustainability reporting"? Can you list some of its expected benefits?

Ans. Sustainability reporting is an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development

Sustainability reporting refers to the information that companies provide about their performance to the outside world on a regular basis in a structured way. It is the comprehensive mechanism of measuring and disclosing sustainability data with performance indicators and management disclosures.

Expected BenefitsI:t can help stakeholders to understand organizations performance vis a vis sustainability and impacts. The reporting process emphasizes the link between financial and non-financial performance.

Such reporting can help entities to focus on long-term value creation, by addressing environmental, social and governance (ESG) issues. Since investors are increasingly recognising that environmental and social issues provide both risks and opportunities in respect of their investments and are seeking disclosures on environmental and social performance of businesses, they can use ESG performance of companies to make investment decisions.

	Investing in social and environmental issues will not only improve own business continuity of companies but also put them in a better position with their B2B (Business to Business) customers as well as enable them to acquire new ones.
2.	Trustworthy Industries Limited (a listed company) has already been preparing and disclosing its sustainability report based upon internationally accepted reporting framework of "Integrated Reporting" on a voluntary basis even some years before BRSR reporting became mandatory. Even after BRSR reporting became mandatory, it is cross-referencing disclosures made under such reporting to disclosures sought under BRSR. The key thrust of "Integrated Reporting" is how company creates value over short, medium and long term.
	Following further information is provided in respect of the above company: -
(i)	It has increased the number of customers using digital customer mobile app of the company from 2 lac users to 4 lac users. There is 100% increase in digital collection. It has benefitted customers of the company and resulted in use of digital methods for business operations of the company.
(ii)	It has increased the number of beneficiaries under its flagship CSR programmes from previous 10000 to 75000. It has provided value for communities and provided sustainable livelihood to them.
	Discussing above information, identify which of the capitals of "Integrated Reporting" are being referred to at [i] and [ii] respectively?
Ans.	The information at [i] states that company has increased the number of customers using digital mobile app. Besides, it has led to 100% increase in digital collection. Therefore, it involves use of technology for deriving business benefits. It has invested in innovation deriving business benefits from digitization. The capital referred to at [i] is "Intellectual Capital".
	Increase in number of beneficiaries under flagship CSR programmes providing value for communities and sustainable livelihood is an example of relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being. The capital referred to at [ii] is "Social and Relationship Capital."

❖	**THEORY QUESTIONS**
1.	What type of companies are required to mandatorily furnish the Business Responsibility and Sustainability Report (BRSR) as per the SEBI circular with effect from FY 2022-23?
Ans.	Refer para 7.1
2.	What are the nine principles of BRSR? How are the nine principles of BRSR linked with the 17 UN Sustainable Development Goals?
Ans.	Refer para 7.1.1
3.	What are the global trends in sustainable reporting?
Ans.	Refer para 5
4.	What are the 6 C's of Integrated reporting?
Ans.	Refer para 4
5.	What is the methodology of providing assurance in BRSR?
Ans.	Refer para 7.1.4
6.	What is the auditor's role on ESG aspects in an audit of financial statements of the Company?
Ans.	Refer para 8
❖	**INTEGRATED CASE SCENARIO**
	"Quick Push Finance Limited" is one of the top listed 1000 companies by market capitalization. As per a SEBI circular, Business Responsibility and Sustainability Report (BRSR) based on ESG parameters is mandatory from financial year 2022-23 for top listed 1000 companies. The company is an NBFC and is engaged mainly in providing finance for commercial vehicles.
	The report is to be prepared in three sections- Section A, B and C. Whereas Section A and B relate to general disclosures and management & process disclosures respectively,

	Section C of the report relates to principle wise performance disclosures. Under this section C, information is sought on each of the 9 principles of "National Guidelines on Responsible Business Conduct" (NGBRCs). This information is categorized on two indicators i.e., "Essential indicators" and "Leadership indicators".
	The said company has an anti-corruption/anti-bribery policy which is available on its website. Besides, the company has regularly conducted awareness programmes for its dealers highlighting relevant governance practices of the company.
	The company is sensitive to environmental concerns. It has established mechanisms to recycle hazardous e-waste in accordance with applicable laws. Further, disposal of paper waste is also made responsibly. It is also a member of 5 prominent industry chambers/trade associations including FICCI, CII and ASSOCHAM. Besides, regular inputs to government are provided by the company through various forums for improvement in administrative processes relating to automobile and financial sectors.
	One of the NGBRC principles states that businesses should promote inclusive growth and equitable development. The scope of this principle is wide and quite encompassing. Many activities of company could fall under promotion of inclusive growth and equitable development.
	The CFO of company is clueless as to preparation of BRSR. Help him out by answering the following questions.
	Based upon above, answer the following questions: -
1.	**As regards anti-corruption/anti-bribery policy and organization of awareness programmes for dealers conducted during the year, which of the following is most likely to be true?**
(a)	Having an anti-corruption/anti-bribery policy and organization of awareness programmes for dealers are in nature of essential indicators.
(b)	Having an anti-corruption/anti-bribery policy and organization of awareness programmes for dealers are in nature of leadership indicators.
(c)	Having an anti-corruption/anti-bribery policy is in nature of essential indicators. Organization of awareness programmes for dealers is in nature of leadership indicators.
(d)	Having an anti-corruption/anti-bribery policy is in nature of leadership indicators. Organization of awareness programmes for dealers is in nature of essential indicators.

2.	**As regards established mechanisms for recycle of hazardous e-waste and disposal of paper waste by company, which of the NGBRC principle(s) are involved?**
(a)	Principle 5 only
(b)	Principle 9 only
(c)	Principles 6 and 9
(d)	Principles 2 and 6
3.	**Considering description of membership of various industry chambers/ trade associations and providing of inputs to government for improvement in administrative processes, which of the NGBRC principle is referred to?**
(a)	Principle 8
(b)	Principle 4
(c)	Principle 3
(d)	Principle 7
4.	**Which of the following activities relates to the principle that businesses should promote inclusive growth and equitable development?**
(a)	CSR projects undertaken by the company in designated aspirational districts of country
(b)	Carrying out real time digital Net Promoter score (NPS) with all public customers to gauge customer reactions and satisfaction
(c)	Getting conducted "energy audits" in the company
(d)	Conducting programmes to assist employees in finding employment after retirement
5.	**Which of the following statements is true in respect of essential indicators and leadership indicators as far as their reporting in BRSR is concerned?**
(a)	Both types of indicators are mandatorily required to be disclosed.
(b)	Essential indicators require mandatory disclosure whereas leadership indicators require voluntary disclosure.
(c)	Essential indicators require voluntary disclosure whereas leadership indicators require mandatory disclosure.

(d) All indicators based information whether relating to essential indicators or leadership indicators is voluntary.

