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AUDIT QUESTION BANK

By CA Shubham Keswani

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Make My Delivery

8-9-10, Hans Bhawan Building,Wing-2,
IP Estate , New delhi 110002
Ph.: +91 9958000380, 9899632870
E- Mail : Contact@makemydelivery.com
Web : makemydelivery com

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SQC-1 "Quality Control for Firms that Perform Audits & Reviews of Historical Financial Information, and Other Assurance & Related Services Engagements"

1. 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.

(Nov-19 New + RTP May 19)

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

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

2. J.A.C.K. & Co., a Chartered Accountant firm was appointed as the statutory auditor of Falcon Ltd. after ensuring the compliance with relevant provisions of the Companies Act, 2013. Mr. Jay was the engagement partner for the aforesaid audit and prior to commencement of the audit, Mr. Jay had called for a meeting of the engagement team in order to direct them and assign them their responsibilities. At the end of meeting, Mr. Jay assigned review responsibilities to two of the engagement team members who were the most experienced amongst all, for reviewing the work performed by the less experienced team members. While reviewing the work performed by the less experienced members of the engagement team, what shall be the considerations of the reviewers?

(Mar-21 MTP)

As per **SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements"**, review responsibilities are determined on the basis that more experienced team members, including the engagement partner, review work performed by less experienced team members.

In the given situation, Mr. Jay, engagement partner assigned review responsibilities to two of the engagement team members who were the most experienced team members. While reviewing the work performed by less experienced members of the engagement team, both the more experienced Reviewers should consider whether:

(i) The work has been performed in accordance with **professional standards and regulatory and legal requirements.**

(ii) **Significant matters** have been raised for further consideration.

(iii) **Appropriate consultations** have taken place and the resulting conclusions have been documented and implemented.

(iv) There is a **need to revise the nature, timing and extent of work performed**.

(v) The **work performed supports the conclusions reached** and is appropriately documented.

(vi) The **evidence obtained** is sufficient and appropriate to support the report; and

(vii) The **objectives of the engagement procedures have been achieved**.

3. M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y 2019-2020. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2018-19 were incorrectly brought forward. It was found that M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period. Accordingly, a complaint was filed against NK & Co. in relation to this matter. You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC). (Jan-21 New)

Complaints and Allegations in a Firm:

(i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:

(a) Complaints and allegations that the **work performed by the firm** fails to comply with **professional standards and regulatory and legal requirements**; and

(b) Allegations of **non-compliance with the firm's system of quality control.**

(ii) Complaints and allegations (which do not include those that are clearly frivolous) **may originate from within or outside the firm**. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.

(iii) As part of this process, the firm establishes **clearly defined channels** for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

(iv) The firm **investigates such complaints and allegations** in accordance with established policies and procedures. The investigation is **supervised by a partner with sufficient and appropriate experience** and authority within the firm but who is not otherwise involved in the engagement, and includes **involving legal counsel** as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. **Complaints, allegations and the responses to them are documented.**

(v) Where the **results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies** and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, **the firm takes appropriate action.**

4. HK & Co. Chartered Accountants have been auditors of SAT Ltd (a listed entity) for the last 8 financial years. CA. H, partner of the firm, has been handling the audit assignment very well since the appointment. The audit work of CA. H and her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards and regulatory and legal requirements. CA. K was out of India for some personal reasons, so this year CA. G has been asked to review the audit work. In your opinion, what areas CA. G should consider at the time of review. List any four areas and also comment whether firm is complying with Standard on Quality Control or not. (July-21)

Compliance with Standard on Quality Control on review of audit work - As per **SQC 1, reviewer should consider following**:

(i) The work has been performed in accordance with **professional standards and regulatory and legal requirements**;

(ii) **Significant matters** have been raised for further consideration;

(iii) Appropriate **consultations** have taken place and the resulting conclusions have been documented and implemented;

(iv) There is a need to revise the **nature, timing and extent of work performed**;

(v) The work performed supports the conclusions reached and is appropriately **documented**;

(vi) The **evidence obtained is sufficient and appropriate** to support the report; and

(vii) The **objectives** of the engagement procedures have been **achieved**.

The firm should establish policies and procedures:

(i) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and

(ii) For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with the Code.

The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the **engagement partner should be rotated after a predefined period, normally not more than seven years.**

From the facts given in the question and from the above stated paras of SQC 1, it can be concluded that firm is not complying with SQC 1 as Engagement Partner H is continuing for more than 7 years.

5. PQR & Associates, Chartered Accountants, is a partnership firm having 3 partners CA P, CA Q and CA R. PQR & Associates are appointed as Statutory Auditors of ABC Limited, a listed entity for the financial year 2021-22 and CA P is appointed as Engagement Partner for the audit of ABC Limited. Before issuing the Audit Report of ABC Limited, CA P asked CA R to perform Engagement Quality Control Review and is of the view that his responsibility will be reduced after review by CA R. Whether the contention of CA P is correct? What are the aspects that need to be considered by CA R while performing Engagement Quality Control Review for audit of financial statements of ABC Limited?

As per **SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements"**, the review does not reduce the responsibilities of the engagement partner. Hence, contention of CA. P that after engagement quality control review by CA. R, his responsibility will be reduced, is not correct.

However, CA. R needs to consider the following aspect while performing Engagement

Quality Control Review for audit of financial statements of a listed entity ABC Ltd.:

1. The **engagement team's evaluation of the firm's independence** in relation to the specific engagement.
2. **Significant risks** identified during the engagement and the responses to those risks.
3. **Judgments** made, particularly with respect to materiality and significant risks.
4. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
5. The significance and disposition of **corrected and uncorrected misstatements** identified during the engagement.
6. The **matters to be communicated to management and those charged with governance** and, where applicable, other parties such as regulatory bodies.
7. Whether **working papers selected for review reflect the work performed** in relation to the significant judgments and support the conclusions reached.
8. The **appropriateness of the report** to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations

6. AP & Associates, Chartered Accountants, are Statutory Auditors of XP Limited for the last four years. XP Limited is engaged in the manufacture and marketing of FMCG Goods in India. During 2021-22, the Company has diversified and commenced providing software solutions in the area of "e-commerce" in India as well as in certain European countries. AP & Associates, while carrying out the audit for the current financial year, came to know that the

company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise and infrastructure to carry out the audit of this diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw. [Nov-22]

Acceptance and Continuance of Client Relationships and Specific Engagements: As per **SQC 1**, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the firm should establish **policies and procedures for the acceptance and continuance of client relationships and specific engagements**, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

In the given case, AP & Associates, Chartered Accountants, statutory auditors of XP Limited for the last four years, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise for the same, therefore, AP & Associates wish to withdraw from the engagement and client relationship.

Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

- **Discussing** with the appropriate level of the client's management and those charged with its governance regarding the **appropriate action that the firm might take based on the relevant facts and circumstances.**
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance **withdrawal** from the engagement or from both the engagement and the client relationship, and the **reasons for the withdrawal.**
- Considering whether there is a **professional, regulatory or legal requirement** for the firm to remain in place, or for the firm to **report the withdrawal** from the engagement, or from both the engagement and the client relationship, **together with the reasons for the withdrawal, to regulatory authorities.**
- **Documenting** significant issues, consultations, conclusions and the basis for the conclusions.

AP & Associates should address the above issues before deciding to withdraw.

SA 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

1. M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020-2021. The Company implemented internal controls for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement?
Also discuss certain subject matters or assertions where it is difficult to detect material misstatements due to potential effects of inherent limitations. (July-21 New)

Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations -

As per **SA 200 - "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" and** as per **SQC 1** because of the **inherent limitations of an audit,** there is an unavoidable risk

that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence.

Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in the light of the overall objectives of the auditor.

In view of above, it can be concluded that auditors did not give correct statement.

In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant.
Such assertions or subject matters include:
(i) **Fraud**, particularly fraud involving senior management or collusion.
(ii) The existence and completeness of **related party** relationships and transactions.
(iii) The occurrence of **non-compliance with laws and regulations**.
(iv) Future events or conditions that may cause an entity to cease to continue as a **going concern**.

2. Yupee (P) Ltd. got incorporated on 15th May 2021 and Mr. Harsh, the director of Yupee (P) Ltd. proposed to Kamal & Co. on 24th May 2021, for being appointed as its statutory auditor. Mr. Kamal, the sole proprietor of Kamal & Co., after checking the compliance with all the statutory requirements, accepted the said offer and issued an audit engagement letter vide email to Yupee (P) Ltd.

Mr. Harsh found all terms of audit engagement to be proper but in the paragraph relating to auditor's responsibly in the engagement letter, as produced below:-
"We will conduct our audit in accordance with Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement."

Certain queries raised in his mind that what does reasonable assurance meant? Which Standard on Auditing requires the auditor to obtain such reasonable assurance? Is it possible to give absolute assurance on such financial statements?
Assuming that you are Mr. Kamal, the newly appointed statutory auditor of Yupee (P) Ltd. Please address to the queries of Mr. Harsh as stated above. [MTP Apr-22]

As per **SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"**, the auditor is required:- "To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework."

Reasonable assurance is a high level of assurance and is less than absolute assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The **nature of financial reporting**;
- The nature of **audit procedures**; and
- The need for the audit to be conducted within a **reasonable period of time and at a reasonable cost.**

SA 210: Agreeing the Terms of Audit Engagement

1. T & Co, a firm of Chartered Accountants has not revised the terms of engagements and obtained confirmation from the clients for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement. (Nov-19 Old)

Circumstances that may Warrant the Revision in Terms of Engagement : As per **SA 210 on "Agreeing the Terms of Audit Engagements",** auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

(i) Any indication that the **entity misunderstands** the objective and scope of the audit.
(ii) Any **revised or special terms** of the audit engagement.
(iii) A **recent change** of **senior management**.
(iv) A significant change in **ownership**.
(v) A significant change in **nature or size** of the entity's business.
(vi) A change in legal or **regulatory requirements**.
(vii) A change in the **financial reporting framework** adopted in the preparation of the financial statements.
(viii) A change in **other reporting requirements**.

2. Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram. What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement? (RTP Nov-19)

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

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

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

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

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

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

[SM +RTP May-23]

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.

SA 220: Quality Control for an Audit of Financial Statements

1. Ace Limited (manufacturer of textile goods) got an order of manufacturing of PPE kits in December 2020. But there was shortage of machinery and manpower to accomplish the ordered requirement of PPE kits. Ace Ltd. approached another manufacturing unit Jack Limited for purchase of the unit. Jack Limited was interested in the sale of unit, so the deal went through and Ace Limited acquired ninety five percent shares of Jack Limited. The new management of Jack Limited proposed and appointed NKB Associates, Chartered Accountants, (already auditors of Ace Limited) as new auditors of Jack Limited. NKB Associates accepted the assignment without considering information whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. Comment with respect to appropriate Standard on Auditing what type of information assists the engagements partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate or not?

[Nov-21 Old + MTP Sep-22]

Acceptance and Continuance of Client Relationships and Audit Engagements : As per **SA 220, "Quality Control for an Audit of Financial Statements" , SQC 1**, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", requires the firm to obtain

information considered 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.

Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The **integrity** of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is **competent** to perform the audit engagement and has the necessary capabilities, including time and resources;
- Whether the firm and the engagement team can comply with relevant **ethical requirements**; and
- **Significant matters** that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

2. 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.

(RTP May-19 + MTP Oct-19 + SM)

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.

3. Rishikumar & Co. has been appointed as an auditor of PK Ltd. for the financial year 2016 -17. CA. Kumar, one of the partners of M/s Rishikumar & Co., completed entire routine audit work by 29th May, 2017. Unfortunately, on the very next morning, while roving towards office of PK Ltd. to sign final audit report, he met with a road accident and died. CA. Rishi, another partner of M/s Rishikumar & Co., therefore, signed the accounts of PK Ltd., without reviewing the work performed by CA. Kumar. Advise, whether CA. Rishi is right in expressing an opinion on financial statements the audit of which is performed by another auditor. (MTP April-18)

Relying on Work Performed by Another Auditor: As per **SA 220 "Quality Control for an Audit of Financial Statements",** an engagement partner taking over an audit during the engagement may apply the review procedures such as

- the work has been performed in accordance with **professional standards and regulatory and legal requirements;**
- **significant matters** have been raised for further consideration;
- appropriate **consultations** have taken place and
- the resulting **conclusions** have been **documented and implemented;**
- there is a need to revise the nature, timing and extent of work performed;
- the work performed supports the **conclusions** reached and is appropriately documented;
- the **evidence** obtained is sufficient and appropriate to support the auditor's report; and
- the **objectives** of the engagement procedures have been achieved.

Further, one of the basic principles, which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried, is that when the **auditor delegates work** to assistants or uses work performed by other auditor and experts, he will **continue to be responsible** for **forming and expressing his opinion on the financial information**.

However, he will be **entitled to rely on work performed by others**, provided he **exercises adequate skill and care** and is **not aware of any reason** to believe that he **should not have so relied.** This is the fundamental principle which is ethically required as per Code of Ethics. However, the auditor should carefully **direct, supervise and review** work delegated.

He should obtain **reasonable assurance** that work performed by other auditors/experts and assistants is adequate for his purpose.

In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA. Kumar. However, the report could not be signed by him due to his unfortunate death. Later on, CA. Rishi signed the report relying on the work performed by CA. Kumar. Here, CA. Rishi is allowed to sign the audit report, though, will be responsible for expressing the opinion.

He may rely on the work performed by CA. Kumar provided he further exercises adequate skill and due care and review the work performed by him as required in compliance with SA 220.

4. OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Engagement partner had completed his reviews in entirety by May 10, 2018. Comment. (MTP Mar-19)

As per SA 220, the engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. For **audits of financial statements of listed entities, the engagement partner shall:**

- Determine that an **engagement quality control reviewer has been appointed;**
- Discuss **significant matters arising during the audit engagement,** including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- **Not date the auditor's report until the completion** of the engagement quality control review.

SA 700 also requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an

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

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

In the given case, the **signing of auditors' report before completion of review of engagement quality control review is not right.**

SA 230: Audit Documentation

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

(RTP May-20)

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

(i) The **size and complexity of the entity.**
(ii) The **nature of the audit procedures** to be performed.
(iii) The identified **risks of material misstatement.**
(iv) The **significance of the audit evidence** obtained.
(v) The nature and extent of **exceptions** identified.
(vi) The **need to document a conclusion** or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
(vii) The **audit methodology and tools used.**
(viii) **Timely preparation** of Audit Documentation.

2. You are the team leader of 10 members for an audit of a Multinational company. All the team members are concerned about Audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned, In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard on Auditing. [May-22]

As per **SA 230, "Audit Documentation"** it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file.
For example:

- ✓ The existence of an **adequately documented audit plan** demonstrates that the auditor has planned the audit.
- ✓ The existence of a **signed engagement letter** in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
- ✓ An auditor's report containing an **appropriately qualified opinion** demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.
- ✓ In relation to **requirements that apply generally throughout the audit,** there may be a number of ways in which compliance with them may be demonstrated within the audit file:

- For example, there may be **no single way in which the auditor's professional skepticism is documented**. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include **specific procedures performed to corroborate management's responses** to the auditor's inquiries.
- Similarly, that the **engagement partner has taken responsibility for the direction, supervision and performance** of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as **participation in the team discussion required by SA 315**.

SA 240: The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements

1. Arihant Limited was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2021-22.
While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition.
During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to ₹35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings.

In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement. [RTP Nov-22]

As per **SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"** and **SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"**, the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a **presumption that there are risks of fraud in revenue recognition**, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

In accordance with **SA 240**, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and **SA 330**," The Auditor's Responses to Assessed Risks" the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level and assertion level.

The **presumption** that there are risks of fraud in revenue recognition **may be rebutted**. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property. However, when there is a complex revenue structure or when there is lack of controls on revenue recognition, then there is a high probability of fraud risk in revenue recognition.

Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), **is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.**

In the current scenario, the company was earning revenue from multiple streams. Also, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. During the year it was identified that the management did not account for revenue from corporate hotel bookings amounting to ₹ 35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

Therefore, the auditor while performing the risk assessment procedures should **consider the complexity and nature of the revenue for determining the fraud risks** in revenue recognition. Also, there were **no adequate controls** addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk. Moreover, the audit team should have **recognised fraud risk by identifying the deficiencies of internal control** over the revenue recognition process and should have treated the risk of improper revenue recognition as a **significant risk.**

Also, as per **Section 143(12),** the auditor is required to report all the frauds identified during the course of the audit involving amounts above ₹ 1 crore within the prescribed time frame to the Central Government

2. In the course of audit of Quick Ltd, you suspect that the management has made misstatements in the financial statements intentionally to deceive the users and to succumb to pressures to meet market expectations. Elucidate how the fraudulent financial reporting may be accomplished and also discuss the techniques of committing fraud by management overriding controls. (Nov-20 New)

As per **SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**

Fraudulent financial reporting may be accomplished by the following:
i. **Manipulation, falsification (including forgery), or alteration of accounting records** or supporting documentation from which the financial statements are prepared.
ii. **Misrepresentation in or intentional omission** from, the financial statements of events, transactions or other significant information.
iii. **Intentional misapplication of accounting principles** relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:
i. Recording **fictitious journal entries**, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
ii. Inappropriately **adjusting assumptions** and changing judgments used to estimate account balances.
iii. **Omitting, advancing or delaying** recognition in the financial statements of events and transactions that have occurred during the reporting period.
iv. **Concealing**, or not disclosing, facts that could affect the amounts recorded in the financial statements.
v. Engaging in complex **transactions** that are structured to misrepresent the financial position or financial performance of the entity.
vi. Altering records and terms related to **significant and unusual transactions.**

3. M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA. Kumar observed that there is misappropriation of

assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA. Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation.

Guide CA. Kumar with respect to Risk factors related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing. (Nov-15, Nov-21 5 Marks)

Risk Factors Relating to Misstatements Arising from Misappropriation of Assets:

As per **SA 240, "The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements"**, misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

Risk factors that relate to misstatements arising from misappropriation of assets are classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. The following are examples of risk factors related to misstatements arising from misappropriation of assets:

Incentives/Pressures: Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:
1. Known or anticipated future employee layoffs.
2. Recent or anticipated changes to employee compensation or benefit plans.
3. Promotions, compensation or other rewards inconsistent with expectations.

Opportunities: Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Inventory items that are small in size, of high value, or in high demand.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.
- Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets.
- Inadequate segregation of duties or independent checks.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behaviour or lifestyle that may indicate assets have been misappropriated.

4. Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud. (May-17 6 Marks)

Misstatement in the financial statements can arise from fraud or error. The term **fraud refers to an 'Intentional Act'** by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

As per **SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. The auditor, conducting an audit, is **responsible for obtaining reasonable assurance** that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. **Owing to the inherent limitations** of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

As described in **SA 200, the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud**. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because **fraud may involve sophisticated and carefully organized schemes** designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

Furthermore, the **risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud**, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

When obtaining reasonable assurance, the auditor is **responsible for maintaining professional skepticism throughout the audit**, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

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

The auditor is also required to report as per **Clause (xi) of Paragraph 3 of CARO, 2020**, Whether any fraud by the company or any fraud on the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

5. You notice a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit. As a Statutory Auditor, how would you deal? (PM)

Impossibility to continue the performance of audit: According to **SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**, if, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

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.

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

6. The Managing Director of the Company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company. As a Statutory Auditor, how would you deal? (PM + Mar'18 MTP + CA Inter SM)

The Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240.

First of all, as per SA 240, the auditor needs to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment.

Secondly, the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report.

Thirdly, the auditor should communicate the matter to the Chairman and Board of Directors.

Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management.

+Sec 143(12) + CARO 2020

7. On 15th March, 2020, the directors of Phony Ltd. instructed their accountant to enter purchases amounting Rs. 1.02 crores from a company incorporated dated 11th March, 2020. However, no amount was actually paid and Rs. 1.02 crore was provided in the books of account as purchases for the year ending on 31stMarch, 2020.

On inspection, no documentary or other evidence of such purchases was found. As the auditor of Phony Ltd., what would be your approach regarding reporting of such bogus purchases? (July 20 MTP, RTP Nov-18, Nov-13)

Reporting of Fraud Committed by Management/Directors of the Company: As per **SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements",** fraud can be committed by management overriding controls using such techniques as recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives. In the given case, Phony Ltd. has made purchases amounting Rs. 1.02 crores, at year-end. It also debited the sum in the books of account, however, no documentary or other evidence of such purchases was found, on investigation. It is clear that company has passed fictitious journal entries, near year-end, to manipulate the operating results.