ANSWERS:

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

❖ **CASE STUDY**

The agrochemical sector is about a $35 billion industry in India. The Indian agrochemicals market is segmented by product type (fertilizers, pesticides, adjuvants, and plant growth regulators) and application (crop-based and non-crop-based). India is one of the most prominent exporters of agrochemicals in the world and is being keenly looked at as an ideal hub for export-oriented production of agrochemicals. There has been a recent surge in the production of agrochemicals to overcome problems such as lack of right nutritious elements required for proper growth of crops, etc. While there is low awareness about the use and impact of agrochemicals, there is also a push from the industries to use more agrochemicals, linking it to better yield. The continuous and increased use of agrochemicals seems to have an adverse effect on humans, animals, and nature in whole.

The toxicity levels of the agrochemicals are harmful, not only to the workers in the manufacturing process but also to farmers, the soil, and the end consumers. The Central Insecticide Board (CIB) of India has categorized agrochemical toxicity levels based on a labeling system—using red, yellow, blue, and green labels—where red is the most toxic and green is the least. Most of the red-labeled products are banned abroad but are being sold in India due to the lack of a strong regulatory environment.

In India, it is estimated that almost 25% of the total amount of agrochemicals sold are counterfeit products. The quality and the efficacy of these counterfeit products differ from the original products, which can lead to reputational damages for the companies. Agrochemical companies need to add barcodes or other identifying technologies to their product packaging, to allow end- use consumers to check for authenticity. Also, since India is a multilingual country, the companies will have to publish the usage instructions in multiple languages.

	Company A and B are both listed companies and part of top 1000 listed companies. They are engaged in the production of agrochemicals. Company A has been looking for opportunities to comply with the recently launched and evolving guidelines for ESG in India while Company B on the other hand is just focused to increase revenue and profits. In December 2022, Company A made a decision to eliminate red-labeled products from its portfolio and to increase its research and development (R&D) spending to safeguard itself from the market shift due to the new regulatory norms; in 2022, it also discontinued yellow-labeled products. Company A is also planning to incur a small expenditure to improve their backend systems and provide for all its products a unique labeling system that is user friendly and interactive. At the other end of the spectrum, 14% of Company B's top-selling products are derived from red- and yellow labeled products.
	Initially, Company A's phasing out of its toxic products negatively affected its revenues by 8%. But as the country's regulatory landscape evolves toward more stringent norms, Company A will be cushioned for regulatory changes and thus, would not face potential future downsides. Company B has recently witnessed a 9% year on year growth in revenue from the last financial year and is planning to increase the production of its bestselling product, an insecticide DDT, categorized as red labelled by the Central Insecticide Board. Company B has recently been approached by the regulatory authority for an investigation for its products which include performing additional tests and studies to testify that its products have no adverse effects.
1.	What would be the reporting requirements for each of the two companies?
2.	Which Company has absorbed the impacts of possible future regulatory changes? What are the steps taken by that Company for complying with the regulatory standards?
3.	What would be the consideration by the auditors of Company A and B in the audit of financial statements?
	SOLUTION
1.	Both Companies A and B are among part of top 1000 listed companies. Hence, these companies have to mandatorily provide BRSR reporting (Business responsibility and Sustainability reporting) in accordance with 9 principles of NGBRC as mandated by SEBI.

2.	Company A has absorbed impact of regulatory changes. It has decided to eliminate red-labelled and yellow-labelled products from its portfolio which are toxic in nature. Besides, it has increased its expenditure on R & D to meet with new regulatory norms. It has also incurred expenditure for improving its labelling system which would help end users to know about the nature of the product. All these steps have been taken by Company A for complying with regulatory standards. Company A is trying to meet with requirements of Principle 2 by making R & D expenditure. Further, it has also eliminated red-labelled/yellow-labelled products from its portfolio. Principle 2 relates to the requirement that businesses should provide goods and services in a manner that is sustainable and safe. Besides, by adopting a friendly bar-coded packaging labelling system, company is adhering to requirements of Principle 9 which states that businesses should engage with and provide value to their consumers in a responsible manner. Steps taken by a company to inform its consumers about safe and responsible usage of products fall in its domain. Since toxic agrochemicals are also harmful to workers engaged in their manufacturing process, their discontinuation bodes well for workers in the company A in line with Principle 3 which states that businesses should respect and promote the well-being of all employees including those in their value chains. By discontinuing products which are harmful to soil, company A is meeting requirements of Principle 6 which states that businesses should respect and make efforts to protect and restore the environment.
2.	Company A is complying with regulatory norms whereas 14% of company B's revenue are derived from red and yellow labelled products. In fact, company B is planning to increase production of its red labelled product i.e., insecticide DDT which has been categorized as such by Central Insecticide Board. The auditor of Company B would have to keep in mind requirements of SA 250 in this regard. Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements. It can result in material misstatements. Central Insecticide Board has already launched its investigation into products of company. All these factors would be taken into consideration by auditor of Company B.

Auditors of Company A and Company B need to obtain audit evidence regarding compliance with laws and regulations and audit procedures have to be designed accordingly. Auditor of Company A can obtain assurance from regulatory compliance by the company. Fall of revenue by 8% in one year is not a matter of concern to them as it is a transitory phase.

However, auditors of Company B would also have to take into consideration requirements of SA 570 as non-compliance with regulatory requirements could result into claims from such proceedings which the company may not be able to satisfy.

CHAPTER – 19 PROFESSIONAL ETHICS

❖ ILLUSTRATIONS WITH SOLUTION

1. A Chartered Accountant in practice has been suspended from practice for a period of 6 months and he had surrendered his Certificate of Practice for the said period. During the said period of suspension, though the member did not undertake any audit assignments, he undertook representation assignments for income tax whereby he would appear before the tax authorities in his capacity as a Chartered Accountant.

Ans. **Undertaking Tax Representation Work:** A chartered accountant not holding certificate of practice cannot take up any other work because it would be violation of the relevant provisions of the Chartered Accountants Act, 1949.

In case a member is suspended and is not holding Certificate of Practice, he cannot in any other capacity take up any practice separable from his capacity to practice as a member of the Institute. This is because once a person becomes a member of the Institute; he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations.

If he appears before the income tax authorities, he is only doing so in his capacity as a chartered accountant and a member of the Institute. Having bound himself by the said Act and its Regulations made there under, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity.

Conclusion: Thus, in the instant case, a chartered accountant would not be allowed to represent before the income tax authorities for the period he remains suspended. Accordingly, in the present case he is guilty of professional misconduct.

2. Mr. A, a practicing Chartered Accountant agreed to select and recruit personnel, conduct training programmes for and on behalf of a client where he is not providing any assurance service. Is this a professional misconduct?