Accordingly, the auditor would adopt the approach which will be based on the result of misstatement on the basis of such fictitious journal entry, i.e. if, as a result of a misstatement resulting from fraud or suspected fraud, the auditor

encounters **exceptional circumstances that bring into question the auditor's ability to continue performing the audit**, the auditor shall 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; or the auditor may consider for appropriateness of withdrawal from such engagement, where withdrawal from the engagement is legally permitted.

In addition, the auditor is required to report according to **section 143(12) of the Companies Act, 2013**. As per section 143(12), if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of Rs. 1 crore or above is being or has been committed in the company by its officers or employees, he shall report the matter to the Central Government in prescribed manner.

The auditor is also required to report under **clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020**, whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

8. Is it appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it? Discuss. (Nov-16 5 Marks)

Appropriateness of making inquiries of management regarding assessment of fraud: SA 240 "Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements" requires the auditor to make inquiries of management regarding:

(a) Management's assessment of risk of material misstatement due to fraud;

(b) Management's process for identifying & responding to the risks of fraud in the entity, including any specific risks of fraud;

(c) Management's communication, if any, to TCWG; and

(d) Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.

Management is responsible for the entity's internal control and for the preparation of the financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it.

The nature, extent and frequency of management's assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent.

The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

SA 250 (Revised) "Consideration of Laws and Regulations in an Audit of Financial Statements"

1. PQ Limited, a listed entity, is in the business of manufacturing of specialty chemicals. The company has appointed CA Jazz as CFO of the company. CA Jazz is concerned about compliance with the provisions of laws and regulations that determine the reported amounts and disclosure in financial statements of PQ Limited. Accordingly, CA Jazz

wants to implement such policies and procedures that can assist him in the prevention and detection of non-compliance with laws and regulations. Help CA Jazz by citing examples of such policies and procedures. (Nov-20)

As per **SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements",**
The following are examples of the types of policies and procedures PQ Ltd. may implement to assist in the prevention and detection of non-compliance with laws and regulations:

(i) **Monitoring** legal requirements and ensuring that operating procedures are designed to meet these requirements.
(ii) Instituting and operating appropriate systems of **internal control**.
(iii) Developing, publicizing and following a **code of conduct**.
(iv) Ensuring **employees are properly trained** and understand the code of conduct.
(v) **Monitoring compliance with the code of conduct** and acting appropriately to discipline employees who fail to comply with it.
(vi) Engaging **legal advisors** to assist in monitoring legal requirements.
(vii) Maintaining a **register of significant laws and regulations** with which the entity has to comply within its particular industry and a record of complaints.

2. While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws. Comment in accordance with relevant Standards on Auditing. (MTP May 20)

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

Further, **non-compliance with other laws and regulations may result in fines**, litigation or other consequences for the entity, the **costs of which may need to be provided for in the financial statements,** but are not considered to have a direct effect on the financial statements.

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

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that noncompliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement as per **SA 705 "Modifications to the Opinion in the Independent Auditor's Report".**

3. As an Auditor of TRP Ltd., you are suspicious that there might be non-compliance with laws and regulations to which the Company is subject to. Indicate the possible areas or aspects where you may have to look out for forming an opinion as to whether your suspicion has some basis to further inquire. (May-18 New, May 16, Nov-21 Old)

OR

You are appointed as an auditor of Moksh Ltd., a company engaged in export of agricultural equipment. During the course of audit, your audit team informed you regarding non-deduction of TDS on huge payments made to legal counsel of Moksh Ltd. You want to alert your team on the possibility of non-compliance with Laws and Regulations by Moksh Ltd. Help your audit team in identifying any other indications of non-compliance with Laws and Regulations particularly related to payments made by the company. [MTP May-23]

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

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

4. XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-3-18 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:
Income Tax relating to Assessment Year 2014-15 Rs. 125 lacs - Appeal is pending before Hon'ble ITAT since 30-9-16.
Customs duty Rs. 85 lakhs - Demand notice received on 15-9-17 but no action has been taken to pay or appeal.
Comment. (MTP Oct-18)

As per **SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement",** it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report on certain matters specified in Para 3 of CARO, 2020 under section 143 of the Companies Act, 2013.

One of such matter is non-payment of dues to Government, on account of any dispute. As per **clause (vii)(a) of Para 3 of CARO, 2020,** in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value

added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the present case, there is Income Tax demand of Rs. 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis.

Therefore, as per **AS 29 "Provisions, Contingent Liabilities and Contingent Assets",** partly to the extent the company considers that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of the members by reporting.

Additionally, the demand notice has been received for Customs duty of Rs. 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting.

5. During the course of audit of CT Ltd. for the financial year 2017-18, it is noticed that Rs. 3.00 lakhs of employee contribution and Rs. 7.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that Rs. 5.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2018. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due, but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor. (MTP Aug-18)

Non-Compliance of Laws and Regulations & Reporting Requirements: As per **SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement",** it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report under **clause (vii)(a) of Para 3 of CARO, 2020** whether the company is regular in depositing undisputed statutory dues including employees' state insurance with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of rupees 5.50 lakhs in his report.

6. CA Abhinanadan is an auditor of KM Private Limited. During the course of audit, CA Abhinanadan becomes aware of information concerning an instance of noncompliance or suspected non-compliance with laws and regulations. Being a senior partner of CA. Abhinanadan, guide him regarding audit procedures to be followed when non-compliance is identified or suspected. [RTP May-22]

As per **SA 250, "Consideration of Laws and Regulations in an Audit of 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:

(i) An **understanding of the nature of the act and the circumstances** in which it has occurred; and
(ii) **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.**

Auditor shall evaluate the implications of non-compliance in relation **to other aspects of the audit**, including the **auditor's risk assessment and the reliability of written representations**, and take appropriate action.

SA 260 "Communication with those Charged with Governance"

1. "The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such Communication. (PM)

As per **SA 260 "Communication with those Charged with Governance",** the auditor shall communicate with those charged with governance, the responsibilities of the auditor in relation to the financial statement audit, including that:
(a) The auditor is responsible for **forming and expressing an opinion on the financial statements** that have been prepared by management with the oversight of those charged with governance; and
(b) The audit of the financial statements **does not relieve management or those charged with governance of their responsibilities.**

The auditor shall communicate with those charged with governance the following:
(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**, if any, arising from the audit that were discussed, or subject to correspondence with management; and
ii. **Written representations** the auditor is requesting; and

d) **Other matters**, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

2. M/s Manidhari & Associates have been appointed as an auditor of JIN Limited, a multinational company dealing in spare parts. During the course of audit, CA Manidhari is facing many problems including the problem of not getting the desired information from the management. Accordingly, he decided to communicate with those charged with the governance about significant difficulties encountered during the audit. CA Manidhari seeks your guidance on matters which can be considered as significant difficulties as per SA 260. [RTP May-22]

As per **SA 260, "Communication with Those Charged with Governance"**, significant difficulties encountered during the audit may include such matters as:

(i) **Significant delays** by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary for the auditor to perform the auditor's procedures.
(ii) An **unreasonably brief time** within which to complete the audit.
(iii) **Extensive unexpected effort** required to obtain sufficient appropriate audit evidence.
(iv) The **unavailability** of expected information.
(v) **Restrictions** imposed on the auditor by management.
(vi) **Management's unwillingness** to make or extend its assessment of the entity's ability to continue as a going concern when requested.

In some circumstances, such difficulties may constitute a **scope limitation** that leads to a **modification of the auditor's opinion** as per **SA 705** (Revised), Modifications to the Opinion in the Independent Auditor's Report.

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

1. Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd., you observed that significant deficiency exists in the internal control system and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization. (Jan-21 + RTP May-23)

As per **SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management"**, Indicators of significant deficiencies in internal control include, for example:

(i) Evidence of **ineffective aspects of the control environment**, such as:
   a. Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
   b. Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
   c. Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.

(ii) **Absence of a risk assessment process** within the entity where such a process would ordinarily be expected to have been established.
(iii) Evidence of an **ineffective entity risk assessment process**, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
(iv) Evidence of an **ineffective response** to identified significant risks (e.g., absence of controls over such a risk).
(v) **Misstatements detected** by the auditor's procedures that were **not prevented, or detected and corrected**, by the entity's internal control.
(vi) Disclosure of a material misstatement due to error or fraud as **prior period items** in the current year's Statement of Profit and Loss.
(vii) Evidence of **management's inability** to oversee the preparation of the financial statements.

2. CA. N has been appointed as an auditor of TRP Ltd. While conducting the audit he has identified some deficiencies in the Internal control. He needs to determine whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency" and has to communicate them in writing to those charged with Governance and management on a timely basis. Guide CA. N with some examples of matters to be considered while determining 'significant deficiency' in internal control with reference to relevant SA. (Nov-20)

As per **SA 265 "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management"**, significant deficiency in internal control means a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgement, is of sufficient importance to merit the attention of those charged with governance.

Examples of matters that CA N, auditor of TRP Ltd may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

(1) The **likelihood of the deficiencies** leading to material misstatements in the financial statements in the future.

(2) The **susceptibility to loss** or fraud of the related asset or liability.

(3) The **subjectivity and complexity of determining estimated amounts**, such as fair value accounting estimates.

(4) The **financial statement amounts exposed to the deficiencies.**

(5) The **volume of activity** that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.

(6) The **importance of the controls** to the financial reporting process; for example:

- General **monitoring controls** (such as oversight of management).
- Controls over the **prevention and detection of fraud.**
- Controls over the **selection and application of significant accounting policies.**
- Controls over significant transactions with **related parties.**
- Controls over significant transactions **outside the entity's normal course of business.**
- Controls over **period-end financial reporting process** (such as controls over non-recurring journal entries).

(7) The **cause and frequency of the exceptions** detected as a result of the deficiencies in the controls.

(8) The **interaction of the deficiency** with other deficiencies in internal control.

SA 299: Joint Audit of Financial Statements

1. Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March, 2019. In the course of audit, it has been observed that there is a major understatement in the value of inventory. The inventory valuation work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors. Comment on the above situation with regard to responsibilities among joint auditors. (May-19)

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

In **respect of the audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him**, whether or not he has prepared a separate audit of the work performed by him.

On the other hand all the joint auditors are jointly and severally responsible –

(i) The **audit work which is not divided** among the joint auditors and is carried out by all joint auditors;

(ii) **Decisions taken by all** the joint auditors under audit planning phase concerning the nature, timing and extant of the audit procedure to be performed by each of the auditor;

(iii) **Matters which are bought to the notice of the joint auditors** by any one of them and on which there is an agreement among the joint auditors;

(iv) Examining that the **financial statements** of the entity comply with the requirements of the **relevant statute;**

(v) Presentation and disclosure of financial statements as required by the **applicable financial reporting framework**;
(vi) Ensuring that the **audit report** complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI;

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

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

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

2. KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2019-20. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.
(a) You are required to briefly explain the responsibilities of auditors when they are jointly and severally responsible in respect of audit conducted by them and also guide Mr. Z in such situation.
(b) Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.
[Nov. 18-RTP + SM]

(a) SA 299 on, "Joint Audit of Financial Statements" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In **respect of the work divided** amongst the joint auditors, each joint auditor is **responsible only for the work allocated to him**, whether or not he has made a separate report on the work performed by him.

On the other hand the joint auditors are **jointly and severally responsible** in respect of the audit conducted by them as under:
(i) in respect of the **audit work which is not divided** among the joint auditors and is carried out by all of them;
(ii) in respect of **decisions taken by all** the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors;
(iii) in respect of **matters** which are **brought to the notice** of the joint auditors **by any one** of them and on which there is an **agreement among** the **joint auditors**;
(iv) for examining that the financial statements of the entity **comply** with the requirements of the **relevant statute**;
(v) for **ensuring presentation and disclosure of the financial statements** as required by the applicable FRF;
(vi) for ensuring that the **audit report** complies with the requirements of the relevant statutes, SA and the other relevant pronouncements issued by ICAI.
(vi) It is the **separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control** relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;
(vii) the **responsibility of obtaining and evaluating information and explanation from the management** is generally a joint responsibility of all the auditors;

(viii) each joint auditor is **entitled to assume that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures** and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

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

Normally, the **joint auditors are required to issue common audit report**, however, where the joint auditors are in **disagreement** with regard to the **opinion** or any matters to be covered by the audit report, they shall **express their opinion in a separate audit report.**

A joint auditor is **not bound by the views of the majority** of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement.

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

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

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

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

The auditor shall **evaluate the adequacy of the auditor's expert's work** for the auditor's purposes, including the **relevance and reasonableness of that expert's findings or conclusions**, and their **consistency with other audit evidence** as per SA 500. Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the **relevance and reasonableness of those assumptions and methods** must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the **relevance, completeness, and accuracy of that source data** in the circumstances must be verified by the auditor.

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

reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

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

3. Excellent Bank Ltd. is a Public Limited Company. The said Bank has various branches all over India. The Bank appoints 3 Joint Auditors for the financial year ending 31/03/2019. All the 3 Joint Auditors divide the work with mutual consent. Verification of Consolidation, however, remained undivided. All branches and zones were divided amongst the 3 Joint Auditors. During audit of zones, CA. Z, one of the Joint auditors expressed a concern about internal control in one of the large corporate branches situated. in his zone. The irregularity was not reported in the final accounts as the other 2 Joint Auditors were not in favour of reporting and decision of not reporting the same was taken on the basis of majority. Subsequently, fraud was detected in the said branch which was audited by CA. Z. The Bank seeks your advice about the responsibility of the 3 Joint Auditors in the above situation.

(Nov-19 Old)

As per **SA 299, "Joint Audit of F.S."** where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of the work would usually be in terms of audit identifiable units or specified area.

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

In the instant case, Excellent Bank Ltd. appoints 3 joint auditor for the financial year ending 31.03.2019. All the joint auditors divided the work with mutual consent. The only work which remained undivided was verification of Consolidation. In accordance with SA 299, all the joint auditors are responsible for the same.

Further, during audit of zone, CA Z, one of the joint auditors expressed a concern about internal control in one of the large corporate branches situated in his zone, however, this irregularity was not reported as 2 of the joint auditors (i.e. majority of the joint auditors) were not in favour of the same. Later on, fraud has been detected in the same branch which was audited by CA. Z.

As per SA 299, **before finalizing their audit report, the joint auditors shall discuss and communicate with each other their respective conclusions** that would **form the content of the audit report**. Further, 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.

But in the present scenario, CA. Z brought this matter in the notice of the other 2 joint auditors and the decision for not reporting was taken on majority basis and no separate opinion was expressed through separate audit report pointing out irregularity. Thus, **all the 3 joint auditors will be held responsible for the fraud detected in the branch** audited by CA. Z as per SA 299.

4. NMN & Co., LLP and ABC & Associates, LLP are the joint statutory auditors of BHS Ltd. BHS Ltd. is a listed company and has been in existence for the last 50 years. Since beginning this company was audited by MQS & Associates but due to audit rotation, the company had to bring in new auditors. Considering the size of the company, two auditors were appointed as joint auditors. Since the company is new to these auditors and the concept of joint auditors to

whom audit work has been divided, management had a discussion and understood that each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. Advise. (MTP Apr-19)

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

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

Each joint auditor is entitled to assume that:
The **other joint auditors have carried out their part of the audit** work and the **work has actually been performed in accordance with the Standards on Auditing** issued by the Institute of Chartered Accountants of India. It is **not necessary for a joint auditor to review the work performed by other** joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.

The other joint auditors have brought to said joint auditor's notice any departure from applicable financial reporting framework or significant observations that are relevant to their responsibilities noticed in the course of the audit.
Where financial statements of a division/branch are audited by one of the joint auditors, the other joint auditors are entitled to proceed on the basis that such financial statements comply with all the legal and regulatory requirements and present a true and fair view of the state of affairs and of the results of operations of the division/branch concerned.

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

SA 315: Identifying and Assessing ROMM through Understanding the Entity and its Environment

1. You are engaged by M/s. Real Ltd. as an internal auditor for the financial year 2020-2021. While applying risk assessment procedures of inquiring from management and various analytical procedures, you have identified some risks which in your opinion may lead to material misstatement at the financial level and assertion level. Which factors as an auditor will you consider while exercising judgement as to whether such risks are significant risks or not? (Jan'21 New + Nov'18 New)

As per **SA 315, "Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and its Environment",** in exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

1. Whether the risk is a risk of **fraud**;
2. Whether the risk is related to **recent significant economic, accounting, or other developments** like changes in regulatory environment, etc., and, therefore, requires specific attention;

3. The **complexity** of transactions;
4. Whether the risk involves significant transactions with **related parties**;
5. The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of **measurement uncertainty**; and
6. Whether the risk involves significant transactions that are **outside the normal course of business** for the entity, or that otherwise appear to be unusual.

2.While commencing the statutory audit of B Company Limited, the auditor undertook the risk assessment and found that the detection risk relating to certain class of transactions cannot be reduced to acceptance level. **(PM + May-17)**

- **SA 315 and SA 330 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" and "The Auditor's Responses to Assessed Risks"** establishes standards on the procedures to be followed to obtain an understanding of the accounting and internal control systems and on audit risk and its components: inherent risk, control risk and detection risk.
- SA 315 and SA 330 require that the auditor should use professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level.
- "Detection risk" is the risk that an auditor's substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material.
- The higher the assessment of inherent and control risks, the more audit evidence the auditor should obtain from the performance of substantive procedures.
- When both inherent and control risks are assessed as high, the auditor needs to consider whether substantive procedures can provide sufficient appropriate audit evidence to reduce detection risk, and therefore audit risk, to an acceptably low level.
- The auditor should use his professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level.
- If it cannot be reduced to an acceptable level, the auditor should express a qualified opinion or a disclaimer of opinion as may be appropriate.

3.IT systems also pose specific risks to an entity's internal control? What are those risks? (Nov-17 + PM)

Specific Risk to an Entity's Internal Control: As per **SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment",** IT system also poses specific risks to an entity's Internal Control.

They are–

i) **Reliance on systems or programs** that are inaccurately processing data, processing inaccurate data or both.
ii) **Unauthorised access to data** that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risk may arise when multiple users access a common database.
iii) The **possibility of IT personnel gaining access beyond those necessary** to perform their assigned duties thereby breaking down segregation of duties.
iv) **Unauthorised changes** to **data in Master files.**
v) Unauthorised changes to **systems or programs.**
vi) **Failure to make necessary changes** to systems or programs.
vii) **Inappropriate manual intervention.**
viii) **Potential loss of data** or inability to access data as required.

4. While commencing the statutory audit of ABC Company Limited, what should be the considerations of the auditor to assess Risk of Material Misstatement and his response to such risks? (Nov 14) **OR**

In the course of audit of PB Ltd., you observe that there is a likelihood of misstatement in the account balances and disclosures in the financial statements. What should be your considerations as an auditor for "Assessing the Risk of Material Misstatements"? (Nov-18 Old)

As per **SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment",** the auditor shall identify and assess the risks of material misstatement at the financial statement level; and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures.

For this purpose, the auditor shall-
(i) **Identify risks** throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
(ii) **Assess the identified risks,** and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
(iii) **Relate the identified risks to what can go wrong at the assertion level**, taking account of relevant controls that the auditor intends to test; and
(iv) **Consider the likelihood of misstatement**, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Auditor's Responses to the Assessed Risk of Material Misstatement: According to **SA 330 "The Auditor's Responses to Assessed Risks",** the auditor shall design and implement overall responses to address the assessed risks of material misstatement.

In designing the audit procedures to be performed, the auditor shall-
(i) Consider the **reasons for the assessment given to the risk of material misstatement** at the assertion level for each class of transactions, account balance, and disclosure, including:
(1) The **likelihood of material misstatement** due to the particular characteristics of the relevant class of transactions, account balance, or disclosure; and
(2) Whether the risk assessment takes into account the **relevant controls**, thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively; and
(ii) Obtain **more persuasive audit evidence the higher the auditor's assessment of risk.**

5. What are the points to be considered while evaluating the "Knowledge of the Business" in the conduct of an audit? (May 10)

The broad matters to be considered while obtaining knowledge of business for a new audit assignment are set out in SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment.
These are:

i. **Relevant industry, regulatory, economic and other external factors** including the applicable financial reporting framework.
ii. The **nature of the entity**, including:
   a) its operations;
   b) its ownership and governance structures;
   c) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and

d) the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements

iii. The **entity's selection and application of accounting policies**.

iv. The entity's objectives and strategies, and those related **business risks** that may result in risks of material misstatement.

v. The measurement and review of the entity's **financial performance**.