Ans. **Providing Management Consultancy and Other Services:** Under Section 2(2)(iv) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed "to be in practice" when individually or in partnership with Chartered Accountants in practice, he, in consideration of remuneration received or to be received renders

	such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice. Pursuant to Section 2(2)(iv) above, the Council has passed a resolution permitting a Chartered Accountant in practice to render entire range of "Management Consultancy and other Services".
	The definition of the expression "Management Consultancy and other Services" includes Personnel recruitment and selection. Personnel Recruitment and selection includes, development of human resources including designing and conduct of training programmes, work study, job description, job evaluation and evaluations of workloads.
	Conclusion: Therefore, Mr. A is not guilty of professional misconduct.
3.	Mr. X & Mr. Y, partners of a Chartered Accountant Firm, one in-charge of Head Office and another in-charge of Branch at a distance of 80 km. from the municipal limits, puts up a name-board of the firm in both premises and also in their respective residences.
Ans.	**Putting Name Board of the Firm at Residence:** The council of the Institute has decided that with regard to the use of the name-board, there will be no bar to the putting up of a name-board in the place of residence of a member with the designation of chartered accountant, provided, it is a name-plate or board of an individual member and not of the firm.
	In the given case, partners of XY & Co., put up a name board of the firm in both offices but not in their respective residences.
	Conclusion: Thus, the chartered accountants are guilty of misconduct. Distance given in the question is not relevant for deciding.
4.	Mr. K, Chartered Accountant practicing as a sole proprietor has an office in the suburbs of Chennai. Due to increase in the income tax assessment work, he opens another office near the income tax office, which is within the city and at a distance of 30 km. from his office in the suburb. For running the new office, he has employed a retired Income Tax Commissioner who is not a Chartered Accountant.
Ans.	**Maintenance of Branch Office in the Same City:** As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office

	in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 km. from the municipal limits of a city, in which the first office is located.
	In the given case, Mr. K, Chartered Accountant in practice as a sole proprietor at Chennai has an office in suburbs of Chennai, and due to increase in the work he opened another branch within the city near the income tax office. He also employed a retired income tax commissioner to run the new office and the second office is situated within a distance of 30 kilometers from his office in the suburb.
	Conclusion: In view of above provisions, there will be no misconduct if Mr. K will be in - charge of both the offices. However, he is bound to declare which of the two offices is the main office.
5.	Mr. C, Chartered Accountant, in practice allowed his brother-in-law Mr. P who is not a Chartered Accountant, to practice in the name of CA. C. He also allowed Mr. T who is employee in his firm to practice in the name. Whether Mr. C is correct in allowing his brother-in-law Mr. P and Mr. T employee of his firm to practice in his name.
Ans.	**Allowing to Practice in a Chartered Accountant's name:** As per Clause (1) of Part I to the First Schedule to Chartered Accountants' Act, 1949, a Chartered Accountant in practice is 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.
	In the given situation Mr. C, Chartered Accountant who is in practice allowed a non-Chartered Accountant his brother-in-law Mr. P to practice in the name of CA. C is not correct in view of Clause 1 of Part I to the First Schedule. However, he can allow Mr. T who is employee in his firm to practice in his name.
	Conclusion: Thus, CA. C will be held guilty of professional misconduct for allowing Mr. P who is not a Chartered Accountant to practice in his name as a chartered accountant as per Clause (1) of Part I to the First Schedule.

6.	Mr. Qureshi, Chartered Accountant, in practice died in a road accident. His widow proposes to sell the practice of her husband to Mr. Pardeshi, Chartered Accountant, for ₹ 5 lakhs. The price also includes right to use the firm name - Qureshi and Associates. Can widow of Qureshi sell the practice and can Mr. Pardeshi continue to practice in that name as a proprietor?
Ans.	**Sale of Goodwill:** With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.
	It lays down that the sale is permitted subject to certain conditions discussed in the above flowchart. It further resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.
	Conclusion: Thus, in a given case, the widow of Mr. Qureshi, who has proposed to sell the practice for ₹ 5 lakhs is in effect proposing the sale of goodwill. Thus, the act of Mrs. Qureshi is permissible and Mr. Pardeshi can continue to practice in that name as a proprietor.
7.	Mr. S, a Chartered Accountant published a book and gave his personal details as the author. These details also mentioned his professional experience.
Ans.	**Soliciting Professional Work:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means. Therefore, members should not adopt any indirect methods to advertise their professional practice with a view to gain publicity and thereby solicit clients or professional work. Such a restraint must be practiced so that members may maintain their independence of judgement and may be able to command the respect of their prospective clients. While elaborating forms of soliciting work, the Council has specified that a member is not permitted to indicate in a book or an article, published by

	him, his association with any firm of chartered accountants. In this case, Mr. S, a Chartered Accountant published the book and mentioned his professional experience in detail in the same.
	Conclusion: Mr. S being a chartered accountant in practice has committed the professional misconduct by mentioning his professional experience.
8.	M/s XYZ, a firm of Chartered Accountants created a website "www.xyzindia.com". The website besides containing details of the firm and bio-data of the partners also contains the passport size photographs of all the partners of the firm.
Ans.	**Hosting Details on Website:** As per detailed guidelines of the ICAI laid down in Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant of the firm can create its own website using any format subject to guidelines. However, the website should be so designed that it does not solicit clients or professional work and should not amount to direct or indirect advertisement. The guidelines of the ICAI to allow a firm to put up the details of the firm, bio-data of partners and display of a passport size photograph.
	Conclusion: In the case of M/s XYZ, all the guidelines seem to have been complied and there appears to be no violation of the Chartered Accountants Act, 1949 and its Regulations.
9.	M/s LMN, a firm of Chartered Accountants responded to a tender from a State Government for computerization of land revenue records. For this purpose, the firm also paid ₹ 50,000 as earnest deposit as part of the terms of the tender.
Ans.	**Responding to Tenders:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. As per the guidelines if a matter relates to any services other than audit, members can respond to any tender. Further, in respect of a non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits.
	Conclusion: In the instance case, since computerization of land revenue records does not fall within exclusive areas for chartered accountants, M/s LMN can respond to tender as well as deposit ₹ 50,000 as earnest deposit and shall not have committed

any professional misconduct.

10. Mr. Honest, a Chartered Accountant in practice, wrote two letters to M/s XY Chartered Accountants a firm of CAs; requesting them to allot him some professional work. As he did not have a significant practice or clients he also wrote a letter to M/s ABC, a firm of Chartered Accountants for securing professional work. Mr. Clever, another CA, informed ICAI regarding Mr. Honest's approach to secure the professional work. Is Mr. Honest wrong in soliciting professional work?

Ans. **Securing Professional Work:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Provided that nothing herein contained shall be construed as preventing or prohibiting any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice.

Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Conclusion: In the given case, Mr. Honest wrote letters only to other Chartered Accountants, M/s XY and M/s ABC requesting them to allot some professional work to him, which is not prohibited under Clause (6) as explained above. Thus, Mr. Honest has not committed any professional misconduct by soliciting professional work.

11. A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, as a Tax Consultant.

Ans. **Tax Consultant:** Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public.

	Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.
	Conclusion: Thus, it is improper to use designation "Tax Consultant" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council.
12.	B, a Chartered Accountant in practice is a partner in 3 firms. While printing his personal letter heads, B gave the names of all the firms in which he is a partner.
Ans.	**Advertisement of Professional Attainments:** Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public. Even a member is not permitted to specify the date of setting up of practice or establishment of firm on letterheads. However, there i s no prohibition for printing names of all the three firms on the personal letterheads in which a member holding Certificate of Practice is a partner.
	Conclusion: Thus, B is not guilty of any misconduct under the Chartered Accountants Act, 1949.
13.	The offer document of a listed company in which Mr. D, a practising Chartered Accountant is a director mentions the name of Mr. D as a director along with his various professional attainments and spheres of specialisation.
Ans.	**Advertisement of Professional Attainments:** The Council of the ICAI has in a communication to members stated that if a public company, in which a chartered accountant in practice is a director, issues a prospectus or gives any announcement that gives descriptions about the Chartered Accountant's expertise, specialisation and

	knowledge in any particular field, it shall constitute a misconduct under Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The Council has further stated that in such cases the member concerned has to take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the members.
	Conclusion: Thus, in the instant case, Mr. D would be held to be guilty of professional mis-conduct and liable for disciplinary action.
14.	A Chartered Accountant in practice, empanelled as an Insolvency Professional (IP) has mentioned the same on his visiting cards, letter heads and other communications also. A person residing in his neighbourhood, has filed a complaint for professional misconduct against the said member for such mention of IP.
Ans.	**Using Designation of Insolvency Professional:** As per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than 'Chartered Accountant" on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.
	Here, a Chartered Accountant empaneled as IP (Insolvency Professional) can mention "Insolvency Professional" on his visiting cards, letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause 7 of Part 1 of First Schedule to the Chartered Accountants Act, 1949.
	Conclusion: Thus, complaint of neighbor is not enforceable/ valid.
15.	Mr. X, a Chartered Accountant accepted his appointment as tax auditor of a firm under Section 44AB, of the Income-tax Act, and commenced the tax audit within

two days of his appointment since the client was in a hurry to file Return of Income before the due date. After commencing the audit, Mr. X realised his mistake of accepting this tax audit without sending any communication to the previous tax auditor. In order to rectify his mistake, before signing the tax audit report, he sent a registered post to the previous auditor and obtained the postal acknowledgement. Will Mr. X be held guilty under the Chartered Accountants Act?

Ans. **Communication with the Previous Auditor:** As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, Mr. X will be held guilty since he has accepted the tax audit, without first communicating with the previous auditor in writing. The object of the incoming auditor communicating in writing with the retiring auditor is to ascertain whether there are any circumstances which warrant him not to accept the appointment, for example, whether the previous auditor has been changed on account of having qualified the report or he had expressed a wish not to continue on account of something inherently wrong with the administration of the business. The retiring auditor may even give out information regarding the condition of the accounts of the client or the reason that impelled him to qualify his report. Under all circumstances, it would be essential for the incoming auditor to carefully consider the facts before deciding whether or not he should accept the audit. As a matter of professional courtesy and professional obligation it is necessary for the new auditor appointed to communicate with such earlier auditor.

Conclusion: Therefore, Mr. X will be held guilty of professional misconduct.

16. W, a Chartered Accountant had sent letters under certificate of posting to the previous auditor informing him his appointment as an auditor before the commencement of audit by him.

Ans. **Communication with the Previous Auditor:** Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 requires communication by the incoming auditor with the previous auditor before accepting a position by him. The Council of the Institute has taken the view that a mere posting of a letter "under certificate of posting" is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person

	communicated with. A Chartered Accountant who relies solely upon a letter posted "under certificate of posting" therefore does so at his own risk. Since the letters were sent by "W" to the previous auditor informing him of his appointment as an auditor before the commencement of audit by him under Certificate of Posting is not sufficient to prove communication with the retiring auditor. In the opinion of the Council, communication by a letter sent "Registered Acknowledgement Due" or by hand against a written acknowledgement would in the normal course provide positive evidence.
	Conclusion: Hence "W" was guilty of professional misconduct under Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949.
17.	CA Raja was appointed as the Auditor of Castle Ltd. for the year 2022-23. Since he declined to accept the appointment, the Board of Directors appointed CA Rani as the auditor in the place of CA Raja, which was also accepted by CA Rani.
	Appointment of Auditor by Board: Board can appoint the auditor in the case of casual vacancy under section 139(8) of the Companies Act, 2013. The non-acceptance of appointment by CA. Raja does not constitute a casual vacancy to be filled by the Board. In this case, it will be deemed that no auditor was appointed in the AGM.
Ans.	Further, as per Section 139(10) of the Companies Act, 2013 when at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. The appointment of the auditor by the Board is defective in law.
	Clause (9) of Part I of First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant is deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956 (now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013), in respect of such appointment have been fully complied with.
	Conclusion: Hence, CA. Rani is guilty of professional misconduct since she accepted the appointment without verification of statutory requirements.

18.	Mr. X is a Chartered Accountant accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor before accepting the audit. He also failed to ascertain the compliance of requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.
Ans.	Communication by incoming auditor with previous auditor: Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 requires communication by the incoming auditor with the previous auditor before accepting a position by him. Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (now Section 139 and 140 of the Companies Act, 2013), in respect of such appointment have been duly complied with.
	Under this clause it is obligatory on the incoming auditor to communicate with previous auditor and ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment. In this case Mr. X accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor. Further, he accepted the appointment without first ascertaining whether the requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.
	Conclusion: Therefore, Mr. X is liable for misconduct under clause 8 and Clause 9 since he accepted the appointment without communicating with previous auditor as well as for not verifying the compliance of statutory requirements.
19.	Mr. P a practicing chartered accountant acting as liquidator of AB & Co. charged his professional fees on percentage of the realization of assets.
Ans.	Restriction on fees based on a Percentage: According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in

	practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.
	However, CA Regulation allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of a receiver or a liquidator, and the fees may be based on a percentage of the realization or disbursement of the assets.
	In the given case, Mr. P, a practicing Chartered Accountant, has acted as liquidator of AB & Co. and charged his professional fees on percentage of the realisation of assets.
	Conclusion: Therefore, Mr. P shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the realisation of assets being a liquidator.
20.	A chartered accountant holding certificate of practice and having four articled clerks registered under him accepts appointment as a full-time lecturer in a college. Also, he becomes a partner with his brother in a business. Examine his conduct in the light of Chartered Accountants Act, 1949 and the regulations thereunder.
Ans.	**Specific Permission to be Obtained:** Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. This clause, in effect, has empowered the Council of the Institute to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper. Accordingly, the Council had formulated Regulations 190A and 191 to the Chartered Accountants Regulations, 1988 to provide a basis for considering applications of chartered accountants seeking permission to engage in other business or occupation.
	A member can accept full- time lecturer-ship in a college only after obtaining the specific and prior approval of the Council as also becoming a partner in a business with his brother would require specific permission.

	Conclusion: Thus, the chartered accountant is liable for professional misconduct since he failed to obtain specific and prior approval of the Council in each case.
21.	Mr. A, a practicing Chartered Accountant, took over as the executive chairman of Software Company on 1.4.2023. On 10.4.2023 he applied to the Council for permission.
Ans.	**Specific Permission to be Obtained:** As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.
	In the instant case, Mr. A took over as the executive chairman on 01.04.2023 and applied for permission on 10.04.2023. On the basis of these facts, he was engaged in other occupation between the period 01.04.2023 and 10.04.2023, without the permission of the Council. **Conclusion:** Therefore, Mr. A is guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.
22.	CA. Prabhu is a leading income tax practitioner and consultant for derivative products. He resides in Mumbai near to the ABC commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 50% of his time to settle the commodity transactions. Is C.A. Prabhu liable for professional misconduct?
Ans.	**Engaging into a Business:** As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.
	However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.
	In this case, CA. Prabhu is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

	Conclusion: Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.
23.	S, a practicing chartered accountant gives power of attorney to an employee chartered accountant to sign reports and financial statements on his behalf.
Ans.	**Power of Signing Reports and Financial Statements:** Under Clause (12) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.
	This clause read in conjunction with Section 26 of the Chartered Accountants Act, 1949 stipulates that no person other than the member of the institute shall sign any document on behalf of a Chartered Accountant in practice or a firm of Chartered Accountants in his or its professional capacity.
	The term 'Financial Statement' for this purpose would cover an examination of the accounts or financial statements given under a statutory enactment or otherwise.
	Further, Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.
	Conclusion: Accordingly, S is guilty of professional misconduct under Clause (12) of Part I of First Schedule and also under Clause (1) of Part II of Second Schedule for contravening Section 26.
24.	CA. Smart, a practicing Chartered Accountant was on Europe tour between 15-9-23 and 25-9-23. On 18-9-23 a message was received from one of his clients requesting for a stock certificate to be produced to the bank on or before 20-9-23. Due to urgency, CA. Smart directed his assistant, who is also a Chartered Accountant, to

	sign and issue the stock certificate after due verification, on his behalf.
Ans.	**Allowing a Member Not Being a Partner to Sign Certificate:** As per Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behal f of his firm, any balance sheet, profit and loss account, report or financial statements".
	In this case, CA. Smart allowed his assistant who is not a partner but a member of the Institute of Chartered Accountants of India to sign stock certificate on his behalf and thereby commits misconduct.
	Conclusion: Thus, CA. Smart is guilty of professional misconduct under Clause (12) of Part I of First Schedule to the Chartered Accountants Act, 1949.
25.	Mr. 'C', a Chartered Accountant holds a certificate of practice while in employment also, recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from employer paid a particular sum as referral fee to Mr. 'C'.
Ans.	**Referral Fee from Lawyer:** According to Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949, a member of the Institute(other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.
	In the present case, Mr. C who beside holding a certificate of practice, is also an employee and by referring a lawyer to the company in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.
	Conclusion: Therefore, Mr. C is guilty of professional misconduct by virtue of Clause (2) of Part II of First schedule.
26.	Mr. 'G', while applying for a certificate of practice, did not fill in the columns which

	solicit information about his engagement in other occupation or business, while he was indeed engaged in a business.
Ans.	**Disclosure of Information:** As per Clause (2) of Part III of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant, in practice or not, does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;
	In the given case, Mr. "G", a Chartered Accountant while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business. Details of engagement in business need to be disclosed while applying for the certificate of practice as it was the information called for in the application, by the Institute.
	Conclusion: Thus, Mr. G will be held guilty for professional misconduct under the Clause (2) of Part III of First Schedule of the Chartered Accountants Act, 1949.
27.	Mr. X, a Chartered Accountant, employed as a paid Assistant with a Chartered Accountant firm, leaves the services of the firm on 31st December, 2023. Despite many reminders from ICAI he fails to reply regarding the date of leaving the services of the firm.
Ans.	**Failed to Supply Information Called For:** As per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.
	Conclusion: Thus, in the given case, Mr. X has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant. Therefore, he i s held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

28.	YKS & Co., a proprietary firm of Chartered Accountants was appointed as a concurrent auditor of a bank. YKS, the proprietor, used his influence to get a loan and thereafter failed to repay the loan.
Ans.	**Disrepute to the Profession:** This is a case which is covered under the expression in other misconduct of the Chartered Accountants Act, 1949. As per Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work. Here the Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards calls for disciplinary action. In the present case, YKS & Co, being a concurrent auditor used his position to obtain the funds and failed to repay the same to the bank. This brings disrepute to the profession of a Chartered Accountant. This act of YKS & Co is not pardonable. **Conclusion:** Therefore, YKS & Co will be held guilty of other misconduct under Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949.
29.	Mr. P, a Chartered Accountant was invited by the Chamber of Commerce to present a paper in a symposium on the issues facing Indian Leather Industry. During the course of his presentation, he shared some of the vital information of his client's business under the impression that it will help the Nation to compete with other countries at international level.
Ans.	**Disclosure of Client's Information:** Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 deals with the professional misconduct relating to the disclosure of information by a chartered accountant in practice relating to the business of his clients to any person other than his client without the consent of his client or otherwise than as required by any law for the time being in force would amount to breach of conduct. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. The Chartered Accountant may however, disclose the information in case it is required as a part of performance of

	his professional duties. In the given case, Mr. P has disclosed vital information of his client's business without the consent of the client under the impression that it will help the nation to compete with other countries at International level.
	Conclusion: Thus, it is a professional misconduct covered by Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949.
30.	Mr. J, a Chartered Accountant during the course of audit of M/s XYZ Ltd. came to know that the company has taken a loan of ₹ 10 lakhs from Employees Provident Fund. The said loan was not reflected in the books of account. However, the auditor ignored this information in his report.
Ans.	**Failure to Disclose Material Facts:** As per Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading. In this case, Mr. J has come across information that a loan of ₹ 10 lakhs has been taken by the company from Employees Provident Fund. This is contravention of Rules and the said loan has not been reflected in the books of accounts. Further, this material fact has also to be disclosed in the financial statements. The very fact that Mr. J has failed to disclose this fact in his report, he is attracted by the provisions of professional misconduct under Clause (5).
	Conclusion: Mr. J will be liable of professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.
31.	A practicing Chartered Accountant was appointed to represent a company before the tax authorities. He submitted certain information and explanations to the authorities on behalf of his clients, which were found to be false and misleading.
Ans.	**Submitting Information as Authorised Representative:** As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, if a member in practice fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional

	capacity, he will be held guilty under Clause (5)· As per Clause (6) of Part I of Second Schedule if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity, he will be held guilty under Clause (6)·
	In given case, the Chartered Accountant had submitted the statements before the taxation authorities· These statements are based on the data provided by the management of the company· Although the statements prepared were based on incorrect facts and misleading, the Chartered Accountant had only submitted them acting on the instructions of his client as his authorized representative·
	Conclusion: Hence the Chartered Accountant would not be held liable for professional misconduct·
32·	CA C who conducted statutory audit of a Haryana daily 'New Era' certified the circulation figures based on Management Information System Report (M·I·S Report) without examining the books of Account·
Ans·	**Failed to exercise Due Diligence:** According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties"·
	In the instant case, CA C did not exercise due diligence and is grossly negligent in the conduct of his professional duties since he certified the circulation figures without examining the books of accounts·
	To ascertain the number of paid copies verification of remittances from the agents, credit allowed to the agents for unsold copies returned, examination of books of account is essential· Further certification of circulation figures based on statistical information without cross verification with financial records amounts to gross negligence and failure to exercise due diligence·
	Conclusion: Hence, CA C is guilty of professional misconduct as per Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949·

33.	Mr. D, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.
Ans.	**Not Exercising Due Diligence:** According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties. It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence. Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard. He was guilty of professional misconduct under Clause (7). Since Mr. D has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements. **Conclusion:** Therefore, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.
34.	Mr. A, a Chartered Accountant was the auditor of 'A Limited'. During the financial year 2022-23, the investment appeared in the Balance Sheet of the company of ₹ 12 lakh and was the same amount as in the last year. Later on, it was found that the company's investments were only ₹ 25,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan.
Ans.	**Grossly Negligent in Conduct of Duties:** As per Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by

	a partner or an employee in his firm or by another chartered accountant in practice, under Clause (2); does not exercise due diligence, or is grossly negligent in the conduct of his professional duties, under Clause (7); or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, under Clause (8). The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation. In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty. **Conclusion:** Accordingly, Mr. A, will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.
35.	A charitable institution entrusted ₹ 10 lakhs with its auditors M/s R & Co., a Chartered Accountant firm, to invest in a specified securities. The auditors deposited it in their Savings bank account and no investment was made in the next three months.
Ans.	**Failure to Keep Money in Separate Bank Account:** If a Chartered Accountant in practice fails to keep moneys of his clients in a separate bank account or fails to use such moneys for purposes for which they are intended then his action would amount to professional misconduct under Clause (10) of Part I of Second Schedule to the Chartered Accountants Act, 1949. In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilise such funds only in accordance with the instructions of the client or for the purposes intended by the client.

	Conclusion: In the given case by depositing the client's money by M/s R & Co., a firm of Chartered Accountants, in their own savings bank account, the auditors have committed a professional misconduct. Hence in the given case, M/s R & Co. will be held guilty of professional misconduct.
36.	L, a chartered accountant did not maintain books of account for his professional earnings on the ground that his income is less than the limits prescribed u/s 44AA of the Income Tax Act, 1961.
Ans.	**Maintenance of Books of Account:** As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct. Accordingly, it does not matter whether section 44AA of the Income Tax Act, 1961 applies or not.
	Conclusion: Hence, Mr. L is guilty of professional misconduct.
37.	A member of the institute shall not accept in a year more than the specified number of tax audits under section 44AB of the Income Tax Act.
	Mr. G is a partner in M/s. XYZ & Co., a firm of Chartered Accountants with 6 partners.
	During the assessment year 2022-23, Mr. G alone had signed 290 tax audit reports consisting of both corporate and non-corporate assesses.
Ans.	**Ceiling limit for signing the Tax Audit Reports:** As per Council General Guidelines 2008, a member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961. It is also provided further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate.

	In the case of firm of Chartered Accountants in practice "the specified number of tax audit assignments" means, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.
	Further, as per clarification issued by the Institute on Tax Audit Assignments, tax audit reports may be signed by the partners in any manner whosoever in accordance with specified audit limits. Thus, one partner can individually sign all the tax audit reports subject to specified tax audit assignment limits on behalf of all the partners in the firm of Chartered Accountants in practice or all the partners of the firm can collectively sign the tax audit reports.
	In the instant case, there are 6 partners in M/s XYZ & Co., a Chartered Accountants firm, accordingly, specified ceiling limit for the firm will be (60 tax audit assignments per partner X 6 partners) = 360. Therefore, all the 6 partners of the firm can collectively sign 360 tax audit reports. This maximum limit of 360 tax audit reports. This maximum limit of 360 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 360 tax audit reports in case remaining 5 partners are not signing any tax audit report. Assuming Mr. G has signed 290 tax audit reports consisting of both corporate and non-corporate assesse on behalf of firm and remaining partners are signing audit reports within the specified number of tax audit assignments u/s 44AB i.e. upto 70.
	Conclusion: Hence, Mr. G shall not be deemed to guilty of professional misconduct provided total number of tax audit reports on behalf of firm do not exceeds 360.
38.	Mr. C accepted the statutory audit of M/s PSU Ltd., whose net worth is negative for the year 2021-22. The audit was to be conducted for the year 2022-23. The audited accounts for the year 2022-23 showed liability for payment of tax audit fees of ₹ 15,000 in favour of Mr. E, the previous auditor.
Ans.	**Accepting Appointment as an Auditor:** As per Chapter 7 of Council General Guidelines 2008, a member of the Institute of Chartered Accountants of India in practice shall be deemed to be guilty of professional misconduct if he accepts appointment as auditor of an entity in case the undisputed audit fee of another chartered accountant for carrying out the statutory audit under Companies Act or various other statutes