SA 320: Materiality in Planning & Performing an Audit

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

(May-18 New)

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

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

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

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

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

2. CA. B was appointed as auditor of SRT Limited for financial year 2021-22. During course of planning for audit, CA. B intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to factors that may affect the identification of an appropriate benchmark for this purpose.
What benchmark should be adopted by CA. B, if SRT 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. [Nov-22 + Nov-20 Old]

SA 320 "Materiality in Planning and Performing an Audit" prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole. Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

As auditor of X Ltd., for determining the materiality level, **factors that may affect the identification of an appropriate benchmark include the following:**

i. The **elements of the financial statements** (for example, assets, liabilities, equity, revenue, expenses);

ii. Whether there are items on which the **attention of the users of the particular entity's financial statements tends to be focused** (for example, for the purpose of evaluating financial performance, users may tend to focus on profit, revenue or net assets);

iii. The **nature of the entity**, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;

iv. The **entity's ownership structure** and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and

v. The **relative volatility of the benchmark**.

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 SRT 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 SRT 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 criteria relevant for audit of 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.

SA 330: Auditor's Responses to Assessed Risks

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

(MTP Oct-19 + RTP Nov 18/May-22)

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

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

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

(i) A **deficient control environment**.

(ii) Deficient **monitoring of controls**.

(iii) A significant **manual element** to the relevant controls.

(iv) **Personnel changes** that significantly affect the application of the control.

(v) **Changing circumstances** that indicate the need for changes in the control.

(vi) **Deficient general IT-controls**.

2. Mr. Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures. [Dec-21 New]

Factors that may assist Mr. Agarwal, the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

(i) The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.

(ii) The ability or willingness of the intended confirming party to respond – for example, the confirming party:

- May not accept responsibility for responding to a confirmation request;
- May consider responding too costly or time consuming;
- May have concerns about the potential legal liability resulting from responding;
- May account for transactions in different currencies; or
- May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

(iii) The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

3. While formulating the audit plan and responding to the risks of material misstatement identified and assessed in related party transaction and relationships, Ms. K the engagement manager of the audit team of ABC Limited, decided to rely upon the internal controls placed for identification and disclosure of related party relationships and transactions in accordance with the applicable financial reporting framework.

You are requested to guide Ms. K regarding the necessity to test the controls to obtain sufficient and appropriate audit evidence. Also guide, whether Ms. K can use the audit evidence obtained, regarding operative effectiveness of control on identification and disclosure of related party relationships and transactions, in the interim period.

(RTP Nov'21)

As per **SA 550, "Related Parties",** according to para on "Responses to the risks of material misstatement associated with related party relationships and transactions", the auditor should **design and performs further audit procedures** to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.

Further, as per **SA 330, "The Auditor's Responses to Assessed Risks",** auditor shall design and perform tests of controls to **obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls** when:

(a) the **auditor's assessment of risks of material misstatement at the assertion level** includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or

(b) **Substantive procedures alone cannot provide sufficient appropriate audit evidence** at the assertion level.

In designing and performing tests of controls, the auditor shall obtain **more persuasive audit evidence the greater the reliance** the auditor places on the effectiveness of a control.

Moreover, the auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to when the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, and the timing of test of controls over significant risks, in order to provide an appropriate basis for the auditor's intended reliance.

When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:

a. **Obtain audit evidence about significant changes** to those controls subsequent to the interim period; &
b. Determine the **additional audit evidence** to be obtained for the remaining period.

In the current case, Ms. K shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls as she intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures.

Further, she is also required to obtain the audit evidence about significant changes to those controls subsequent to the interim period along with the additional audit evidence to be obtained for the remaining period in accordance with the requirements of Standards on Auditing as discussed above.

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

1. ENN Limited is availing the services of APP Private Limited for its payroll operations. Payroll cost accounts for 65% of total cost for ENN Limited. APP Limited has provided the type 2 report as specified under SA 402 for its description, design and operating effectiveness of control.
APP Private Limited has also outsourced a material part of payroll operation M/s SMP & Associates in such a way that M/s SMP & Associates is sub-service organization to ENN Limited. The Type 2 report which was provided by APP Private Limited was based on carve-out method as specified under SA 402.
CA Raman while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA Raman hence asked his assistant to remove such reference and modify report accordingly. Comment whether CA Raman is correct in removing the reference of the work done by service auditor? (RTP Nov'20 + MTP Apr'21/Sep-22)

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

The user auditor shall **not refer** to the work of a service auditor in the user auditor's report containing an **unmodified opinion** unless required by law or regulation to do so.

If such reference is **required by law or regulation**, the user auditor's report shall indicate that the reference does **not diminish the user auditor's responsibility** for the audit opinion.

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

2. G Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of G Ltd. as to how he can obtain an understanding of how G Ltd. uses the services of the outsourced agency in its operations. (MTP Oct-19)

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

i. The **nature** of the services provided by the service organisation **and the significance of those services** to the user entity, including the effect thereof on the user entity's internal control;
ii. The **nature and materiality of the transactions** processed or accounts or financial reporting processes affected by the service organisation;
iii. The **degree of interaction** between the activities of the service organisation and those of the user entity; and
iv. The **nature of the relationship** between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

3. When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls. The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization? (May'15)

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

A user auditor may need to consider controls at the sub-service organisation. In situations where one or more sub-service organisations are used, the **interaction between the activities** of the user entity and those of the service organisation is expanded to include the interaction between the user entity, the service organisation and the sub-service organisations. The **degree of this interaction**, as well as the **nature and materiality of the transactions** processed by the service organisation and the sub-service organisations are the most important factors for the user auditor to consider in determining the significance of the service organisation's and sub-service organisation's controls to the user entity's controls.

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

If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding by application of the following two methods of presenting description of internal controls i.e. **(i) Type 1 report; or (ii) Type 2 report.**

If a service organisation uses a subservice organisation, the service auditor's report may either include or exclude the subservice organisation's relevant control objectives and related controls in the service organisation's description of its system and in the scope of the service auditor's engagement. These **two methods of reporting are known as the inclusive method and the carve-out method respectively.**

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

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

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

4. Durafone Mobile Co. Ltd. have pan India presence and market leader in mobile operation. It has outsourced all its revenue operation including accounting functions to Set Solutions (P) Ltd. As an Auditor of the mobile company, enumerate the factors to be taken into consideration related to its financial reporting. (May 18-Old)

As per **SA 402 "Audit Considerations relating to an Entity using a Service Organization"**, services provided by a service organisation are relevant to the audit of a user entity's financial statements when those services, and the controls over them, are part of the user entity's information system, including related business processes, relevant to financial reporting.

Although most controls at the service organisation are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets.

A service organisation's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services affect any of the following:

i. The **classes of transactions** in the user entity's operations that are significant to the user entity's financial statements;
ii. The **procedures**, within both information technology (IT) and manual systems, by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
iii. **The related accounting records,** either in electronic or manual form, supporting information and specific accounts in the user entity's financial statements that are used to initiate, record, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;
iv. How the **user entity's information system** captures events and conditions, other than transactions, that are significant to the financial statements;
v. The **financial reporting process** used to prepare the user entity's financial statements,including significant accounting estimates and disclosures; and
vi. **Controls surrounding journal entries**, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

5. A Company gets its accounting data processed by a third party to achieve cost reduction. As a Statutory Auditor of such a company, what are the additional precautions/checks that you would consider for conduct of the audit? (PM)

Processing of accounting data may be given to a third party on account of various considerations such as economy, own computer working to full capacity, an interim measures restricting accessibility to sensitive information, etc. A client may use a service organisation such as one that executes transactions and maintains related accountability or records transactions and processes related data (e.g., a computer systems service organisation). If a client uses a service organisation, certain policies, procedures and records maintained by the service organisation might be relevant to the audit of the financial statements of the client.

Consequently, the auditor would consider the nature and extent of activities undertaken by service organisations so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk.

As per **SA 402 "Audit Considerations relating to an Entity using a Service Organization",** when obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:
(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;

(b) The **nature and materiality of the transactions** processed or accounts or financial reporting processes affected by the service organisation;
(c) The **degree of interaction** between the activities of the service organisation and those of the user entity; and
(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.

Information on the nature of the services provided by a service organisation may be **available from a wide variety of sources**, such as **user manuals; system overviews; technical manuals; the contract or service level agreement** between the user entity and the service organisation; **reports by service organisations, internal auditors or regulatory authorities** on controls at the service organisation; **reports by the service auditor, including management letters**, if available.
[Author's Tip: There can be a separate Question on this para]

Knowledge obtained through the user auditor's experience with the service organisation, for example through experience with other audit engagements, may also be helpful in obtaining an understanding of the nature of the services provided by the service organisation. This may be particularly helpful if the services and controls at the service organisation over those services are highly standardized.

6. How does an auditor report on the description, design and operating effectiveness of controls at a service organization? (May-17)

Report on the Description, Design and Operating Effectiveness of Controls at a Service Organization: As per **SA 402 "Audit Considerations Relating to an Entity using a Service Organisation"**, a report on the description, design and operating effectiveness of controls at a service organization shall comprise-
(i) A **description, prepared by management** of service organisation, of service organisation's **system, control objectives and related controls**, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and
(ii) A **report by the service auditor** with the objective of conveying reasonable assurance that includes:
   a. The **service auditor's opinion** on the description of the service organisation's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
   b. A description of the service auditor's **tests of the controls** and the **results** thereof.

SA 450: Evaluation of Misstatements Identified during the Audits

1. In audit plan for T Ltd, as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them. Identify the sources of misstatements. (RTP Nov-18/May-22)

According to **SA 450 "Evaluation of Misstatements identified during the Audit"**, the following are the sources of misstatements arising from other than fraud –
(i) An **inaccuracy** in gathering or processing data from which the financial statements are prepared;
(ii) An **omission** of an amount or disclosure;
(iii) An **incorrect** accounting estimate arising from overlooking, or clear misinterpretation of facts; and
(iv) **Judgments** of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

2. Discuss the impact of uncorrected misstatements identified during the audit and the auditor's response to the same. (Nov-17)

Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320, to confirm whether it remains appropriate in the context of the entity's actual financial results.

In accordance with **SA 450 "Evaluation of Misstatements identified during the Audit"**, the auditor shall determine whether uncorrected misstatements are material, individually or in aggregate.

In making this determination, the auditor shall consider-
(i) The **size and nature of the misstatements**, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and
(ii) The **effect of uncorrected misstatements** related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

The auditor shall **communicate this with those charged with governance** uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.

The auditor's communication **shall identify material uncorrected misstatements individually**.
The auditor shall request that uncorrected misstatements be corrected.

As per management, if **effect of such uncorrected misstatement is immaterial** then the auditor shall request for a **written representation** from management and, where appropriate, those charged with governance that whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should report accordingly.

SA 500: Audit Evidence

1. 1. CA. Needle had been appointed as an Auditor of M/s Fabric Ltd. In the course of audit, it had been observed that inventory including work-in-process had been valued by Management by using experts hired by them. Analyse relevant factors to decide as to whether or not to accept the findings from the work of Management expert in valuation of inventories. (May 18 New + Jan'21 Old) OR

M/s LNK's group gratuity scheme's valuation by actuary shows wide variation compared to the previous year's figures. As a Statutory Auditor, how would you deal in this situation? (PM)

Using the Work of Management's Expert: As per **SA 500 "Audit Evidence",** when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes,-
(a) Evaluate the **competence, capabilities and objectivity** of that expert;
(b) Obtain an **understanding of the work of that expert;** and
(c) Evaluate the **appropriateness of that expert's work** as audit evidence for the relevant assertion.

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

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

The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:
(i) The **relevance and reasonableness of that expert's findings or conclusions**, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
(ii) If that expert's work involves use of **significant assumptions and methods, the relevance and reasonableness** of those assumptions and methods; and
(iii) If that expert's work involves significant use of source data, the **relevance, completeness, and accuracy of that source data.**

The auditor has to evaluate the work of an expert, say, actuary, before adopting the same.

This becomes more crucial since M/s LNK's group gratuity scheme's valuation by actuary shows wide variation compared to previous year figures. There is no doubt that relevance and reasonableness of assumptions and methods used are the responsibility of the expert, but the auditor has to determine whether they are appropriate based on the auditor's knowledge of the client's business and result of his audit procedures.

In the present case, the auditor must verify the reasonableness of assumptions made and methods adopted by the actuary in the evaluation particularly with reference to factors such as rate of return on investments, retirement age, number and salary of employees, etc.

Accordingly, the auditor has to satisfy himself whether valuation done by the actuary can be adopted, otherwise he may report on his findings for wide variation.

2. The auditor of CROX Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age to 65 years. Comment. (MTP Apr 18)

Same ans as Q1 +

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

3. Gap Ltd. possesses some investment for which there is no ready market and to assess its fair market value it hires an expert, the result of which it can use in preparing its financial statement. Being an Auditor of the Company, state the matters which may affect the nature, timing and extent of audit procedure to be adopted by you in the instant case. (May-18 Old)

As per **SA 500 "Audit Evidence"**, the nature, timing and extent of audit procedures to be adopted by an auditor in case of management's expert, may be affected by such matters as:

(i) The **nature and complexity** of the matter to which the management's expert relates.

(ii) The **risks of material misstatement** in the matter.

(iii) The availability of **alternative sources of audit evidence**.

(iv) The **nature, scope and objectives** of the management's expert's work.

(v) Whether the management's expert is **employed** by the entity, or is a party engaged by it to provide relevant services.

(vi) The **extent to which management can exercise control** or influence over the work of the management's expert.

(viii) Whether management's expert is **subject to technical performance standards** or other professional or industry requirements.

(x) The **nature and extent of any controls** within the entity over the management's expert's work.

(xi) The **auditor's knowledge and experience** of the management's expert's field of expertise.

(xii) The **auditor's previous experience** of the work of that expert.

4. During the course of audit of a Limited company, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence. (July-21 Old)

Inquiry: As per SA 500 Audit Evidence:-

1. Inquiry consists of **seeking information of knowledgeable persons,** financial and nonfinancial, within the entity or outside the entity. Inquiry is **used extensively** throughout the audit in addition to other audit procedures. Inquiries may **range from formal written inquiries to informal oral inquiries**. Evaluating responses to inquiries is an integral part of the inquiry process.
2. Responses to inquiries may provide the auditor with **information not previously possessed or with corroborative audit evidence**. Alternatively, responses might provide **information that differs significantly from other information** that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the **auditor to modify or perform additional audit procedures**.
3. Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the **information available to support management's intent may be limited**. In these cases, **understanding management's past history of carrying out its stated intentions,** management's **stated reasons** for choosing a particular course of action, and management's **ability** to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.
4. In respect of some matters, the auditor may consider it necessary to **obtain written representations from management** and, where appropriate, those charged with governance to confirm responses to oral inquiries.

SA 501: Audit Evidence—Specific Considerations for Selected Items

1. GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2020 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. (Jan 21 New)

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 eg., 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.

2. Moon Ltd. is a dealer in electronic appliances. The Company has a centralised warehouse at the outskirts of Mumbai. The Auditors of the company M/s JK Associates normally attend the physical verification of stocks carried out by the Management at the end of the financial year. However, on account of certain disturbances in the region, the physical inventory counting could not be carried out at the year end. The stock taking is decided to be done by management at some other date subsequently, after a month.

In the light of the above facts:

Enumerate the audit procedures to be considered by M/s JK Associates, if physical inventory counting is conducted at a date other than the date of the financial statements with reference to the relevant Standard on Auditing. (PM)

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.

For **practical reasons**, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the **effectiveness of the design, implementation and maintenance of controls over changes in inventory determines** whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes.

If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor, JK Associates, shall perform the following procedures:

(A) 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

(B) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

In addition to above, auditor shall also perform audit procedures to obtain audit evidence about whether **changes in inventory** between the count date and the date of the financial statements are properly recorded.

Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:

1. Whether the **perpetual inventory records are properly adjusted.**
2. **Reliability of the entity's perpetual inventory records.**
3. **Reasons for significant differences** between the information obtained during the physical count and the perpetual inventory records.

3. RIM Private Ltd is engaged in the business of manufacturing of water bottles and is experiencing significant increase in turnover year on year. During the financial year ended 31 March 2019, the company carried out a detailed physical verification of its inventory and property, plant and equipment. You are the auditor of RIM Private Ltd. The inventory as at the end of the year was ₹ 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order? (RTP May 20)

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

If the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances,

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

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

4. 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 2020-21. 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?
[RTP May 21]

(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.

5. Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 2018-19. While verification of company's inventories as on 31st March 2019, you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of the inventories maintained by other parties. What is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be held and the stock as disclosed in company's records actually belongs to them? [RTP Nov-19]

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

i. Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
ii. Perform **inspection or other audit procedures appropriate in the circumstances,** for example where information is obtained that raises **doubt about the integrity and objectivity of the third party**, the auditor

may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party.

Examples of other audit procedures include:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
- Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
- Requesting confirmation from other parties when inventory has been pledged as collateral.

6. The Engagement Partner of the audit team of High Inventory Limited assessed that the inventory is material with respect to the audit of the financial statement for the current period. Upon inquiring with the management, the Engagement Partner identified that the management will be performing an annual physical inventory count at all the warehouses where the entity stores and maintains its inventory. Moreover, management confirmed in its written representation that they will be performing a 100% physical count of inventory for the current period.
As a result, the engagement Partner decided not to perform any physical count of inventory as it will be a duplication of the work. Moreover, he decided that the written representation from management stating "the inventory exists and is in appropriate physical condition" will be sufficient and appropriate with respect to audit evidence to conclude that the inventory balance in the financial statement is free from any material misstatement.

In the light of SA 501, evaluate whether the decision taken by the Engagement Partner is appropriate or not.
[MTP Sep-22]

As per **SA 501," Audit Evidence - Specific Considerations for Selected Items"**, when inventory is material to F.S., auditor shall obtain SAAE regarding existence and condition of inventory by:

i. Attendance at physical inventory counting, unless impracticable, to
1. **Evaluate management's instructions and procedures** for recording and controlling the results of the entity's physical inventory counting.
2. **Observe** the performance of management's count procedures.
3. **Inspect** the inventory; and.
4. **Perform test counts**; and

ii. Performing audit procedures over the entity's **final inventory records** to determine whether they accurately **reflect actual inventory count results.**

Attendance at physical inventory counting involves:
i. **Inspecting inventory** to ascertain its existence and evaluate its condition and perform test counts.
ii. **Observing compliance with management's instructions** and the performance of procedures for recording and controlling the results of the physical inventory count; and
iii. Obtaining audit evidence as to the **reliability of management's count procedures.**

In given case, **approach of Engagement Partner is not appropriate** as when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

This should be done by performing various audit procedures which also includes attending physical count, observing the count, inspecting the inventory and reperforming physical counts.

SA 505: External Confirmations

1. Neverpermit Limited refuses to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that at least outstanding above a threshold limit needs to be confirmed and reconciliation is to be carried out before finalising the audit. If the Company does not relent, how will you respond? (May 18 New + RTP May 20)

SA 505 "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. If the management refuses to allow the auditor to a send a confirmation request, the auditor shall:
(i) **Inquire** as to Management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness,
(ii) **Evaluate** the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and
(iii) **Perform alternative audit procedures** designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those in charge of governance in accordance with **SA 260 "Communication with Those Charged with Governance"** and also determine its implication for the audit and his opinion in accordance with **SA 705 "Modifications to the Opinion in the Independent Auditor's Report".**

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

2. M/s ABC & Co, LLP are appointed auditors of Sharp Company Ltd. for the year ended 31st March, 2019. As part of the audit process, they want to use confirmation procedures as audit evidence during the course of audit. In view of the fact that positive confirmations are not responded favourably, the firm also intends to use negative confirmation requests. What are the factors to be considered for the same? (May 19 Old)

As per SA 505, "External Confirmation", factors to be considered when designing confirmation requests include:
(i) The **assertions being addressed**.
(ii) Specific identified **risks of material misstatement**, including fraud risks.
(iii) The **layout and presentation** of the confirmation request.
(iv) **Prior experience** on the audit or similar engagements.
(v) The **method of communication** (for example, in paper form, or by electronic or other medium).
(vi) **Management's authorisation or encouragement** to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
(vii) The **ability of the intended confirming party to confirm** or provide the requested information (for example, individual invoice amount versus total balance).

Factors to be considered for Negative Confirmation requests: 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.

Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

(1) The auditor has assessed the **risk of material misstatement as low** and has obtained **sufficient appropriate evidence regarding the operating effectiveness of controls** relevant to the assertion;

(2) The **population** of items subject to negative confirmation procedures comprises a **large number of small, homogenous, account balances,** transactions or conditions;

(3) A very **low exception rate is expected**; and

(4) The auditor is **not aware of circumstances** or conditions that would cause **recipients** of negative confirmation requests to **disregard such requests**.

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.

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

(RTP May 18 + Nov-22)

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

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

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 15 lacs has not sent the confirmation on the credit balance. In case of non-response, the auditor may **examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes**. Further **non response for negative confirmation request does not means that there is some misstatement** as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

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

4. Moon Limited replaced its statutory auditor for the Financial year 2015-16. During the course of audit, the new auditor found a credit item of ₹ 5 lakhs. On enquiry, the company explained him that it is, a very old credit balance. The trade payable had neither approached for the payment nor he is traceable. Under the circumstances no confirmation of the credit balance is available. [PM]

This is a case of external confirmation, covered **by SA 505 "External Confirmations"**. The identities of trade payables are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also not a case of pending litigation.

It **might be a case that an income of ₹ 5 lakhs had been hidden in previous year/s**. The statutory auditor should examine the validity of the credit balance as appeared in the company's financial statements. He should obtain sufficient evidence in support of the balance. He should **apply alternative audit procedures** to get documentary proof for the transaction/s and should not rely entirely on the management representation. Finally, he should include the matter by way of **a qualification in his audit report to the members**.

5. Mr. Z who is appointed as auditor of Elite Co. Ltd. wants to use confirmation request as audit evidence during the course of audit. What are the factors to be considered by Mr. Z when designing a confirmation request? Also state the effects of using positive external confirmation request by Mr. Z. (May 16)

As per **SA 505, "External Confirmation", factors to be considered when designing confirmation requests include:**
"Common factors as discussed in Q2 also"

Positive Confirmation Request
A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information.

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

SA 510: Initial Audit Engagements—Opening Balances

1. Mr. X has been appointed as an auditor of M/s ABC Ltd., Mr. X wants to be satisfied about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements. Lay down the audit procedure, Mr. X should follow, in the initial audit engagement of M/s ABC Ltd. Also suggest the approach to be followed regarding mention in the audit report if Mr. X is not satisfied about the correctness of 'Opening Balances'? (Nov 19)

As per SA 510, the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

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

1. Where the prior year financial statements were audited, **perusing the copies of the audited financial statements** including the other relevant documents relating to the prior period financial statements;

2. Evaluating whether **audit procedures performed in the current period** provide evidence relevant to the opening balances; or

(iv) Performing **specific audit procedures** to obtain evidence regarding the opening balances.

Approach to be followed regarding mention in the Audit Report:

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

2. CA. Jill, a recently qualified practicing Chartered Accountant got his first audit assignment of Natural (P) Ltd. for the financial year 2019-20. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA. Jill left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting Rs. 190 lakhs, continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year. CA. Jill, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor. Comment. (MTP May 20)

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

(i) **Opening balances contain misstatements** that materially affect current period's financial statements; &

(ii) **Appropriate accounting policies** reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

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

Ordinarily, the current auditor **can place reliance on the closing balances** contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

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

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

In the given case, the management of Natural (P) Ltd. has restrained CA. Jill, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Jill, on believing

that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Jill should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme. Consequently, CA. Jill shall **also be held guilty for professional misconduct for not exercising due diligence, or grossly negligence** in the conduct of his professional duties as per the Code of Ethics.

SA 520: Analytical Procedures

1. In audit of DEF Limited, the Auditor had made use of certain analytical procedures with regard to certain key data in the Statement of Profit and Loss. The results obtained showed inconsistencies with other relevant information. State the course of action that the Auditor should take to ensure that the risk of material misstatement would be contained to a low level fixed as per materiality level. (Nov 18 New)

As per **SA 520, "Analytical Procedures",** if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(i) **Inquiring of management** and obtaining **appropriate audit evidence** relevant to management's responses; and
(ii) **Performing other audit procedures** as necessary in the circumstances. Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

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

2. You have been appointed as an auditor of M/s Excellent Hotels Ltd. As a senior partner, you want to use analytical procedures in respect of room rentals as well as payroll expenses. Discuss. (May-19 Old)

Analytical Procedures: As per SA 520 on "Analytical Procedures", in some cases, even an unsophisticated predictive model may be effective as an analytical procedure.

Analytical Procedures in case of Payroll cost- Where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll.

Analytical Procedures in case of Room Rental Income of Hotel- Different types of analytical procedures provide different levels of assurance. Analytical procedures involving the prediction of total rental income in case of Hotel taking the room tariff rates, the number of rooms and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.

SA 530: Audit Sampling

1. Write a short note on Sampling Risk.

Sampling Risk: As per **SA 530 "Audit Sampling",** the 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. Sampling risk can lead to two types of erroneous conclusions:

(i) In case of a **test of controls, that controls are more effective than they actually are**, or in the case of a **test of details**, that a **material misstatement does not exist when in fact it does**. The auditor is primarily concerned with this type of erroneous conclusion because it **affects audit effectiveness** and is more likely to lead to an **inappropriate audit opinion**.

(ii) In the case of a test of controls, that **controls are less effective than they actually are**, or in the case of a **test of details, 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.

2. Write a short note on Tolerable Misstatement.

Tolerable Misstatement: As per **SA 530, "Audit Sampling",** a monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

Further, while designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. Tolerable misstatement is the application of performance materiality, to a particular sampling procedure. Tolerable misstatement may be the same amount or an amount lower than performance materiality.

3. In the course of your audit assignment of Indraprastha Ltd., you want to guide your audit assistants in selecting sample items in such a way that sample can be expected to be representative of the population and all items have an opportunity of being selected. Guide your assistants with principal methods of collecting samples. (May-18 Old)

Principal Methods of Collecting Samples: As per **SA 530 "Audit Sampling",** the principal methods of selecting samples are the use of random selection, systematic selection and haphazard selection.

There are many methods of selecting samples. The principal methods are as follows:

(i) Random selection (applied through random number generators, for example, random number tables).

(ii) Systematic selection, in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerised random number generator or random number tables. When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.

(iii) Monetary Unit Sampling is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

(iv) Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

(v) Block selection involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

4. Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2021 - 2022. 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. [RTP Nov-22]

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.

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

1. While auditing REAL 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? (MTP Apr 21 + Mar'18) OR

CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s Delist Limited is a listed entity at National Stock Exchange and the financial statements are to be drawn up in compliance with Ind AS. M/s Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active and open market. CA Harry is concerned with identification and assessment of the risks of

material misstatement for accounting estimates. Guide him with regard to the estimation making process adopted by management with reference to the relevant Standard on Auditing. [May-22]

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. Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing. (Nov 19 New)

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

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

(i) About the **appropriateness of the measurement processes,** including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.

(ii) That the **assumptions appropriately** reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.

(iii) That **disclosure** related to accounting estimates are complete and appropriate under the applicable financial reporting framework.

(iv) That **no subsequent event** requires adjustment to the accounting estimates and disclosures included in the financial statements.

3. During the Audit of Data Solutions Ltd., a listed company, your audit manager observed that several estimates are made by the Company. He seeks your guidance to know areas of accounting estimates that may give rise to lower level of risk of material misstatement. Guide him with examples. (Nov-19 Old)

As per **SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"**, some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in **business activities that are not complex**.
- Accounting estimates that are **frequently made and updated** because they relate to routine transactions.
- Accounting estimates derived from **data that is readily available**, such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as "observable" in the context of a fair value accounting estimate.
- Fair value accounting estimates where the **method of measurement** prescribed by the applicable financial reporting framework is **simple and applied easily** to the asset or liability requiring measurement at fair value.
- Fair value accounting estimates where the **model used to measure the accounting estimate is well-known or generally accepted**, provided that the assumptions or inputs to the model are observable.

4. A Pvt Ltd is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period. The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise. (RTP May-19 + May-23)

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**.

5. With reference to the Standards on Auditing state the examples of accounting estimates that may have a high estimation uncertainty. [PM]

Examples of Accounting Estimates that may have a High Estimation Uncertainty: As per **SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures",** the auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.

Examples of accounting estimates that may have high estimation uncertainty include the following:

- Accounting estimates that are **highly dependent upon judgment**, for example, judgments about the outcome of pending litigation or the amount and timing of future cash flows dependent on uncertain events many years in the future.
- Accounting estimates that are **not calculated using recognised measurement techniques**.
- Accounting estimates where the results of the auditor's review of similar accounting estimates made in the prior period financial statemen ts indicate a substantial difference between the original accounting estimate and the actual outcome.
- Fair value accounting estimates for which a **highly specialised entity-developed model** is used or for which there are no observable inputs.

6. What are the factors that may influence estimation uncertainty associated with an accounting estimate?

The degree of estimation uncertainty associated with an accounting estimate may be influenced by factors such as:

- The extent to which the accounting estimate **depends on judgment**.
- The sensitivity of the accounting estimate to **changes in assumptions**.
- The **existence of recognised measurement techniques** that may mitigate the estimation uncertainty (though the subjectivity of the assumptions used as inputs may nevertheless give rise to estimation uncertainty).
- The **length of the forecast period**, and the relevance of data drawn from past events to forecast future events.
- The availability of **reliable data from external sources**.
- The extent to which the accounting estimate is based on **observable or unobservable inputs**.

7. M/s. HK & Co. was appointed as an auditor of GSB Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, GSB Limited is required to pay certain percentage of its annual revenue as license fee. GSB Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues and not only on core business revenues. Matter was disputed and went to court of law. On prudence basis, GSB Limited made a provision on estimated business in its books of accounts of agreed percentage on non-core business receipts also. The amount of provision was of such huge amount that the GSB Limited's profit and loss account for that quarter reflected loss due to that provision. How you as an auditor can evaluate this accounting estimate which involves significant risk and what if Management has not addressed the effects of estimation uncertainty on provision made? (Jan-21 New + MTP May-23)

In given case, HK & Co. was appointed as an auditor of GSB Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that GSB Ltd.'s profit and loss account reflected a loss due to that provision.

As an auditor evaluation would be done as under:

For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

(i) How **management has considered alternative assumptions or outcomes**, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.

(ii) Whether the **significant assumptions used by management are reasonable**.

(iii) Where **relevant to the reasonableness** of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, **management's intent to carry out specific courses of action and its ability** to do so.

(iv) If, in the auditor's judgment, management has not adequately **addressed the effects of estimation uncertainty** on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, **develop a range** with which to evaluate the reasonableness of the accounting estimate.

8. M/s ABC Limited is engaged in the business of construction of 4 infrastructure and housing projects. While preparing the financial statements for the year ended 31.03.2023 management has made various accounting estimates and confirmed to the auditor that all necessary accounting estimates have been recognized, measured and disclosed in the financial statements are in accordance with the applicable financial reporting framework. The auditor during the course of audit observed some changed circumstances giving rise to the need for an accounting estimate. Inquiries of same were sought from the management. Can you list down some circumstances, change of which will result in inquiries from the management ? [May-23]

Inquiries from management: As per SA 540, auditor's understanding of the entity and its environment obtained during the performance of risk assessment procedures, together with other audit evidence obtained during the course of the audit, assist the auditor in identifying circumstances, or changes in circumstances, that may give rise to the need for an accounting estimate.

Inquiries of management about changes in circumstances may include, for example, inquiries about whether:

- The entity has engaged in **new types of transactions** that may give rise to accounting estimates.
- **Terms of transactions** that gave rise to accounting estimates that have changed.
- **Accounting policies** relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework or otherwise.
- **Regulatory or other changes** outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- **New conditions or events** have occurred that may give rise to the need for new or revised accounting estimates.

During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. SA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.

SA 550 : Related Parties

1. JKL Limited is engaged in the business of Construction and real estate having various projects across states. M/s YT & Co, Chartered Accountants have been appointed as Statutory Auditors. Audit Team from M/s YT & Co for audit of JKL Limited comprises of CA Z — Engagement Partner, CA Q, a paid assistant and 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is a managing partner. The engagement team discussed that SA 315 and SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the JKL Limited's related party relationships

and transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant standard on Auditing. [May-22]

As per **SA 550, Related Parties,** matters that maybe addressed in the discussion by engagement team may include:

- ✓ **Nature & extent** of entity's relationship & transactions with Related Parties
- ✓ An emphasis on maintaining **professional skepticism** throughout audit regarding potential of material misstatements from RP relationships & transactions
- ✓ **Circumstances or conditions** that may indicate RP relationships or transactions not disclosed by management to the Auditor
- ✓ **Records or documents** that may indicate existence of Related party relationships or transactions
- ✓ Importance management & TCWG attach to maintaining **internal controls** regarding identification, accounting and disclosure of RP relationships & transactions.

2. Mr. X, while conducting audit of PQR Ltd, comes across certain transactions which according to him are significant transactions with related parties and identified to be outside the entity's normal course of business. Guide Mr. X with examples of such transactions and to understand the nature of significant transactions outside the entity's normal course of business. (Nov-20)

In the given case of PQR Ltd, Mr. X, while conducting audit has come across certain significant related party transaction which are identified to be outside the entity's normal course of business.
Mr. X wants guidance through examples of such significant transactions which are given in SA 550.

As per **SA 550 "Related Parties",** examples of transactions outside the entity's normal course of business may include:
1. **Complex equity transactions**, such as corporate restructurings or acquisitions.
2. **Transactions with offshore entities** in jurisdictions with weak corporate laws.
3. The **leasing of premises** or the rendering of management services by the entity to another party if no consideration is exchanged.
4. **Sales transactions** with unusually large discounts or returns.
5. Transactions with **circular arrangements,** for example, sales with a commitment to repurchase. 6. Transactions under contracts whose terms are changed before expiry.

3. Whilst the Audit team has identified few matters, they need your advice to conclude on the same. Engagement partner has asked them to review the board minutes & other records based on which following additional matters were brought to the attention of Engagement partner:-

(i) Long term borrowings from parent company has no written terms and neither the interest nor principal has been repaid so far.

(ii) Certain computers were received from Parent Co. free of Cost, the value if which is Rs 0.23 lacs & no accounting or disclosure of the same has been made in accounts.

(iii) An amount of ₹ 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by ₹0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts' paid, no separate disclosure of this related party transaction has been made in the notes to accounts forming part of the financial statements highlighting the same as a 'related party' transaction.

Audit Manager has reported that she had asked certain information relating to another 'related party' transaction (amounting to approx. ₹ 47 lac) but the CFO refused to provide the same since the same is perceived to be confidential and cannot be shared with the Auditors.

You are required to advise about items to be reported to TCWG, where applicable, based on your audit findings in the given situation. (MTP Nov'20)

As per **SA 550, Related Parties,** communicating significant matters arising during audit in connection with entity's RP helps the auditor to establish a common understanding with TCWG.

It may be noted that unless all of TCWG are involved in managing the entity, the **auditor shall communicate with TCWG significant matters arising during** the audit in connection with the entity's RP.

The auditor is also required to ensure compliance of **Ind AS 24 / AS 18 Related Party Disclosures.**

In view of above in the given scenario, the auditor is required to prepare a brief summary of following items to be reported to TCWG in accordance with **SA 260 Communication with TCWG**:

(i) One of related party transaction amounting 3.25 lac per month i.e. in lieu of marketing services has been noticed of which amount ₹ 0.25 lac per month is exceeds the arm's length price has not been disclosed highlighting the same as related party transactions as per Ind- AS 24 / AS 18 Related Party Disclosures.

(ii) Refusal by CFO of the company to provide the details of related party transaction amounting to rupees 47 lac on the ground that same is perceived to be confidential and cannot be shared with auditors, is not in order, as denying for the related part details of ₹ 47 lac is **imposing limitation of scope of auditor in view of SA 705.**

(iii) Receipt of free of cost Computers and long-term borrowing (on no agreed terms and repayment of interest and principal) from the Parent Company need separate disclosure in financial statements as per Ind AS 24 / AS 18 Related Party Disclosures.

Further, in case of all above cases, auditor would also need to assess his reporting requirements under the **clauses (xiii) of Paragraph 3 of CARO 2020** with respect to related party transactions that whether all transactions with the RP are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable Accounting Standards.

4. In the course of audit of QRT Ltd, its statutory auditor wants to be sure of the adequacy of related party disclosures? Kindly guide the auditor in identifying the possible source of related party information. (MTP Oct-18)

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

SA 550 requires that to identify names of all known related parties, the **auditor may inspect records or documents** that may provide information about related party relationships and transactions, **for example**

- entity **income tax returns,**
- information supplied by the entity to **regulatory authorities,**
- **shareholder registers** to identify the entity's principal shareholders,
- **statements of conflicts of interest** from management and those charged with governance,

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

Auditor should also **obtain a written representation from the management** concerning the completeness of information provided regarding the identification of related parties.

5. You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was ₹ 12,000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for ₹ 850 crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with Ind AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises. Analyse this issue in finalizing the Audit Report. (Nov-18 New)

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

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:
(1) the **name of the government and the nature of its relationship** with the reporting entity (i.e. control, joint control or significant influence);
(2) the **following information** in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:

(i) the **nature and amount of each individually significant transaction**; and
(ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

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

In the instant case, Power Supply Corporation Limited, a Government Company has procured spares for transmitters for rupees 850 crore from abroad through a corporation namely Procurement and Supply India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Power Supply Corporation Limited has to disclose the matters specified above (i.e.name of Government,natures of its relationship with reporting entity, the nature and amount of transaction etc.).

Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise in **not tenable**.

7. In the course of your audit you have come across a related party transaction which prima facie appears to be biased. How would you deal with this? (PM)

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. Since it is the management, which is primarily responsible for identification of related parties, SA 550 requires that to identify names of all known related parties, the auditor may inspect records or documents that may provide information about related party relationships and transactions.

In this case, the auditor is finding a related party transaction which prima facie appears to be biased. So the auditor is required to confirm the same. For identified significant related party transactions outside the entity's normal course of business, the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:

(i) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets,
(ii) The terms of the transactions are consistent with management's explanations; and
(iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

The auditor should also obtain audit evidence that the transactions have been appropriately authorised and approved.

SA 560: Subsequent Events

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

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** &, if so,
iii. **Inquire** how management intends to address the matter in the financial statements.

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

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

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

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

2. You are the auditor of PQR Ltd. which is in the business of supplying food products to various airline companies operating aircrafts in domestic circle only. As per terms of agreement with airlines, the company needs to stock various non- perishable food items for coming one month (average holding of inventory to the tune of INR 75 Crores). Also the payment terms have been settled and the company receives payment in 45 days after the supply of goods. Everything was going-on well till the end of March 2020 when pandemic Covid hit the world and everything came to a standstill. Aviation sector was hit hard and there were no flights from April 2020 onwards. Consequently, the business of PQR Ltd. also got severely affected and the scheduled supplies of goods to airlines also were not made. Also, the liquidity position of airline companies got hit and the scheduled payments were also not received on due dates. As the auditor of PQR Ltd. what audit procedures would you perform to ensure that all subsequent events are considered, so that financial statements for the year ended 31.03.2020 represent true and fair view? (Nov 20 New)

As per **SA 560 "Subsequent Events",** the auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required in above paragraph so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.

Being the auditor of PQR Ltd, to ensure that all subsequent events are considered so that financial statements for the year ending 31.03.2020 represent true and fair view, the auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

(a) Obtaining an **understanding of any procedures management** has established to ensure that subsequent events are identified.
(b) **Inquiring of management** and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
(c) **Reading minutes,** if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
(d) Reading the **entity's latest subsequent interim financial statements**, if any.