	has not been paid.
	As per the proviso, such prohibition shall not apply in case of a sick unit where a sick unit is defined to mean "where the net worth is negative".
	Conclusion: In the instant case, though the undisputed fees are unpaid, Mr. C would still not be guilty of professional misconduct since the M/s PSU Ltd. is a sick unit having negative net worth for the year 2021-22.
39.	A is the auditor of Z Ltd., which has a turnover of ₹ 200 crore. The audit fee for the year is fixed at ₹ 50 lakhs. During the year, the company offers A an assignment of management consultancy within the meaning of Section 2(2)(iv) of the CA Act, 1949 for a remuneration of ₹ 1 crore. A seeks your advice on accepting the assignment.
Ans.	**Appointment as a Statutory Auditor of a PSUs'/Govt. Company(ies)/Listed Company(ies) and Other Public Company(ies):** As per the Council General Guidelines 2008, under Chapter IX on appointment as statutory auditor a member of the Institute in practice shall not accepts the appointment as a statutory auditor of a PSUs'/Govt company(ies)/Listed company(ies) and other public company(ies) having a turnover of ₹ 50 crores or more in a year and where he accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking. For this purpose, the other work/services include Management Consultancy and all other professional services permitted by Council excluding audit under any other statute, Certification work required to be done by the statutory auditor and any representation before an authority.
	Conclusion: In view of the above position it would be a misconduct on A's part if he accepts the management consultancy assignment for a fee of ₹ 1 crore.
40.	D, who conducts the tax audit u/s 44AB of the Income Tax Act, 1961 of M/s ABC, a partnership firm, has received the audit fees of ₹ 2,50,000 on progressive basis in respect of the tax audit for the year ended 31.3.2023. The audit report was, however, signed on 25.5.2023.
Ans.	Entire Audit Fees Received in Advance: As per Chapter X of Council General Guidelines,

2008 a member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ₹ 1,00,000/-.

However, the Research Committee of the ICAI has expressed the opinion that where in accordance with the terms of engagement of auditor by a client, the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company at any stage.

Conclusion: In the instant case, Mr. D is appointed to conduct a tax audit u/s 44AB of the Income Tax Act, 1961. He has received the audit fees of ₹ 2,50,000 in respect of the tax audit for the year ended 31.3.2023 which is on progressive basis. Therefore, Mr. D will not be held guilty for misconduct.

❖ **THEORY QUESTIONS**

1. P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2023, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Is P guilty of professional misconduct?

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

	In view of this, P would be guilty of misconduct under the Chartered Accountants Act, 1949.
2.	Mr. G, a Chartered Accountant in practice as a sole proprietor has an office in Mumbai near Church Gate. Due to increase in professional work, he opens another office in a suburb of Mumbai which is approximately 80 kilometers away from the municipal limits of the city. For running the new office, he employs three retired Income-tax Officers. Is Mr. G guilty of professional misconduct?
Ans.	In terms of section 27 of the Chartered Accountants Act, 1949, if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. There is however an exemption for the above if the second office is located in the same premises, in which the first office is located; or the second office is located in the same city, in which the first office is located; or the second office is located within a distance of 50 kms. from the municipal limits of a city, in which the first office is located. Since the second office is situated beyond 50 kms. of municipal limits of Mumbai city, he would be liable for committing a professional misconduct.
3.	Write a short note on Other Misconduct.
Ans.	Refer Para 7.2
4.	Mr. K, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. Discuss this in the light of Professional Ethics issued by ICAI.
Ans.	**Sharing of Audit Fees with Non-Member:** As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant in practice pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other

	professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.
	In the instant case, Mr. K, a practising Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. In this case, it is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into.
	The Chartered Accountant had shared his profits and, therefore, Mr. K will be held guilty of professional misconduct under the Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949.
5.	Mr. X who passed his CA examination of ICAI on 18th July, 2022 and started his practice from August 15, 2022. On 16th August 2022, one female candidate approached him for article ship. In addition to monthly stipend, Mr. X also offered her 1 % profits of his CA firm. She agreed to take both 1 % profits of the CA firm and stipend as per the rate prescribed by the ICAI. The Institute of Chartered Accountants of India sent a letter to Mr. X objecting the payment of 1 % profits. Mr. X replies to the ICAI stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the financial position of the articled clerk is very weak. Is Mr. X liable to professional misconduct?
Ans.	**Sharing Fees with an Articled Clerk:** As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.
	In view of the above, the objections of the Institute of Chartered Accountants of

	India, as given in the case, are correct and reply of Mr. X, stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the position of the articled clerk is weak is not tenable.
	Hence, Mr. X is guilty of professional misconduct in terms of Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949.
6.	M/s XYZ, a firm in practice, develops a website "xyz.com". The colour chosen for the website was a very bright green and the web-site was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator. Is this website in compliance with guidelines issued by ICAI in this regard?
Ans.	**Posting of Particulars on Website:** The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s XYZ are:
♦	No restriction on the colours used in the website;
♦	The websites are run on a "pull" technology and not a "push" technology;
♦	Names of clients and fees charged not to be given.
	However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that "This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].
	In view of the above, M/s XYZ would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

7.	A partner of a firm of chartered accountants during a T.V. interview handed over a bio-data of his firm to the chairperson. Such bio-data detailed the standing of the international firm with which the firm was associated. It also detailed the achievements of the concerned partner and his recognition as an expert in the field of taxation in the country. The chairperson read out the said bio-data during the interview. Discuss whether this action by the Chartered Accountant would amount to misconduct or not.
Ans.	Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means since it shall constitute professional misconduct. The bio-data was handed over to the chairperson during the T.V. interview by the Chartered Accountant which included details about the firm and the achievements of the partner as an expert in the field of taxation. The chairperson simply read out the same in detail about association with the international firm as also the achievements of the partner and his recognition as an expert in the field of taxation. Such an act would definitely lead to the promotion of the firms' name and publicity thereof as well as of the partner and as such the handing over of bio-data cannot be approved. The partner would be held guilty of professional miscount under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
8.	
(a)	An advertisement was published in a Newspaper containing the photograph of Mr. X, a member of the institute wherein he was congratulated on the occasion of the opening ceremony of his office.
Ans.	**Publishing an Advertisement Containing Photograph:** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.
	In the given case, Mr. X published an advertisement in a Newspaper containing his photograph on the occasion of the opening ceremony of his office. On this context, it

	may be noted that the advertisement which had been put in by the member is quite prominent. If soliciting of work is allowed, the independence and forthrightness of a Chartered Accountant in the discharge of duties cannot be maintained.
	The above therefore amounts to soliciting professional work by advertisement directly or indirectly. Mr. X would be therefore held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
(b)	Mr. X, a Chartered Accountant and the proprietor of X & Co., wrote several letters to the Assistant Registrar of Co-operative Societies stating that though his firm was on the panel of auditors, no audit work was allotted to the firm and further requested him to look into the matter.
Ans.	**Soliciting Professional Work:** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.
	In the given case, Mr. X, a Chartered Accountant and proprietor of M/s X and Co., wrote several letters to the Assistant Registrar of Co-operative Societies, requesting for allotment of audit work. In similar cases, it was held that the Chartered Accountant would be guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The writing of continuous letter to ascertain the reasons for not getting the work is quite alright but in case such either amount to request for allowing the work then Mr. X will be liable for professional misconduct.
	Consequently, Mr. X would therefore be held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
9.	A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant. Is this a misconduct?
Ans.	**Cost Accountant:** As stated in the Illustration given in clause 7 with reference to tax consultant, this would also constitute misconduct under section 7 of the Act read