When, as a result of the procedures performed as required above, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

3. M/s LMP Associates, Chartered Accountants, while conducting the audit of PQR Ltd want to conduct an inquiry of management and those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. Guide M/s LMP Associates with the matters where specific enquiry may be conducted to evaluate subsequent events. (May'19 Old)

As per **SA 560, "Subsequent Events"**, in inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

i. Whether **new commitments, borrowings or guarantees** have been entered into.
ii. Whether **sales or acquisitions of assets** have occurred or are planned.
iii. Whether there have been **increases in capital or issuance of debt instruments,** such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
iv. Whether any **assets have been appropriated by government or destroyed,** for example, by fire or flood.
v. Whether there have been any **developments regarding contingencies.**
vi. Whether any **unusual accounting adjustments** have been made or are contemplated.
vii. Whether any events have occurred or are likely to occur that will bring **into question the appropriateness of accounting policies** used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption.
viii. Whether any events have occurred that are relevant to the **measurement of estimates or provisions** made in the financial statements.
ix. Whether any events have occurred that are relevant to the **recoverability of assets.**

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

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

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

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

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

As per **SA 560 "Subsequent Events"**, the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

So the auditor should **request the management to adjust the sum of ₹ 1.50 crores by making provision for expenses.** If the management does not accept the request the auditor should qualify the audit report. **[Author's Note: If Question on Ind AS, then quote Ind AS 10 & 37]**

5. The audit report of Kolsi (P) Ltd. for F.Y. 2020-21 was issued by Bishnoi & Co. on 25th July, 2021. However, a case was filed against Kolsi (P) Ltd. on 4th August, 2021, with the Civil Court, with respect to an incident caused in its factory on 17th January, 2021, the outcome of which may result in paying heavy penalty by Kolsi (P) Ltd.

Mr. Raj Bishnoi, the partner of Bishnoi & Co., discussed the said matter with the management and it was determined to amend the financial statements for F.Y. 2020 -21.

Further, Mr. Raj inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.

The management told Mr. Raj that such disclosure was enough as he would further going a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.

In the context of aforesaid case scenario, please answer the following questions:-

(a) Whether Mr. Raj on behalf of Bishnoi & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Kolsi (P) Ltd.?

(b) Whether the contention of management of Kolsi (P) Ltd. is valid with respect to the disclosure of the court case in the financial statements? (RTP Nov'21)

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:

1. **Discuss the matter** with management and, where appropriate, those charged with governance.
2. Determine whether the **financial statements need amendment** and, if so,
3. Inquire **how management intends to address the matter** in the financial statements.

In the given case, on becoming aware of the court case filed against Kolsi (P) Ltd.,Mr. Raj discussed the said matter with the management and it was determined to amend the financial statements. Also, he inquired how the management intended to address the said matter in the financial statements.

However, If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where Mr. Raj (hereinafter referred as 'the auditor') believes they need to be amended, the auditor shall notify management and, those charged with governance (unless all of those charged with governance are involved in managing the entity), that the auditor will seek to prevent future reliance on the auditor's report.

If despite such notification the management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report in accordance with SA 560.

(b) As per **SA 706, 'Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report',** an

Emphasis of Matter paragraph is not a substitute for:

a) A **modified opinion** in accordance with SA 705 (Revised) when required by the circumstances of a specific audit engagement;
b) **Disclosures in the financial statements** that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or
c) **Reporting in accordance with SA 570 (**Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

In the given case, the management of Kolsi (P) Ltd. has presumed that as the auditor was going to provide a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report, there was no further need for it to provide additional disclosures about the court case in the financial statements.

The said **contention of management of Kolsi (P) Ltd. is not valid** as 'Emphasis of Matter' paragraph cannot be used as a substitute for disclosures required to be made in the financial statements as per the applicable financial reporting framework or that is otherwise necessary to achieve fair presentation, which is the responsibility of the management.

SA 570: Going Concern

1. Abhinandan Limited a chemical manufacturing company, having its factory located at Nanded Village, for the year 2021-22 appointed Subahu & Co. as their statutory auditors. During the course of the audit, Subahu & Co. identified that Abhinandan Limited received a show cause notice from National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Abhinandan Limited was dumping toxic solid waste, without treating it, on the nearby grounds, and because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation performed by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 and a lot of damage has been done to the environment by Abhinandan Limited. A show cause notice was already issued to Abhinandan Limited by the National Green Tribunal for levying the penalty of an amount of ₹ 500 crore. The unaudited profit for the financial year 2021-22 of Abhinandan Limited was ₹ 35 crore and the unaudited turnover was ₹ 100 crore. Upon inquiry it was identified that Abhinandan Limited has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

"The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws and the company's legal department has assessed and found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices."

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter. [RTP Nov-22]

As per **SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements"**, the auditor is required to **obtain an understanding and need to evaluate the impact of 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, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

The auditor shall perform the following audit procedures to help identify instances of non - compliance with other laws and regulations that may have a material effect on the financial statements:

(a) **Inquiring** of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and

(b) **Inspecting correspondence**, if any, with the relevant licensing or regulatory authorities

As per **Section 143(3)(j) read with Rule 11(a)**, the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

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 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 **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 not made** in the financial statements, the auditor shall

(a) Express a **qualified opinion or adverse opinion,** as appropriate, in accordance with SA 705; and

(b) 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 current scenario, Abhinandan Limited has received a show cause notice from the National Green Tribunal of an amount which is more than the net profit and the turnover of the company for the year. In the event of an unfavourable order for Abhinandan Limited, there will be an impact on Abhinandan Limited's ability to continue as a going concern.

As a result, appropriate disclosure should be provided by management for such events which cast significant doubt on the entity's ability to continue as a going concern. As no appropriate disclosure has been provided by Abhinandan Limited for such show cause notice, Subahu & Co. should report this matter in their audit report under **"Going Concern Para" as per SA 570** and under **clause (j) of Section 143(3)** of the Companies Act, 2013.

Also, the auditor is required to issue an adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

2. Star 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 2020-21, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Star Ltd. This happened in the month of December 2020 and as such entire power generation process of Star 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 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 Star Ltd. What course of action should the statutory auditor of the Company consider in such situation? (RTP May'21)

OR

Joy Ltd. is an entertainment company which runs a circus and travels around the country to entertain the masses. The circus began losing its popularity over the past few years and attendance has reportedly dropped by as much as 75% in the current financial year. Animal rights activists continuously targeted the circus for its use of animal creatures like elephants in the show. The CEO noted that the audience seemed to be abandoning the circus due to their expanding entertainment options. The high cost of moving the show from city to city eventually made the business model untenable. As a result, many key managerial personnel of the company left the company, there were delays in the payment of wages and salaries, and the bank from whom the company had taken funds also decided not to extend further finance or to fund further working capital requirements of the company.
When discussed with the management, the statutory auditor understood that the company had no action plan to mitigate such circumstances (Use of going concern assumption is inappropriate) Further, all such circumstances were not reflected in the financial Statements of Joy Ltd. What course of action should the statutory auditor of the company take in the auditor's report in such situation ? [May-23]

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 express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and 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 Star 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 Star 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.

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

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

The approval of NCLT was finally obtained on 4 May 2019. PQR Ltd. Submitted detailed plans and commitments as part of the resolution plan including clearance of all outstanding debts which were leading to negative cash flows. Please suggest how would you deal with this situation as the auditors of MNO Ltd. (RTP Nov-19)

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

These procedures shall include:

(i) Where **management has not yet performed an assessment** of the entity's ability to continue as a going concern, requesting management to make its assessment.
(ii) Evaluating **management's plans for future actions** in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
(iii) Where the entity has **prepared a cash flow forecast**, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in –
  (1) Evaluating the reliability of the underlying data generated to prepare the forecast; and
  (2) Determining whether there is adequate support for the assumptions underlying the forecast.
(iv) Considering whether **any additional facts or information** have become available since the date on which management made its assessment.
(v) **Requesting written representations** from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

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

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists,

the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

In the instant case, the **approval of the resolution plan is a significant mitigating factor** to counter the going concern issues of MNO Ltd. PQR Ltd. Has submitted a detailed plan and commitments that has been given as part of the resolution plan which includes clearance of all outstanding debts which were leading to negative cash flows.

Therefore, it can be said that the **events and conditions are mitigated effectively** and there **is no material uncertainty in relation to the ability of the company to continue as a going concern.**

4. TBR Limited has plan of its business being closed due to huge loss incurred due to the recent outbreak of global pandemic, within a short period from the close of the accounting year ended on 31st March, 2020. The Financial Statements for the said year have been prepared on the same basis as in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above.

[Nov-20 Old + MTP Oct'20 + May'18 New]

As per **SA 570 "Going Concern",** management **intentions to liquidate the entity or to cease operations is one of the events or conditions that may cast significant doubt** on the entity's ability to continue as 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 but, **based on the audit evidence obtained, the auditor concludes that no material uncertainty exists,** the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the **financial statements provide adequate disclosures about these events or conditions.**

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

As per the facts given in the case, intention of TBR Limited has a plan of its business being closed as huge loss is incurred due to the recent outbreak of global pandemic, within short period from 31st March 2020. However, financial statements for the year ended 31.03.2020 have been prepared on the same basis as it had been in earlier periods with an additional note.

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

5. M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2018 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the 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. (Nov-18 New)

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.

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

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

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

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

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

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

7. TUV Ltd. Is a company engaged in the business of manufacture of spare parts. Saroj & Associates are the statutory auditors of the company for the FY 2020-21. During the course of audit, CA Saroj noticed that the company had a major customer, namely, Korean Mart from South Korea. Owing to an outbreak of war and subsequent destruction leading to government ban on import and export in South Korea, the demand from Korean Mart for the products of TUV Ltd. Ended for an unforeseeable time period. When discussed with the management, CA Saroj was told that the company is in the process of identifying new customers for their products. CA Saroj understands that though the use of going concern assumption is appropriate but a material uncertainty exists with respect to the identification of new customers. This fact is duly reflected in the financial statements of TUV Ltd. For the FY 2020-21. How should CA Saroj deal with this matter in the auditor's report for the FY 2020-21? (SM)

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

In the present case, TUV Ltd. Has a key customer in South Korea from which the demand for its products has ended on account of outbreak of war, subsequent destruction and government ban on import and export in South Korea. Further, the company has not yet identified new customers and is in the process of doing the same. As such, the identification of new customer is a material uncertainty that cast a significant doubt on the company's ability to continue as a going concern.

However, this **matter is duly disclosed by the management of TUV Ltd. In the financial statements** for the year ended 31.03.2021.

As such, considering that the going concern assumption is appropriate but a material uncertainty exists with respect to identification of new
customer, CA Saroj should:
(1) Express an **unmodified opinion** and
(2) Include in his audit report, a separate section under the **heading "Material Uncertainty Related to Going Concern"** to:

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

Thus, CA Saroj should deal with this matter in his auditor's report in the above mentioned manner.

8. Enumerate the Operating conditions of an entity that may cast significant doubt on the entity's ability to continue as a "Going Concern". (May-19 Old)

Operating Conditions: As per SA 570 Going Concern, operating conditions of an entity that may cast significant doubt on the entity's ability to continue as a going concern are:

- Management intentions to liquidate the entity or to cease operations.
- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labour difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor

9. CA.K is appointed statutory auditor of SEEK INDIA LTD under Companies Act, 2013 for the first time. The company is preparing its accounts keeping in view applicable requirements of Division II of Schedule III of Companies Act, 2013. On scrutiny of financial statements of company put up for audit, it was noticed that notes to accounts show ageing of trade payables as per amended requirements of Schedule III of the Companies Act, 2013.

The ageing schedule forming part of notes is as under: - Outstanding for following periods from due date of payment (₹ In crore)

Particulars	<1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	-	-	-	-	NIL
Others	2	4	3	1	10
Disputed dues-MSME	-	-	-	-	-
Disputed dues-others	-	-	-	-	-

Besides above, current ratio, debt-equity ratio, trade payables turnover ratio and net profit ratio disclosed in notes to accounts have slipped drastically as compared to last year and from standard norms.

Most of the key financial ratios are in red. There is no other relevant information concerning above in notes to accounts.

Further, on reviewing bank statement of cash credit limit (against hypothecation of paid stocks), it was noticed that there is no debit transaction in the month of March,2022.

On inquiry, he came to know that stock audit of company was conducted in the month of January,2022 and stock auditors have commented vide their report dated 25.2.2022 that company had negative drawing power due to high creditors. Accordingly, the bankers have refused further debits in cash credit account from start of March,2022. There is no information in this respect in financial statements and notes to accounts.
Discuss how CA K should deal with above for reporting in his audit report under the Companies Act, 2013.
[MTP Oct-22]

It is clear from the ageing schedule that company is not able to pay its creditors on time. Outstanding to creditors for a period of 1 year or more account for 80% of total dues to the creditors of the company from due date of payment. Most of key financial ratios are adverse.

Further, bankers have refused further debits in cash credit account due to negative drawing power from March 2022. Cash credit loans are repayable on demand. There is no other information or disclosure available how the company plans to run its business without bank finance.

All the above factors are **indicators that a material uncertainty exists that may cast a significant doubt on the company's ability to continue as going concern**. There is no express disclosure of this fact in financial statements.

Therefore, it is a situation where material uncertainty exists which has cast a significant doubt on company's ability to continue as going concern in accordance with SA 570, "Going Concern".

Keeping in view above the fact that although a material uncertainty exists casting a significant doubt on the ability of company to continue as going concern, **adequate disclosure of material uncertainty is not made in financial statements**, CA K shall give **qualified or adverse opinion** in accordance with **SA-705, "Modifications to the Opinion in the Independent Auditor's Report"**.

SA 580: Written Representation

1. Mokshda & Co is the statutory auditor of Get My Trip Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2765 crore and profits are INR 285 crore. 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. (MTP Mar'21)

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.

2. State briefly the basic elements of Management Representation Letter. (PM)

As per SA 580 "Written Representations", some of the **basic elements** of a Management Representation letter are-

(1) It is a **written statement by management** provided to the auditor to confirm certain matters or to support other audit evidence.
(2) It **does not include financial statements, the assertions therein, or supporting books** and records.
(3) The auditor shall request management to provide a written representation that it has **fulfilled its responsibility** for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement.
(4) The written representations shall be for **all financial statements and period(s)** referred to in the auditor's report.

3. In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty? (May-10)

As per **SA 580 "Written Representations"**, if the management does not provide one or more of the requested written representations, the auditor shall:

i. **Discuss the matter with management,**
ii. **Re-evaluate the Integrity** of the management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general, and
iii. **Take appropriate actions**, including determining the possible effect on the opinion in the auditor's report.

The auditor should **disclaim an opinion** on the financial statements if management does not provide written representations in accordance with SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

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

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

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

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

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

SA 600: Using the Work of Another Auditor

1. BETA Ltd is the Subsidiary company of ALPHA Ltd. PQR & Associates has been appointed as auditor of ALPHA Ltd. for the Financial Year 2019-20 and MNO & Associates has been appointed as auditor of BETA Ltd for the year 2019-20. Explain the role of PQR & Associates and MNO & Associates as auditors of the parent company and subsidiary company respectively. (MTP Oct-20)

As per **SA 600 "Using the Work of Another Auditor"**, there should be sufficient liaison between the principal auditor (hereinafter referred as auditor of Parent Company and the other auditor (hereinafter referred as auditor of Subsidiary Company).

Role of Principal Auditor (PQR & Associates- Auditor of Parent Company):
(i) It is necessary to **issue written communication(s)** as a principal auditor to the other auditor.
(ii) The principal auditor should **advise the other auditor** of any matters that come to his attention that he thinks may have an important bearing on the other auditor's work.
(iii) When considered necessary by him, the principal auditor may require the other auditor to answer a **detailed questionnaire** regarding matters on which the principal auditor requires information for discharging his duties.

Role of Other Auditor (MNO & Associates- Auditor of Subsidiary Company):
(i) The other auditor, knowing the context in which his work is to be used by the principal auditor, should **co-ordinate with the principal auditor**. For example, by bringing to the principal auditor's immediate attention to any significant findings requiring to be dealt with at entity level, adhering to the time-table for audit of the component, etc.
(ii) He should **ensure compliance with the relevant statutory requirements**.
(iii) The other auditor should **respond to the questionnaire** sent by Principal Auditor on a timely basis.

2. B is the Principal Auditor of ABC Co. Ltd., with 8 branches audited by 8 Branch Auditors. B wanted to ensure that the works of Branch Auditors were adequate for the purpose of his audit. Hence he insisted on Branch Auditors to get familiar with a check list he prepared for branches and, besides, required them to share the working papers compiled by them for his review and return. Is Principal Auditor within his right in asking for such sharing of working papers? (May-18 New)

When the accounts of the branch are audited by a person other than the company's auditor, there is need for a **clear understanding of the role of such auditor and the company's auditor** in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit.

In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor".**

It makes clear that in certain situations, the statute governing the entity may confer a **right on the principal auditor to visit a component and examine the books** of account and other records of the said component, if he thinks it necessary to do so.

Where another auditor has been appointed for the component, the principal auditor would **normally be entitled to rely upon the work of such auditor** unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

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

When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:
(1) **advise the other auditor** of the **use of other auditor's work and report** and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit.
(2)The principal auditor would inform the other auditor of matters such as

- **areas requiring special consideration**,
- procedures for the **identification of inter-component transactions** that may require disclosure and
- the **time-table** for completion of audit; and

(2) advise other auditor of the **significant accounting, auditing and reporting requirements and obtain representation** as to compliance with them.

Principal auditor might **discuss with other auditor 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 circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

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

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

3. PQ Limited, a listed entity, headquartered in Mumbai and is having 15 branches all over India. The Company is in the business of buying paddy grown by farmers directly and processing to produce final products for selling in domestic as well as international markets. PQ Limited appointed four firms of Chartered Accountants for audit of its head office and branches. Your firm is one of those firms. It was agreed that your firm will act as Principal auditor. 'What factors will be considered by you while accepting the position of Principal auditor ? (July-21 New)

SA 600 – Using the work of Another Auditor - While accepting the position of Principal Auditor, the auditor should consider whether the auditor's 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.

SA 610: Using the Work of Internal Auditor

1. CA. Amboj, a practicing CA has been appointed as internal auditor of Textile Ltd. He conducted physical verification of inventory at year-end and handed over report of verification to CA. Kishore, statutory auditor of Company, for his view and reporting. Can CA. Kishore rely on such report?
(MTP Oct-18 + ICAI SM)

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

(a) The extent to which internal audit function's organizational status and relevant policies and procedures support **objectivity** of internal auditors;

(b) The **level of competence** of internal audit function; and

(c) Whether IA function applies a **systematic and disciplined approach,** including quality control.

Further, external auditor shall **not use the work of Internal Audit function** if external auditor determines that:

(a) The function's organizational status and relevant policies and procedures **do not adequately support objectivity** of internal auditors;

(b) The function **lacks sufficient competence**; or

(c) The function **does not apply a systematic and disciplined approach**, including quality control.

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

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

2. Moon Ltd. of which you are Statutory Auditor, have internal audit being conducted by outside agency. State factors that weigh considerations in opting to make use of direct assistance of internal auditors for purpose of statutory audit. (May 18 New)

As per **SA 610 'Using the work of Internal Auditor'** in determining nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, external auditor shall consider:

(1) The **amount of judgment involved** in:
   (i) Planning and performing relevant audit procedures; and
   (ii) Evaluating audit evidence gathered;

(2) The **assessed risk of material misstatement;** and

(3) The external auditor's **evaluation of existence and significance of threats to objectivity and level of competence** of internal auditors who will be providing such assistance.

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

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

3. Mr. Sheetal is appointed as statutory auditor of Mahi Ltd. Mahi Ltd is required to appoint an internal auditor as per statutory provisions given in Companies Act, 2013 and appointed Mr. Kunthu as its internal auditor. The external auditor Mr. Sheetal asked internal auditor to provide direct assistance to him regarding evaluating the sufficiency of tests performed and the adequacy of disclosures in the financial statements and other matters affecting the auditor's report. Discuss whether Mr. Sheetal, statutory auditor, can ask direct assistance from Mr. Kunthu, internal auditor as stated above in view of relevant Standard on Auditing. (MTP Apr'21)

As per **SA 610 "Using the Work of Internal Auditor"**, EA shall not use internal auditors to provide direct assistance to perform procedures that Involve making significant judgments in the audit.
Since external auditor has sole responsibility for the audit opinion expressed, 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 adequacy of **disclosures in F.S.**, and other matters affecting the auditor's report.

In view of above, **Mr. Sheetal cannot ask direct assistance** from internal auditors regarding evaluating sufficiency of tests performed and adequacy of disclosures in F.S. and other matters affecting auditor's report.

4. OPQ Ltd is in software consultancy business. The company had large balance of accounts receivables in past years which have been assessed as area of high risk. For year ended 31 March 2019, in respect of valuation of accounts receivable, statutory auditor was assigned with checking of accuracy of aging of accounts receivables and provision based on ageing, to internal auditor providing direct assistance to him. Comment. (MTP Oct-19 + Nov-22)

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

(i) Involve making **significant judgments** in the audit;
(ii) Relate to **higher assessed risks of material misstatement** where judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
(iii) **Relate to work** with which **internal auditors have been involved** and which has already been, or will be, reported to management or TCWG by Internal Audit function; or
(iv) Relate to **decisions external auditor makes** in accordance with this SA regarding the internal audit function and use of its work or direct assistance.

In given case where **valuation of accounts receivable is assessed as an area of higher risk,** statutory auditor could **assign the checking of accuracy of the aging to internal auditor** providing direct assistance.

However, because **evaluation of adequacy of provision based on the aging would involve more than limited judgment, it would not be appropriate to assign** that latter procedure to an internal auditor providing direct assistance.

5. Mr. Anand is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhola as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.
(a) Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhola, internal auditor as stated above in view of Standards on Auditing.
(b) Will your answer be different, if Mr. Anand ask direct assistance from Mr. Bhola, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures? (RTP May-20)

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

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

Significant judgments include the following:

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

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

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

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

6. Smart Ltd is a manufacturing unit and you are External Auditor of the company. Internal auditors are also appointed as per the provisions of the Companies Act, 2013. As an external auditor you want to use the internal auditors to provide direct assistance for the purposes of audit. State the circumstances where the internal auditors cannot be used to provide direct assistance. What would you include in the audit documentation? (July-21 Old)

In the given case of Smart Ltd, a manufacturing unit, an external auditor shall not use internal auditors to provide direct assistance as per **SA 610, Using the work of Internal Auditor**, to perform procedures that:

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

Further, **if the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:**
(1) The **evaluation of the existence and significance of threats to the objectivity** of the internal auditors, and the level of **competence** of the internal auditors used to provide direct assistance;
(2) The basis for the decision regarding the **nature and extent of the work** performed by the internal auditors;
(3) **Who reviewed the work performed** and the date and extent of that review in accordance with SA 230, Audit Documentation;
(4) The **written agreements** obtained from an authorized representative of the entity and the internal auditors; and
(5) The **working papers** prepared by the internal auditors who provided direct assistance on the audit engagement.

SA 620: Using the Work of an Auditor's Expert

1. Rajul Ltd had a net worth of INR 2500 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.
(MTP Mar 21 + RTP May-23)

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.

2. CA Dabu has been appointed as an auditor of M/s MAP Technocraft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take services of Mr. Jay, an engineering consultant. Mr. Jay performed his work and submitted details to CA Dabu. State the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay. (May 19 New)

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

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

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

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

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

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

3. HAM Ltd. is engaged in the business of manufacturing of medicines. The manufacturing process requires raw materials such as hydrochloric acid, caustic soda and other chemicals for the manufacturing of various drugs. The Company has maintained large . stock of raw materials of all types of chemicals being used. The nature of raw material is such that its physical verification requires the involvement of an expert. Management hired their expert for the stock taking and auditors also involved their expert for the same-purpose.
The auditor observed that the work of the auditor's expert was not adequate for the auditor's purposes and he could not resolve the matter through additional audit procedures which included further work performed by both the auditor's expert and the auditor.
Based on above, the auditor knows that it would be right to express a modified opinion in the auditor's report because he has not obtained sufficient appropriate audit evidence. But he was reluctant in doing so and issued a clean audit report and included the name of the expert in his report to reduce his responsibility for the audit opinion expressed. Comment with respect to relevant Standard of Auditing relating to the action of the auditor of issuing clean audit report. [May-23]

Reference to work of Auditor's Expert: As per SA 620, Using the Work of Auditor's Expert, Auditor shall **not refer to work of auditor's expert in auditor's report containing unmodified opinion** unless required by law or regulation. If such reference required by law or regulation, auditor shall indicate in report that reference doesn't reduce auditor's responsibility for audit opinion.
In some cases, law or regulation may require reference to work of an auditor's expert, for purposes of transparency in public sector

If auditor **makes reference to work of auditor's expert in auditor's report** because such **reference is relevant to understanding of modification to auditor's opinion**, indicate in auditor's report that such **reference doesn't reduce auditor's responsibility for that opinion.**

In given case, auditor knows that it would be right to express a modified opinion in the auditor's report because he has not obtained sufficient appropriate audit evidence. But he was reluctant in doing so and issued a clean audit report and included the name of the expert in his report to reduce his responsibility for the audit opinion expressed.

Hence, **Auditor's action isn't right.**

SA 700: "Forming an Opinion and Reporting on Financial Statements

1. KPI Ltd. Is a company on which International Standards on Auditing are applicable along with Standard on Auditing issued by the ICAI. The company appointed new auditors for the audit of the financial statements year ended 31 March 2019 after doing all appointment formalities. Therefore, the auditor's report referred the International Standard on Auditing in addition to the Standard on Auditing issued by the ICAI. As an expert, you are required to advise the auditor regarding auditor's report for audits conducted in accordance with both the Standards. (RTP Nov-19)

As per **SA 700, "Forming an Opinion and Reporting on Financial Statements",** an auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

(a) There is **no conflict between the requirements in the ISAs or such auditing standards** of other jurisdiction and those in SAs that would lead the auditor:

i. to **form a different opinion**, or
ii. **not to include an Emphasis of Matter paragraph or Other Matter paragraph** that, in the particular circumstances, is required by SAs; and

(b) The auditor's report **includes, at a minimum, each of the elements set out in Auditor's Report** Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing.

However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

2. MN & Associates, Chartered Accountants have been appointed as statutory Auditors of Cotton Ltd. For the F.Y 2020-2021. The Company is into the business of yarn manufacturing. For this purpose, cotton ginning is also done within the factory premises. Raw cotton is purchased from local market and processed in-house. The Company received a notice from the State Government to deposit market development fee for the last 5 years to the tune of ₹ 10.00 crores. The Company and all other organizations in the same business have not deposited the market development fee, taking shelter of an old circular issued by the Government. The trade association met with the government officials to resolve the matter and agreed to deposit the same prospectively. However, the matter relating to payment of development fee for the last 5 years is pending before the Government as at the end of the financial year. The Company, however, disclosed the same in notes to accounts, as contingent liability, without

quantifying the effect and proper explanation. If the liability is provided in the books of accounts, entire reserves will be wiped off. Auditor seeks your guidance as to how this disclosure affects them while forming an opinion on financial statements. (July-21 New)

Forming an opinion and reporting on financial statements – As per **Ind AS 37, "Provisions, Contingent Liabilities and Contingent Assets",** an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable .

a) an **estimate of its financial effect**, measured in the standard;
b) an **indication of the uncertainties** relating to the amount or timing of any outflow; and
c) the **possibility of any reimbursement**.

SA – 700 – Forming an opinion and reporting on financial statements: The auditor shall evaluate whether in view of the requirements of the applicable financial reporting framework

(i) The financial statements **adequately disclose the significant accounting policies** selected and applied;
(ii) The accounting policies selected and applied are **consistent with the applicable financial reporting framework** and are appropriate;
(iii) The **accounting estimates** made by the management are **reasonable**;
(iv) The **information presented** in the financial statements is relevant, reliable, comparable and understandable;
(v) The financial statements **provide adequate disclosures** to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall **determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705**.

In the present case, auditor may consider modifying his opinion considering the financial effect of liability not disclosed properly.

3. CA S has been appointed as Statutory Auditor of SRT Ltd. For the financial year 2020-2021. The Company while preparing financial statements for the year under audit prepared one additional profit and loss account that disclosed specific items of expenditure and included the same as an appendix to the financial statements. CA. S has not been able to understand this as the additional profit and loss account is not covered under applicable financial reporting framework. Guide him as to how he should deal with this issue while reporting on the financial statements of SRT Ltd. (July-21 New + RTP May-23)

If **supplementary information that is not required by the applicable financial reporting framework** is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is **nevertheless an integral part of the financial statements due to its nature or how it is presented**. When **it is an integral part** of the financial statements, the supplementary information shall be **covered by the auditor's opinion**.

If supplementary information that is **not required by the applicable financial reporting framework is not considered an integral part** of the audited financial statements, the auditor shall evaluate whether such supplementary information is **presented in a way that sufficiently and clearly differentiates** it from the audited financial statements. If this is **not the case**, then the auditor shall **ask management to change how the unaudited supplementary information is presented**.

If **management refuses** to do so, the auditor shall **identify the unaudited supplementary information and explain** in the auditor's report that such **supplementary information has not been audited**.

When an **additional profit and loss account that discloses specific items of expenditure is disclosed as a separate schedule**, included as an appendix to the financial statements, the auditor may consider this to be supplementary information that can be **clearly differentiated from the financial statements**.

Thus, **additional profit and loss account is not considered an integral part** of the audited financial statements and the auditor shall evaluate that supplementary information is **presented in a way that sufficiently and clearly differentiates it from the audited financial statements**.

SA 701: Communicating Key Audit Matters in the Independent Auditor's Report

1. AKY Ltd. is a listed company engaged in the business of software and is one of the largest company operating in this sector in India. The company's annual turnover is Rs. 40,000 crores with profits of Rs. 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India. The company's contracts with its various customers are quite complicated and different. During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion. This matter was also discussed with management at various stages of audit. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner. After completion of audit for the year ended 31 March 2019, the audit partner was discussing significant matters with the management wherein they also communicated to the management that he plans to include revenue recognition as key audit matter in his audit report. The management did not agree with revenue recognition to be shown as key audit matter in the audit report. Comment. (MTP Oct-19)

SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgment as to what to communicate in the auditor's report and the form and content of such communication.

The auditor shall determine, **from the matters communicated with those charged with governance**, those matters that **required significant auditor attention** in performing the audit.

In making this determination, the auditor shall take into account the following:

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

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

In the instant case, AKY Ltd., a listed company engaged in the business of software and its contracts with its various customers are also quite complicated and different. Further, the audit team spends significant time on audit of revenue and efforts towards audit of revenue also involve significant involvement of senior members of the audit team including audit partner during audit.

This matter was also discussed with management at various stages. After completion of audit, the audit partner communicated the management regarding inclusion of paragraph on revenue recognition as key audit matter in his audit report.

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

2. Mr. Hemant Ramsey was appointed as the engagement partner for conducting the audit of Kshetra Lap Ltd. for F.Y. 2020-21, on behalf of Ramsey & Associates. Mr. Vishay Tyagi was appointed as the engagement quality control reviewer by the firm for the said audit. During F.Y. 2020-21, there was an implementation of ERP system in a phased manner, in Kshetra Lap Ltd. due to which some of its business processes got automated. As a result of the implementation of such a system, there was a significant effect on the auditor's overall audit strategy. Mr. Hemant discussed the implementation of such a system with Mr. Vishay and also told him that such a matter may be a key audit matter to be reported in the audit report. Mr. Vishay considered the significance of such matter but however he was of the opinion that such a matter did not appear to link with the matters disclosed in the financial statements and so there was no need to disclose such matter as a key audit matter. Whether the contention of Mr. Vishay is proper with respect to the matters to be communicated as a key audit matter? (RTP Nov'21)

As per **SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report',** the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit.

In making this determination, the auditor shall take into account the following:

i. **Areas of higher assessed risk of material misstatement**, or significant risks identified in accordance with SA 315.
ii. **Significant auditor judgments** relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
iii. The effect on the audit of **significant events or transactions** that occurred during the period.

The auditor shall determine which of the aforesaid matters considered were of **most significance in the audit of the financial statements** of the current period and therefore are the key audit matters.

These aforesaid considerations **focus on the nature of matters communicated with those charged with governance.** Such matters are **often linked to matters disclosed in the financial statements** and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.

The fact that these considerations are required is **not intended to imply that matters related to them are always key audit matters;** rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit.

In addition to matters that relate to the specific required considerations, there may be other matters communicated with those charged with governance that **required significant auditor attention** and that therefore may be determined to be key audit matters. Such matters may include, for example, matters relevant to the audit that was performed that **may not be required to be disclosed in the financial statements**. For example, the **implementation of a new IT system** (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

In the given case, there was implementation of ERP system in the company due to which some of its business processes got automated and which had a significant effect on the auditor's overall audit strategy during the period.

Accordingly, such a matter can be considered as a key audit matter if according to Mr. Hemant, such a matter required significant attention that had affected his overall audit strategy.

Thus, the **contention of Mr. Vishay is not proper** as **matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter** if it required significant attention of the auditor which had an impact on its audit.

4. (a) You have been appointed as an auditor of Dharmnath & Sons for FY 2020-21, as entity other than a company incorporated under the Companies Act, 2013, using a fair presentation framework. Appointment had been made in the month of April, 2021. The financial statements have been prepared by the management in accordance with the Accounting Standards. The management had introduced the new computerized accounts receivable system from November 2020 and still in the implementation phase and thus management is in the process of rectifying system deficiencies and correcting the errors. At the time of implementation of a new system, the earlier system of accounting of receivables had been discarded. The auditor was unable to obtain sufficient appropriate audit evidence about the entity's accounts receivable and inventories. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Write the opinion paragraph and basis of opinion paragraph to be included in the Independent Auditor's Report.

(b) What is the auditor's responsibility to report a key audit matter for which there are no relevant disclosures in the financial statements?

(c) Where should the placement of the key audit matters section be in the auditor's report? [RTP May-22]

(a) Opinion Paragraph

Disclaimer of Opinion: We **were engaged to audit the financial statements** of Dharmnath & Sons ("the entity"), which comprise the balance sheet as at March 31, 2021, the statement of Profit and Loss, (the statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.
We **do not express an opinion on the accompanying financial statements** of the entity.
Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion: We were not appointed as auditors of the Company until after March 31, 2021, and thus **did not observe the counting of physical inventories** at the beginning and end of the year. We were **unable to satisfy ourselves by alternative means** concerning the inventory quantities held at March 31, 2020, and 2021, which are stated in the Balance Sheets at ₹ xxx and ₹ xxx, respectively.

In addition, the introduction of a new computerized accounts receivable system in November 2020 resulted in **numerous errors in accounts receivable**. As of the date of our report, **management was still in the process of rectifying the system deficiencies and correcting the errors**. We were **unable to confirm or verify by alternative means** accounts receivable included in the Balance Sheet at a total amount of ₹ xxx as at March 31, 2021. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of Profit and Loss (and statement of cash flows)

(b) When communicating key audit matters, the **fact that there are no disclosures in the financial statements** related to a matter determined to be a key audit matter **does not relieve the auditor** from the requirement to communicate it. An auditor may determine a key audit matter related to the audit for which relevant disclosure requirements do not exist in the applicable financial reporting framework. For example, the **implementation of a new IT system** (or significant changes to an existing IT system) during the period may be an area of **significant auditor attention**, in particular, if such a change had a significant effect on the auditor's overall audit strategy or related to significant risk (e.g., changes to a system affecting revenue recognition.

Also, if an auditor determines that it is necessary to include information about the entity in order to effectively describe a key audit matter that has not been disclosed by management and management does not agree to disclose that information, the **auditor should reconsider the adequacy of the disclosures in accordance with applicable financial reporting framework.**

The auditor should **communicate the matter as a key audit matter unless law or regulation precludes public disclosure** about the matter or in **extremely rare circumstances**, the auditor determines that the matter should not be communicated in the auditor's report because the **adverse consequences** of doing so would reasonably be expected to **outweigh the public interest benefits** of such communication.

(c) Generally,

- KAM section is required to be placed **after Basis for Opinion paragraph** and **before the Management's Responsibility paragraph.**
- In case, **'Material uncertainty relating to going concern'** section is required as per SA 570(Revised), then **KAM section is placed after that** section.

Further, regarding placement of KAM section, SA 706 (Revised), "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" provides as under:

When a KAM section is presented in auditor's report, **Emphasis of Matter (EOM) paragraph** may be presented **either directly before or after KAM section**, based on the auditor's judgment as to the relative significance of the information included in the Emphasis of Matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter", such as "Emphasis of Matter – Subsequent Event", to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.

6. While auditing the complete set of consolidated financial statements of J Ltd., a listed company, using a fair presentation framework, PQR & Co., a Chartered Accountant firm, discovered that the consolidated financial statements are materially misstated due to the non-consolidation of one of the subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements could not be determined because it was not practicable to do so. Thus, PQR & Co. decided to provide an adverse opinion for the same and further determined that, there are no key audit matters other than the matter to be described in the Basis for Adverse Opinion section.

Comment whether PQR & Co. needs to report under SA 701 'Communicating Key Audit Matters in the Independent Auditor's Report'? [Dec-21 Old + MTP Sep-22]

SA 700 establishes requirements and provides guidance on forming an opinion on the financial statements. Communicating **key audit matters is not a substitute for disclosures in the financial statements** that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.

SA 705, "Modifications to the Opinion in the Independent Auditor's Report", addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements.

When the auditor **expresses a qualified or adverse opinion** in accordance with SA 705, presenting the description of a matter giving rise to a modified opinion in the Basis for Qualified (Adverse) Opinion section helps to promote intended users' understanding and to identify such circumstances when they occur. **Separating the communication of this matter from other key audit matters** described in the Key Audit Matters section, therefore, **gives it the appropriate prominence in the auditor's report.**

Further, when the auditor expresses a qualified or adverse opinion, **communicating other key audit matters would still be relevant to enhancing intended users' understanding of the audit,** and therefore the requirements to determine key audit matters apply. However, as an adverse opinion is expressed in circumstances when the auditor has concluded that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements depending on the significance of the matter(s) giving rise to an adverse opinion, the **auditor may determine that no other matters are key audit matters.**

In the given situation J Ltd., a listed company, has **not consolidated one of its subsidiary.**

Further, Consolidated Financial Statements of J Ltd. are materially misstated due to such non-consolidation. The material misstatement is also deemed to be material and pervasive and effect of the failure to consolidate have not been determined. In the given situation it is appropriate to give Adverse Opinion by PQR & Co., a Chartered Accountant Firm.

Since, in the given case, Adverse Opinion is being expressed thus PQR & Co. can communicate Key Audit Matter in given below manner: Key Audit Matters: **Except for the matter described in the Basis for Adverse Opinion section, we have determined that there are no other key audit matters to communic ate in our report.**

SA 705: Modifications to the Opinion in the Independent Auditor's Report

1. "When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section."
As an expert you are required to brief the special considerations required for expressing: (i) Qualified Opinion; (ii) Adverse Opinion and (iii) Disclaimer of Opinion. (RTP Nov'19)

Special consideration required for expressing Qualified Opinion: When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, **except for the effects of the matter**(s) described in the Basis for Qualified Opinion section:

(1) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or

(2) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase **"except for the possible effects of the matter(s) ..."** for the modified opinion.

(ii) Special consideration needed for expressing Adverse Opinion:

When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, **because of the significance of the matter(s)** described in **Basis for Adverse Opinion section:**

(1) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or

(2) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

(iii) Special consideration is required for expressing Disclaimer of Opinion:

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:
(1) State that the auditor **does not express an opinion** on the accompanying financial statements;
(2) State that, **because of the significance of the matter**(s) described in the Basis for Disclaimer of Opinion section, the auditor has **not been able to obtain sufficient appropriate audit evidence** to provide a basis for an audit opinion on the financial statements; and
(3) Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the **auditor was engaged to audit the financial statements**.

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall **not include a Key Audit Matters section** in accordance with SA 701.

2. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from: (i) Circumstances beyond the control of the entity; (ii) Circumstances relating to the nature or timing of the auditor's work; or (iii) Limitations imposed by management. Explain with the help of examples. (RTP Nov 19)

The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

i. Circumstances beyond the control of the entity;
ii. Circumstances relating to the nature or timing of the auditor's work; or
iii. Limitations imposed by management.

An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by **performing alternative procedures**. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

Examples of circumstances beyond the control of the entity include when:

- The entity's **accounting records have been destroyed**.
- The accounting records of a significant component have been **seized indefinitely by governmental authorities**.

Examples of circumstances relating to the nature or timing of the auditor's work include when:

- The entity is required to use the **equity method of accounting for an associated entity**, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.