	with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. A chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". However as per the Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant".
10.	Mr. Nigal, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While delivering the speech, he told to the audience that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment.
Ans.	**Using Designation Other Than a CA and Providing Details of Services Offered:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.
	Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a

	misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council. Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write must not be promotional of his or his firm but must be an objective professional view of the topic under consideration. Thus, it is improper to use designation "Management Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Management Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6).
11.	Mr. A is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. Y a Chartered Accountant his employee for taking care of routine matters of his office. During his absence Mr. Y has conducted the under mentioned jobs in the name of M/s A & Co.
(i)	He issued the audit queries to client which were raised during the course of audit.
(ii)	He issued production certificate to a client under the GST Act.
(iii)	He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.
	Please comment on eligibility of Mr. Y for conducting such jobs in name of M/s A & Co. and liability of Mr. A under the Chartered Accountants Act, 1949.
Ans.	**Delegation of Authority to the Employee:** As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a

	member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".
	In this case CA A proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants.
	The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.
(i)	In the given case, Mr. Y, a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here Y is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
(ii)	Further, issuance of production certificate to a client under GST Act by Mr. Y being an employee of M/s A & Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA A is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.
(iii)	In this instance, Mr. Y, CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
12.	XYZ Co. Ltd. has applied to a bank for loan facilities. The bank on studying the financial statements of the company notices that you are the auditor and requests

	you to call at the bank for a discussion. In the course of discussions, the bank asks for your opinion regarding the company and also asks for detailed information regarding a few items in the financial statements. The information is available in your working paper file. What should be your response and why?
Ans.	As per Clause (1) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force. SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".
	In the instant case, the bank has asked the auditor for detailed information regarding few items in the financial statements available in his working papers. Having regard to the position stated earlier, the auditor cannot disclose the information in his possession without specific permission of the client. As far as working papers are concerned, working papers are the property of the auditor. The auditor may at his discretion, make portions of or extracts from his working papers available to his client".
	Thus, there is no requirement compelling the auditor to divulge information obtained in the course of audit and included in the working papers to any outside agency except as and when required by any law.
13.	Mr. A, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. X gave him an idea to start online services and give stock certifications to traders with Cash Credit Limits in Banks. Mr. A started a website with colorful catchy designs and shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services". Besides,

	Mr. A entered in an agreement with a Digital Marketer to give him 5% commission on each service procured through him. Discuss if the actions of Mr. A are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.
Ans.	As per Clause (6) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. Mr. A is wrong in seeking clients through family and friends. Creating a website is not a non- compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines. In the given situation, Mr. A shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on website issued by the ICAI. Thus, CA A would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.
14.	Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. Is Mr. D right in accepting the auditor position?
Ans.	As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest. Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

	As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company. In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. In view of above provisions Mr. D cannot accept the Directorship of the company until the completion of two years after his resignation.
	Thus, CA D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.
15.	Mr. F, a Chartered Accountant, gave advisory services to PQR Pvt. Ltd. Further, he gave them GST consultancy, compilation engagement for historical financial information and helped in ERP set up. Later, the company turned out to be a part of a group of companies involved in money laundering. Mr. F was asked to provide details of the companies. Mr. F refused on the grounds that he gave only consultancy services to the company and wasn't supposed to keep any information about the company. Is Mr. F right as per the guidelines issued by the ICAI?
Ans.	The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice.
	In the given situation, CA. F, gave GST consultancy, compilation engagement for historical financial information and helped in ERP set up along with advisory services to PQR Pvt. Ltd. Mr. F was asked to provide details of the companies as the company, turned out to be a part of a group of companies, involved in money laundering. Contention of Mr. F that he gave only consultancy services and compilation engagement for historical financial information to the company and wasn't supposed to keep any information about the company is not valid as Mr. F should have kept following information in compliance with KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestation functions.

	In the given case of PQR Pvt. Ltd., a Corporate Entity, Mr. F should have kept
	following information:
A.	General Information
•	Name and Address of the Entity
•	Business Description
•	Name of the Parent Company in case of Subsidiary
•	Copy of last Audited Financial Statement
B.	Engagement Information
•	Type of Engagement
C.	Regulatory Information
•	Company PAN No.
•	Company
•	Identification No.
•	Directors' Names & Addresses
•	Directors' Identification No.
16.	Mr. S, the auditor of ABC Pvt. Ltd. has delegated following works to his articles
	and staff:
i.	Issue of audit queries during the course of audit.
ii.	Issue of memorandum of cash verification and other physical verification.
iii.	Letter forwarding draft observations/financial statements.
iv.	Issuing acknowledgements for records produced.
v.	Signing financial statements of the company.
	Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?
Ans.	As per Clause (12) of Part I of the First Schedule of the Chartered Accountants
	Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional
	misconduct if he allows a person not being a member of the institute in practice or
	a member not being his partner to sign on his behalf or on behalf of his firm, any
	balance sheet, profit and loss account, report or financial statements.
	The Council has clarified that the power to sign routine documents on which a
	professional opinion or authentication is not required to be expressed may be delegated

	in the following instances and such delegation will not attract provisions of this clause:
(i)	Issue of audit queries during the course of audit.
(ii)	Asking for information or issue of questionnaire.
(iii)	Letter forwarding draft observations/financial statements.
(iv)	Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
(v)	Acknowledging and carrying on routine correspondence with clients.
(vi)	Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
(vii)	Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.
(viii)	Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
(ix)	Any other matter incidental to the office administration and routine work involved in practice of accountancy.
	In the instant case, Mr. S, the auditor of ABC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company.
	Therefore, Mr. S is correct in allowing first four tasks i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles.
	However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, Mr. S is wrong in delegating signing of financial statements to his staff.
	Conclusion: In view of this, S would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

17.	Mr. S is a practising chartered accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper-setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members).
Ans.	Given situation can be visualised in following parts:
(A)	**Mr. S used to involve himself in equity research and used to advise his friends, relatives and other known people:** As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation.
	In the given case, though Mr. S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr. S shall not make him guilty of professional misconduct.
(B)	Mr. S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities: As per Clause 11 of Part I of First Schedule of Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.
	Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include:

-	Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination.
-	Owning agricultural land and carrying out agricultural activities.
	Therefore, in the given case, the activities of Mr. S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct.
(C)	**Mr. S was discharged insolvent: Disabilities for the Purpose of Membership:** Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period.
	In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council.
	In the given case, it is clearly stated that Mr. S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. S has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.