- The timing of the auditor's appointment is such that the auditor is **unable to observe the counting of the physical inventories**.
- The auditor determines that performing **substantive procedures alone is not sufficient**, but the entity's **controls are not effective**.

Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- **Management prevents** the auditor **from observing the counting of the physical inventory**.
- Management prevents the auditor **from requesting external confirmation of specific account balances**.

3. ALM Associates has been appointed as auditor of M/s Hary Ltd. which acquired 55% shares-in M/s Sam Ltd. on 15th October, 2018. During audit of Harry Ltd., the auditors found that the company has not prepared consolidated financial statements because on the date of acquisition the fair value of certain assets & liabilities has not been ascertained which is significant and are accounted for on estimated basis only. Help ALM Associates in framing opinion paragraph of audit report. (May 19 New)

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

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

Basis for Adverse Opinion is given below:

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

4. XYZ Ltd. is a company engaged in the manufacture of cranes. CA Sudhir is the statutory auditor of the company for the FY 2020-21. The company has taken long term funding for fixed capital requirements and short term funding for its working capital requirements. During the course of audit, CA Sudhir found that the company's financing arrangements are about to expire and the company is unable to re- negotiate or obtain the replacement financing. As such the company may be unable to realize its assets and discharge its liabilities in the normal course of business. Notes to accounts annexed to the financial statements discuss the magnitude of financing arrangements, the

expiration and the total financing arrangements; however the financial statements do not include discussion on the impact or the availability of refinancing. Thus, the financial statements (and notes thereto) do not fully disclose this fact. What kind of opinion should CA Sudhir issue in case of XYZ Ltd.? (SM)

In present case, XYZ Ltd. is unable to re- negotiate or obtain the replacement financing for its long term and short term funding requirements. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore, XYZ Ltd. may be unable to realize its assets and discharge its liabilities in the normal course of business.
Further, the financial statements of XYZ Ltd. do not disclose this fact adequately. Thus, the financial statements of XYZ Ltd. are **materially misstated due to the inadequate disclosure of the material uncertainty**. CA Sudhir will express a qualified opinion as the effects on the financial statements of this **inadequate disclosure are material but not pervasive** to the financial statements.

The relevant extract of Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:
Qualified Opinion
In our opinion and to the best of our information and according to the explanations given to us, **except for the incomplete disclosure** of the information referred to in the **Basis for Qualified Opinion section** of our report, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of XYZ Ltd. as at March 31, 2021, and profit/loss, for the year ended on that date.

Basis for Qualified Opinion
As discussed in Note 6, the Company's **financing arrangements are about to expire and the Company has been unable to conclude renegotiations** or obtain replacement financing. This situation indicates that a **material uncertainty exists** that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements **do not adequately disclose this matter**.

5. ABC Ltd. is a company engaged in the manufacture of iron and steel bars. PP & Associates are the statutory auditors of ABC Ltd. for the FY 2020-21. During the course of audit, CA Prakash, the engagement partner, found that the Company's financing arrangements have expired and the amount outstanding was payable on March 31, 2021. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. What opinion should CA Prakash express in case of ABC Ltd.? (SM)

In the present case based on audit evidence obtained, CA Prakash has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and the entity is considering bankruptcy. The financial statements of ABC Ltd. **omit the required disclosures relating to the material uncertainty**. In such circumstances, CA Prakash should **express an adverse opinion** because the effects on the financial statements of such omission are material and pervasive.

The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

Adverse Opinion
In our opinion, **because of the omission of the information** mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of the entity as at March 31, 2021, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

The financing arrangements of ABC Ltd. has expired and the amount outstanding was payable on March 31, 2021. The entity has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The **financial statements do not adequately disclose this fact**.

6. MNO Ltd. is a power generating company having its plants in the north eastern states of the country. For the FY 2020-21, M/s PRT & Associates are the statutory auditors of the company. During the course of audit, the audit team was unable to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment (in XYZ Ltd.) that represents over 90% of the entity's net assets. What kind of opinion should the statutory auditors issue in such case?

(SM + Dec-21 Old)

M/s PRT & Associates are unable to obtain sufficient appropriate audit evidence about the financial information of a joint venture investment that represents over 90% of the entity's net assets. The **possible effects of this inability to obtain sufficient appropriate audit evidence are both material and pervasive** to the consolidated financial statements.

Therefore, the statutory auditor should issue a disclaimer of opinion.

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

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

Basis for Disclaimer of Opinion

The Group's investment in its joint venture XYZ Company is carried at ₹ 95 crores on the Group's consolidated balance sheet, which represents over 90% of the Group's net assets as at March 31, 2021. We were not allowed access to the management and the auditors of XYZ Company, including XYZ Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, (and the elements making up the consolidated statement of changes in equity) and the consolidated cash flow statement.

7. While conducting audit of VED Ltd., you as an auditor are not only prevented in completing certain audit procedures but also are not able to obtain audit evidence even by performing alternative procedures. How you will deal with this situation? (Jan-21 Old)

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

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

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

(1) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or

(2) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

(i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or

(ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

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

8. What are the circumstances in which auditors are required to qualify their reports of companies for mattes related to AS-I 'Disclosure of Accounting Policies'? (Jan-21 Old)

While discharging their attest function, the members of the Institute may keep the following in mind with regard to mandatory Accounting Standards. As per **AS 1 - Disclosure of Accounting Policies, in the case of a company, members should qualify their audit reports in case:**

(i) **accounting policies** required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013, have **not been disclosed**, or

(ii) accounts have **not been prepared on accrual basis**, or

(iii) the **fundamental accounting assumption of going concern has not been followed** and this **fact has not been disclosed** in the financial statements, or

(iv) proper **disclosures regarding changes in the accounting policies** have **not been made**.

9. CA Madhu is the statutory auditor of Lakshmi Ltd. for the Financial year 2020-21. In respect of loans and advances of ₹ 75 Lakh given to Srinian Pvt. Ltd., the Company has not furnished any agreement to CA Madhu and in absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms. Justify the type of opinion which CA Madhu should give in such situation. Also, Draft an appropriate Opinion paragraph and Basis of opinion paragraph. [Dec-21 New]

In the present case, with respect to loans and advances of ₹ 75 Lacs given to Sriman Pvt. Limited, the Company has not furnished any agreement to CA Madhu. In the absence of such an agreement, CA Madhu is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidence is the loan agreement. Therefore, the absence of such document in the present case, tantamount to a material misstatement in the financial statements of the company. However, the inability of CA Madhu to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion.

Thus, in the present case, CA Madhu should give a qualified opinion

The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Lakshmi

Limited give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2021 and profit/ loss for the year ended on that date.

Basis for Qualified Opinion

The Company is unable to furnish the loan agreement with respect to loans and advances of ₹ 75 Lacs given to Sriman Pvt Limited. Consequently, in the absence of such an agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.

10. CA. Uma is the Statutory Auditor of RJ Ltd. for the financial year 2021-22. The company is engaged in the production of electronic products. During the course of audit, CA. Uma obtained certain audit evidence of incorrect disclosure of related party transactions and structured finance deals which was not considered with the affirmation leading to misstatement in the financial statements. Discuss how CA Uma should deal with the situation in the auditor's report and the different options which can be considered? [Nov-22]

Auditor's duties in case of inconsistency in Audit evidence: SA 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

The decision regarding which type of modified opinion is appropriate depends upon:

(a) The **nature of the matter giving rise to the modification**, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; &

(b) The **auditor's judgement 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, that the financial statements as a whole are not free from material misstatement:

In the present case, during the course of the audit, CA Uma obtained certain audit evidence which was not consistent with the affirmation made in financial statements. Therefo re CA Uma should modify his report in accordance with SA 705.

Conclusion:

Since CA Uma has **obtained audit evidence** which is **inconsistent with the affirmations** made in the financial statements. CA Uma should modify his opinion as per the circumstances of the case.

- CA Uma shall express **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.
- CA Uma shall express an **Adverse opinion**, where the auditor, having obtained sufficient appropriate evidence, concludes that misstatements, individually, or in the aggregate, are both material and pervasive to the financial statements.

SA 706: "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report"

1. Enumerate certain important matters which can be included in 'Emphasis of Matter paragraph' in an auditor's report. (Nov-19 Old)

Emphasis of Matter Paragraph in Audit Reports: SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", deals with **additional communication** in the auditor's report when the auditor considers it necessary to **draw user's attention** to a **matter presented or disclosed in the financial statements** that, in the auditor's judgment, is of such importance that it is **fundamental to user's understanding of the financial statements,** the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements.

Specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances. These circumstances include:

- When a **financial reporting framework prescribed by law or regulation would be unacceptable** but for the fact that it is prescribed by law or regulation.
- To **alert users** that the financial statements are prepared in accordance with a **special purpose framework.**
- When **facts become known to the auditor after the date of the auditor's report** and the auditor provides a new or amended auditor's report (i.e., subsequent events).

Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An **uncertainty relating to the future outcome** of exceptional litigation or regulatory action.
- A **significant subsequent event** that occurs between the date of the financial statements and the date of the auditor's report.
- **Early application** (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A **major catastrophe** that has had, or continues to have, a significant effect on the entity's financial position.

However, a widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor's communication about such matters.

2. Difficult Books Limited is engaged in manufacturing of active pharmaceutical ingredients. Due to change in laws and regulations, every company engaged in manufacturing in active pharmaceutical ingredients would now require production capacity license which will restrict the production of companies. Management of the company assessed the impact of the change in law over the financial position of company and appropriately disclosed the same in the financial statement. Audit Team of the company evaluated management's disclosure and found it appropriate and sufficient. However, considering the said matter as most important and fundamental to users understanding regarding financial statement the audit team decided to disclose the same in Other Matter Paragraph.
You as an Engagement Partner are required to guide the Audit Team with respect to reporting of the said matter in Audit Report. [MTP Nov-22]

As per **SA 706**, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of financial statements, the auditor shall include an **Emphasis of Matter paragraph** in the auditor's report provided:
(i) The auditor would **not be required to modify the opinion** in accordance with SA 705 as a result of the matter; and

(ii) When SA 701 applies, the matter has **not been determined to be a key audit matter** to be communicated in the auditor's report.

In given case, since Difficult Books Ltd is engaged in manufacturing of active pharmaceutical ingredients, would now require production capacity license which will restrict the production of companies, due to change in laws and regulations. Management of the Difficult Books Limited assessed the impact of the change in law over the financial position of company and appropriately disclosed the same in financial statement. Audit team evaluated management's disclosure and found it appropriate and sufficient. However, considering said matter as most important and fundamental to users understanding regarding financial statement the audit team decided to disclose the same.

The said matter is already disclosed and presented appropriately in financial statement and is of such importance that is fundamental to the users understanding of the financial statement and hence, it required to be disclosed under Emphasis of Matter paragraph.

Therefore, decision of audit team to disclose the same in Other Matter Paragraph is not in order, it should be disclosed in Emphasis of Matter Paragraph.

SA 710: Comparative Information – Corresponding Figures and Comparative Financial Statements

1. It was observed from the modified audit report of the financial statements of ULFA Ltd. for the year ended 31st March, 2019 that depreciation of ₹ 4.25 crore for the year 2018-2019 had been charged off to the Statement of Profit and Loss instead of including it in "carrying value of asset under construction". State in relation to the audit for the year ended 31st March 2020, whether such modification in the previous year's audit report would have any audit implication for the current year i.e. FY 2019-20 and if yes, how the auditor is required to deal with the same in his audit report for the current year? (MTP Oct'20)

OR

The audit report of P Ltd. for the year 2020-21 contained a qualification regarding non-provision of doubtful debts. As the statutory auditor of the company for the year 2021-22, decide how would you report, if :
(i) The company does not make provision for doubtful debts in 2021-22?
(ii) The company makes adequate provision for doubtful debts in 2021-22? (MTP Mar'18)

Auditor's responsibility in cases where audit report for an earlier year is qualified is given in **SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements"**.

As per SA 710, when the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is **resolved** and **properly accounted** for or **disclosed** in the financial statements in accordance with the applicable financial reporting framework, the **auditor's opinion on the current period need not refer to the previous modification**.

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

In the **Basis for Modification paragraph** in the auditor's report, the auditor shall either:

- **Refer to both** the current period's figures and the corresponding figures in the description of the matter giving rise to the modification **when the effects or possible effects of the matter on the current period's figures are material**;

- In **other cases**, explain that the audit opinion has been modified because of the **effects or possible effects of the unresolved matter on the comparability** of the current period's figures and the corresponding figures.

In the instant case, if ULFA Ltd. does not correct the treatment of depreciation to the extent of rupees 4.25 crore for previous year, the auditor will have to modify his report for both current and previous year's figures as mentioned above. If, however, the figures and provisions are corrected, the auditor need not consider to the earlier year's modification.

2. You as a statutory auditor had audited the financial statements of A Ltd., a listed company, for F.Y. 2019-20. The company has included the comparative financial information in the financial statements prepared for the current F.Y. 2020-21. You as an auditor want to obtain sufficient appropriate audit evidence that comparative financial information has been presented, in all material aspects, in accordance with the requirements in the applicable financial reporting framework. List out audit procedures, as specified in relevant SA, which you are required to follow for the purpose. [Dec-21 Old] OR
What are the auditor's responsibilities in respect of corresponding figures? (May-2010)

Auditor's Responsibilities in Respect of Corresponding Figures: As per **SA 710 "Comparative Information—Corresponding Figures and Comparative Financial Statements",** in respect of corresponding figures, the auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified.

(1) For this purpose, the auditor shall evaluate whether:

(i) The **comparative information agrees with the amounts and other disclosures** presented **in the prior period**; and

(ii) The **accounting policies** reflected in the comparative information are **consistent** with those applied in the current period or, if there have been **changes in accounting policies**, whether those changes have been **properly accounted for and adequately presented and disclosed.**

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

(3) If the **auditor had audited the prior period's financial statements,** the **auditor shall also follow the relevant requirements of SA 560 "Subsequent Events".**

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

SA 720: The Auditor's Responsibility in Relation to Other Information

1. GS & Co., Chartered Accountants, have been appointed Statutory Auditors of MAP Ltd. for the F.Y 2019-20. The audit team has completed the audit and is in the process of preparing audit report Management of the company has also prepared draft annual report. Audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. Audit Manager discussed this issue with partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Do you think that the partner is correct in his approach on this issue. Discuss with reference to relevant Standard on Auditing the Auditor's duties with regard to reporting. (Nov'20 + RTP/MTP May-23)

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists:
As per **SA 720, "The Auditor's Responsibility in Relation to Other Information"**, Descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be included in the other information. The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include **requesting management to provide support for the basis of management's statements in the other information**. Based on management's further information or explanations, the auditor **may be satisfied that the other information is not materially misstated**. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor's duties with regard to reporting in the given case are given hereunder:
As per SA 720, "The Auditor's Responsibility in Relation to Other Information", if the auditor concludes that a **material misstatement of the other information exists**, the auditor shall **request management to correct** the other information.

If management:
(i) **Agrees** to make the correction, the auditor shall **determine that the correction has been made**; or
(ii) **Refuses** to make the correction, the auditor shall **communicate the matter with those charged with governance and request that the correction be made**.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is **incorrect**.

2. LMP Associates, Chartered Accountants, conducting the audit of PQR Ltd., a listed Company for the year ended 31st March 2019 is concerned with the auditor's responsibilities relating to other information, both financial and non-financial, included in the Company's annual report. While reading other information, LMP Associates considers whether there is a material inconsistency between other information and the financial statements. As a basis for the consideration the auditor shall evaluate their consistency, compare selected amounts or other items in the other information with such amounts or other items in the financial statements. Guide LMP Associates with examples of "Amounts" or "other items" that may be included in the "other information" with reference to SA 720. (Nov-19 New)

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

Amounts

i) **Items in a summary of key financial results**, such as net income, earnings per share, dividends, sales and other operating revenues, and purchases and operating expenses.
ii) **Selected operating data**, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
iii) **Special items**, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
iv) **Liquidity and capital resource information**, such as cash, cash equivalents and marketable securities; dividends; and debt, capital lease and minority interest obligations.
v) **Capital expenditures** by segment or division.
vi) Amounts involved in, and related financial effects of, **off-balance sheet arrangements**.

vii) Amounts involved in **guarantees, contractual obligations, legal or environmental claims**, and other contingencies.

viii) **Financial measures or ratios**, such as gross margin, return on average capital employed, return on average shareholders' equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilable to the financial statements.

Other Items

i) Explanations of **critical accounting estimates and related assumptions**.

ii) Identification of **related parties and descriptions of transactions** with them.

iii) Articulation of the **entity's policies or approach to manage commodity**, foreign exchange or interest rate risks, such as through the use of forward contracts, interestrate swaps, or other financial instruments.

iv) Descriptions of the **nature of off-balance sheet arrangements**.

v) **Descriptions** of **guarantees, indemnifications, contractual obligations**, litigation or environmental liability cases, and other contingencies, including management's qualitative assessments of the entity's related exposures.

vi) **Descriptions of changes in legal or regulatory requirements,** such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position, or will have a material impact on the entity's future financial prospects.

vii) **Management's qualitative assessments of the impacts of new financial reporting standards** that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.

viii) General **descriptions of the business environment and outlook**.

ix) Overview of **strategy**.

1. The professional accountants need to observe certain fundamental principles, which are covered in the Code of Ethics of the Institute of Chartered Accountants of India. Briefly explain each of the five principles which needs to be complied by the Chartered Accountants? [Nov-22]

Fundamental Principles: In order to achieve the objectives of the Accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles. The fundamental principles as discussed in Code of Ethics of ICAI, to be complied, are given below:

(i) Integrity – A professional accountant shall comply with the principle of integrity, which requires an accountant to be **straightforward and honest** in all professional and business relationships. Integrity implies **fair dealing and truthfulness**.

(ii) Objectivity – A professional accountant shall comply with the principle of objectivity, which requires an accountant **not to compromise professional or business judgment** because of bias, conflict of interest or undue influence of others.

(iii) Professional Competence and Due Care – A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:
(a) **Attain and maintain professional knowledge and skill** at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
(b) **act diligently** in accordance with applicable technical and professional standards.

(iv) Confidentiality – A professional accountant shall comply with the principle of confidentiality, which requires an accountant to **respect the confidentiality of information** acquired as a result of professional and employment relationships.

(v) Professional Behaviour – A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to **comply with relevant laws and regulations** and **avoid any conduct that accountant knows or should know might discredit the profession**.

Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

2. A professional accountant in public practice is always subject to various threats in compliance with fundamental principles of his profession and you, as a professional accountant, are worried about engagement specific threat in your audit assignment of M/s Soft Ltd. and want to implement some measures to eliminate and reduce the same. Enumerate some engagement specific safeguards which you may introduce in your work environment to ward off such threats. (May-19 New)

Engagement-specific safeguards in the work environment may include:

- Assigning **additional time and qualified personnel** to required tasks when an engagement has been accepted might address a self-interest threat.

- Having an **appropriate reviewer**, who was not a member of the team, review the work performed or advise as necessary might address a self-review threat.
- Using **different partners and engagement teams** with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review, advocacy or familiarity threats.
- **Involving another firm** to perform or re-perform part of the engagement might address self-interest, self-review, advocacy, familiarity or intimidation threats.
- **Separating teams** when dealing with matters of a confidential nature might address a self-interest threat.

3. The audit team is preparing to conduct audit for ABC Company for the period ending 31.3.2020. However, the audit team has not received its audit fees from ABC Company for its audit concluded for the period ended 31.3.2019. The audit team might be tempted to issue a favorable report so that ABC Company is able to secure a loan to settle the fees outstanding for their 31.3.2019 audit. The audit team is not complying the fundamental principles of auditing hence hindering the Auditor's Independence. Explain the types of threats that may hinder Auditor's Independence while issuing Audit Report. (Jan-21 New)

In given case of ABC Company, audit team is preparing to conduct its audit for the F.Y ending on 31.03.2020. Audit firm did not receive its fees for the F.Y ending on 31.03.2019. Audit team is tempted to issue a favourable report so that auditee can secure a loan to settle auditor's outstanding fees. The audit team did not comply with fundamental principles of auditing and hence compromising Auditor's Independence.

The **Code of Ethics for Professional Accountants** prepared by the **International Federation of Accountants (IFAC) identifies five types of threats**. These are:

1. Self-interest threats, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include (i) **direct financial interest** or materially significant indirect financial interest in a client, (ii) **loan or guarantee** to or from the concerned client, (iii) **undue dependence** on a client's fees and, hence, **concerns about losing the engagement**, (iv) **close business relationship** with an audit client, (v) **potential employment** with the client, and (vi) **contingent fees** for the audit engagement.

2. Self-review threats, which occur when during a **review of any judgement or conclusion reached in a previous audit** or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor is having **recently been a director or senior officer of the company,** and (ii) when auditors **perform services that are themselves subject matters of audit**.

3. Advocacy threats, which occur when the auditor **promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised**, and e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.

4. Familiarity threats are self-evident, and occur when auditors form relationships with the client where they **end up being too sympathetic to the client's interests**. This can occur in many ways: (i) **close relative of the audit team working in a senior position** in the client company, (ii) **former partner** of the audit firm being a director or senior employee of the client, (iii) **long association** between specific auditors and their specific client counterparts, and (iv) **acceptance of significant gifts or hospitality** from the client company, its directors or employees.

5. Intimidation threats, which occur when auditors are **deterred from acting objectively** with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

4. P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2020, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Is P guilty of professional misconduct? (SM)

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 Accountant s Act, 1949.

5. 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? (SM)

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.**

6. 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. (SM)

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**.

7. Mr. X who passed his CA examination of ICAI on 18th July, 2020 and started his practice from August 15, 2020. On 16th August 2020, one female candidate approached him for articleship. In addition to monthly stipend, Mr. X also offered her 1 % profits of his CA firm. She agreed to take both 1 % profits of the CA firm and stipend as per the rate prescribed by the ICAI. The Institute of Chartered Accountants of India sent a letter to Mr. X objecting the payment of 1 % profits. Mr. X replies to the ICAI stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the financial position of the articled clerk is very weak. Is Mr. X liable to professional misconduct? (SM)

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.**

8. 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? (SM)

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, 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.**

9. 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. (SM)

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.

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.**

10. (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.

(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. (SM)

(a) 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) 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 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.

Consequently, Mr. X would therefore be **held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.**

11. A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant. Is this a misconduct? (SM)

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".**

12. 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. (Apr-21 MTP + May-22)

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).

13. 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. (SM)

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

Council has clarified that 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 course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to Sec 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 client under GST Act by Mr. Y being an employee of M/s A & Co. (an audit firm), is **not routine work** and 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 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, 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.

14. 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? (SM)

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.

15. 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 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 colourful catchy designs and shared the website address on his all social media posts and stories and tagged 30 traders of his local community with caption "Easy Online Stock Certification Services". Besides, Mr. A entered in an agreement with a Digital Marketer to give 5% commission on each service procured through him. Discuss if actions of Mr. A are valid in light of Professional Ethics and various pronouncements and guidelines issued by ICAI. (SM)

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.

Author's note: ICAI has asked this Q. twice & ignored Clause(2), Part I, First Schedule, so kindly avoid that.

16. 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? (SM + Dec-21 New)

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, 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 statutory audit of company until 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.**

17. Mr. F, a Chartered Accountant, gave advisory services to PQR Pvt. Ltd. Further, he gave them GST consultancy and helped in ERP set up. Later, the company turned out to be a part of a group of companies involved in money laundering. Mr. F was asked to provide details of the companies. Mr. F refused on the grounds that he gave only consultancy services to the company and wasn't supposed to keep any information about the company. Is Mr. F right as per the guidelines issued by the ICAI? (SM)

The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). **Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice.**

In the given situation, CA. F, gave GST consultancy and helped in ERP set up along with advisory services to PQR Pvt. Ltd. Mr. F was asked to provide details of the companies as the company, turned out to be a part of a group of companies, involved in money laundering. Contention of Mr. F that he gave only consultancy services to the company and wasn't supposed to keep any information about the company is not valid as Mr. F should have kept following information in compliance with KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestation functions.

In the given case of PQR Pvt. Ltd., a Corporate Entity, Mr. F should have kept following information:

A General Information

- ✓ Name and Address of the Entity
- ✓ Business Description
- ✓ Name of the Parent Company in case of Subsidiary
- ✓ Copy of last Audited Financial Statement

B. Engagement Information Type of Engagement

C. Regulatory Information

- ✓ Company PAN No.
- ✓ Company Identification No.
- ✓ Directors' Names & Addresses
- ✓ Directors' Identification No.

18. 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? (SM)

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**.
(viii) **Raising of bills and issuing acknowledgements** for money receipts.
(ix) Attending to **routine matters in tax practice**, subject to provisions of **Section 288** of Income Tax Act.
(x) Any **other matter incidental** to the office administration and routine work involved in practice of accountancy.

In 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 signing of 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.

19. Nam & Co., conducted Stock Audit of DEF Ltd. as per instructions issued by HEG Bank. However instead of visiting the site where the stock was lying, the firm relied on the Management Information Systems report along with inspections reports and photographs of Stock taken by the employees of DEF Ltd. The photographs were also

carrying the date and time printed on them. Comment with reference to the Chartered Accountants Act, 1949 and its schedules thereto. (Jan-21 New)

According to **Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949,** a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he **"does not exercise due diligence or is grossly negligent in the conduct of his professional duties".**

It is a vital clause which usually 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.

In the instant case, CA. Nam &Co. did not exercise due diligence and is grossly negligent in the conduct of his professional duties since it did not visit the site where the stock was lying and instead the firm relied on the MIS report along with inspection reports and photographs of stock taken by the employees of DEF Ltd, which is incorrect.

To conduct stock audit, ascertainment of existence and physical condition of stocks, cross tallying the stock with Stock statement submitted by bank borrower, correct classification of stocks for valuation purpose etc. is essential. Further submitting stock audit report without physically verifying the stock amounts to gross negligence.

From the above, it can be concluded that Nam & Co. is **guilty of professional misconduct under Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.**

20. CA N was appointed as an auditor of JAL Ltd. The company has branches all over the state of Haryana. CA N, in consultation with management, decided to Visit 6 out of 10 branches. Management decided to pay him advance of ₹ 2.00 Lacs against the estimated expenses of ₹ 2.50 Lacs on visits to be conducted as a part of services rendered. As agreed, ₹ 2.00 Lacs was transferred in his bank account from which he met all the expenses. Comment with reference to Chartered Accountants Act, 1949 whether the action of CA N of receiving the advance money in his saving accounts and not keeping it in separate bank account is valid. (Jan-21 New)

As per **Clause (10) of Part I of Second Schedule to the Chartered Accountant Act, 1949,** a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he fails to keep moneys of his client other than the fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

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 utilize such funds only in accordance with the instructions of the client or for the purposes intended by the client.

In this connection the Council has considered some practical difficulties of the members and the following suggestion, among other suggestions, has been made to remove these difficulties: **"An advance received by a Chartered Accountant against services to be rendered does not fall under Clause (10) of Part I of the Second Schedule"**

In the given case, CA N was given an advance of ₹ 2 Lakhs against the estimated expenses of ₹ 2.50 Lakhs on visits to be conducted as a part of services rendered.

Applying the above, it can be concluded that CA N is **not guilty** of professional misconduct under Chartered Accountants Act, 1949.

21. CA AB, a practicing chartered accountant, is a promoter director of ABG Pvt. Ltd. and moreover he is also a sleeping partner in his family business of garments manufacturing firm. Is CA. AB liable for professional misconduct as per Chartered Accountant Act 1949? (Jan-21 New)

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.

Promoter/Promoter Director - There is **no bar for a member to be a promoter / signatory to the Memorandum and Articles of Association of any company**. There is also **no bar for such a promoter / signatory to be a Director Simplicitor of that company** irrespective of whether the object of the company include areas which fall within the scope of the profession of chartered accounts. Therefore, members are not required to obtain specific permission of the Council in such cases.
Sleeping partner in the family business-

Prior Approval – Members of the Institute in practice may engage in the following category, among other points, of business or occupations, after obtaining the specific and prior approval of the Council in case of:
Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken.

In the given case, CA AB is a promoter director of ABG Pvt Ltd and also he is a sleeping partner in his family business of garments manufacturing firm.
Applying the above to the given case, it can be concluded that-CA AB:
- **As Promoter Director- Not guilty** of professional misconduct under Chartered Accountants Act, 1949
- **As Sleeping Partner- guilty** of professional misconduct under Chartered Accountants Act, 1949 as he did not obtain prior approval of the Council.

22. CA Natraj, in practice, accepted an assignment as advisor and consultant to the public issue of shares by his client M/s Super Ltd. Besides helping the company as an advisor, he also underwrote the public issue of the company to the extent of 25% at a commission of 1%. Remaining shares were underwritten by banks and other financial institutions at the same rate of commission. He contends that above assignments are part of management consultancy work permitted by the council of the Institute. Do you agree with the view of CA Natraj? Decide in the light of applicable code of conduct. (May-19 New)

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

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

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

23. CA Sant, a newly qualified professional with certificate of practice, approached CA Pant, the auditor of his father's company M/s Max Ltd., to allow him to have some practical and professional knowledge and experience in his firm before he can set up his own professional practice. CA Pant allowed him to sit in his office for 6 month and allotted a small chamber with other office infrastructure facility. In the course of his association with CA Pant's office, he used to provide tax consultancy independently to the client of the firm and also filed few IT and GST return and represented himself before various tax authorities on behalf of the firm although no documents were signed by him. During his association in CA Pant's office, he did not get any salary or share of profit or commission but only re-imbursement of usual expenses like conveyance, telephone etc. was made to him. After the end of the agreed period, he was given a lump sum amount of ₹ 3,00,000 by CA Pant for his association out of gratitude. Examine the case in the light of code of professional misconduct. (May-19 New + MTP Apr-22/May-23)

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

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

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

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

Author's Note: Clause (2) won't be attracted as sharing fees with another member of ICAI is allowed.

24. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: A special notice has been issued for a resolution at 3rd annual general meeting of LED Ltd., providing expressly that CA. Anoop shall not be re-appointed as an auditor of the company. Consequently, CA. Anoop submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Anoop included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company. (Nov-19 New)

Soliciting Clients: As per **Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949,** a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, **section 140(4)(iii) of the Companies Act, 2013**, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a **dignified manner** how he has been **acting independently and conscientiously** through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re- appointed by the shareholders.

The proposition of the auditor to highlight contributions made by him in strengthening the control procedures in the representation should not be included in such representations because the representation letter should not be prepared in a manner so as to seek publicity.

Thus, highlighting contributions made by him in strengthening the control procedures, while submitting representation U/S 140(4)(iii) of the Companies Act 2013, would amount to canvassing or soliciting for his continuance as auditor.

Therefore, CA. Anoop **will be held guilty for professional misconduct** under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

25. Mr. 'K', a practicing Chartered Accountant is the proprietor of M/s K & Co. since 1995. He went abroad in the month of December 2018. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee for taking care of the important matters of his office. During his absence Mr. 'Y' has conducted the undermentioned jobs in the name of M/s K & Co.

(i) He issued Net worth certificate to a client for furnishing to a Bank.

(ii) He attended the GST proceedings for a client as authorized representative before GST Authorities.

Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s K & Co. and liability of Mr. 'K' under the Chartered Accountants Act, 1949. (Nov-19 New)

Delegation of Authority to the Employee: As per **Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949**, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA. 'K' proprietor of M/s K & Co., went abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of the important matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

(i) In the given case, Mr. 'Y', a chartered accountant being employee of M/s K & Co. has **issued net worth certificate for furnishing to a bank**. Since the issuance of net worth certificate to a client by Mr. "Y" being an employee of M/s K& Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA. 'K' is **guilty of professional misconduct** under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.

(ii) Further, Mr. "Y", CA employee of the audit firm M/s K& Co. has **attended the GST proceedings** for a client as authorized representative before GST Authorities. Since the **council has allowed the delegation of such work**, the chartered accountant employee can attend to routine matter in tax practice as decided by the council. Therefore, there is **no misconduct in this case** as per Clause (12) of Part I of First schedule to the Act.

26. Mr. 'C', a Chartered Accountant employed as Senior executive in charge of Tax in a company, and not holding certificate of practice recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from the employer of Mr. 'C' paid a particular sum as referral fee to Mr. 'C'. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. (Nov-19 New & Old)

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 **is 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.

27. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: CA Dice had signed the Balance sheet of QR Ltd. for the year ended 31st March, 2019 which failed to give disclosure of the charge created for ₹ 4.35 crores against the Corporate Guarantee given in favour of a Group Company. The Balance Sheet size of the company filed with the Registrar of Companies was ₹ 26.12 crores. (Nov-19 New)

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 a financial statement**, but disclosure of which is necessary in making such financial statement not misleading where he is concerned with that financial statement in a professional capacity.

It may be observed that this clause refers to failure to disclose a material fact, which is known to him, in a financial statement reported on by the auditor. It is obvious, that before a member could be held guilty of misconduct, materiality has to be established. The determination of materiality has been provided in **SA 320, "Materiality in Planning and Performing an Audit".**

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain, among other points, that Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both.

In this case, CA Dice has signed a Balance Sheet which failed to give disclosure of ₹ 4.35 crores (considered material fact applying above SA 320 principle) against the corporate guarantee given in favour of a Group Company. Size of Balance Sheet of QR Ltd is ₹ 26.12 crore.

This **material fact has to be disclosed in the financial statements.** Keeping in view the above, he is attracted by the provisions of professional misconduct under **Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.**

Author's Note: In ICAI SM, same example is given under Clause(6) of Part I of Second Schedule of Chartered Accountants Act, 1949. So, it's better you quote both if this question repeats in exam.

28. Mr. Kushal, a practicing Chartered Accountant has signed the GST Audit Reports, Tax Audit Reports u/s 44AB of the Income tax Act, 1961 for the financial year 2019-20 that are filed online using Digital Signature and without

generating UDIN on the ground that there is no field for mentioning UDIN on digitally signed online reports. Is the contention of Mr. Kushal valid? Give your comments with reference to the Chartered Accountants Act, 1949 and schedules thereto. (Nov-20 New)

Non Generation of UDIN: Whereas, to **curb the malpractice of false/certification/attestation** by the unauthorized persons and to eradicate the practice of bogus certificates and to save various regulators, banks, stakeholders etc. from being misled, the Council of the Institute decided to implement an innovative concept to generate **Unique Document Identification Number (UDIN) mandatorily for all kinds of the certificates/GST and tax audit reports and other attest function** in phased manner, for which members of ICAI were notified through various announcements published on website of ICAI at the relevant times.

In exercise of the powers conferred on it under **clause 1 of Part II of the Second Schedule to the Chartered Accountants Act,1949, Council of ICAI** issued following guidelines for information of public and necessary compliance by members of the Institute-

A member of the Institute in practice shall generate UDIN for all kinds of certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him which are made mandatory from the following dates through announcements published on the website of the ICAI-

- For all Certificates w.e.f. 1st February,2019.
- For all GST and Tax Audit Reports w.e.f. 1st April, 2019.
- For all other Audit, Assurance and Attestation functions, w.e.f. 1st July, 2019.

Conclusion: UDIN will be applicable to GST & Tax Audit Reports signed by Mr. Kushal for the financial year 2019-20 that are filed online using Digital Signature. In case where there is no field for mentioning UDOIN on digitally signed online reports, UDION has to be generated and communicated to "Management" or "Those Charged with Governance" for disseminating it to the stakeholders from their end.

Hence he will be **held guilty under Clause 1 of Part II of the Second Schedule** to the Chartered Accountants Act,1949.

Alternative Answer

According to **Clause (9) of 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 fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.**

This clause implies that audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for **any reason the auditor has not been able to perform the audit in accordance with such procedure**, his **report should draw attention to the material departures from such procedures.**

What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available in general terms from the various pronouncements of the Institute is issued by way of statements and Guidance Notes and SAs to members.

A member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him.

In given case, Mr. Kushal has signed GST Audit Reports, Tax Audit Reports under section 44AB of Income Tax Act, 1961 for the F.Y.2019-20 and also has filed online using Digital Signature without generating UDIN on the ground that there is no field for mentioning UDIN on digitally signed online reports. Applying the above clause, UDIN provision etc. to the given case, **Mr. Kushal would be held guilty of professional misconduct.**

29. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: Mr. Vineet, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in purple colour. The website also displayed the nature of assignments handled along with the names of clients without such requirement from any of the regulator. He also circulated the information contained in the website through e-mail to acknowledge public at large about his expertise. However, he did not intimate his website address to the Institute. (Nov-20 New)

Circulating Information Contained in Own Website: As per **Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949**, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

1. However, guidelines approved by Council of ICAI permit creation of own website by a chartered accountant in his or his **firm name** and **no standard format or restriction on colours** is there. Hence there is **no misconduct** as per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

2. The chartered accountant or firm, as per the guidelines, should ensure that **none of the information contained in the website be circulated on their own or through E-mail** or by any other mode **except on a specific "Pull" request**. Mr. Vineet has circulated the information contained in the website through e-mail to public at large. Therefore, he is **guilty of professional misconduct** under Clause (6) of Part I of the First Schedule to the said Act.

3. **Nature of assignments handled** (to be displayable only on **specific "pull" request**). **Names of clients and fee charged cannot be given** without such requirement from any of the regulator. Mr. Vineet has displayed the nature of assignments handled along with the name of clients without such requirement from the regulator. Therefore, he is **guilty** of professional misconduct under Clause (6) of Part I of the First Schedule to the said Act.

4. The **website address of the member be obtained on annual basis in the annual form** required to be filed by the member while paying fee and the same be taken as entry on record.

Thus guilty of professional misconduct.

30. P, a CA availed a loan against his securities held as investments from a nationalized bank. He issued 2 cheques towards repayment of the said loan. Both the cheques were returned unpaid by the bank with the remark "Refer to Drawer". Comment with reference to the Chartered Accountants Act, 1949 as amended by the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto. (Jan-21 Old)

Bringing Disrepute to the Profession: A Chartered Accountant is expected to maintain the highest standard of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work would expose him to disciplinary action.

A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any professional or "Other Misconduct".

As per **Clause (2) of Part IV of the 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. The question whether a particular act or omission constitutes "other misconduct" should be based on fact and circumstances of each case.

Under **Negotiable Instruments Act 1881**, where any cheque drawn by a person for the discharge of any liability is returned by the bank unpaid, either for insufficiency of funds or the cheque amount exceeds the arrangements made by the drawer of the cheque, the drawer of such cheque shall be deemed to have committed an offence.

In the given case the cheque was dishonoured with the remark "refer to drawer". However, such dishonour need not necessarily be only due to insufficiency of funds.

If it is proved that the cheques were dishonoured due to insufficiency of funds, the CA P would be held guilty of "other misconduct".

Author's Note: Most students forget to quote reference of Negotiable Act and give wrong conclusion.

31. Mr. P, a practicing Chartered Accountant did not reply within a reasonable time and without any cause to the letter received from the local Police Station, a public authority, soliciting his suggestions as regards some non-professional work. Comment with reference to Chartered Accountant Act, 1949. (Jan 21- Old)

Section 21 of the Chartered Accountants Act, 1949 provides that a member is liable for disciplinary action if he is guilty of any professional or "Other Misconduct." Though the term "Other Misconduct" has not been defined in the said Act, this provision enables the Council to enquire into any misconduct of a member even if it does not arise out of his professional work.

This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards even in his non-professional work, would expose him to disciplinary action. **The Council has also laid down that among other things "non-replying within a reasonable time and without a good cause to the letter of the public authorities." would amount to "other misconduct".**

In the given scenario, CA. P did not reply within a reasonable time and without any cause to the letter received from the local police station, a public authority regarding soliciting his suggestion as regards some non-professional work. Thus, in the instant case, CA. P would be **liable for disciplinary action**.

Author's Note: Don't confuse it with clause(3)/Part II/Second Schedule its about false info to ICAI

32. 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. You are required to examine the same with reference to the Chartered Accountants Act, 1949. (May-19 Old)

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 empanelled as IP (Insolvency Professional) **can mention "Insolvency Professional" on his visiting cards, letter heads and other communication,** as this is a title recognised by the Central Government in terms of Clause 7 of Part 1 of First Schedule to the Chartered Accountants Act, 1949. Thus, **complaint of neighbour is not enforceable/ valid.**

33. Mr. A, Chartered Accountant in practice as a sole proprietor at Mumbai has an office in the suburbs of Mumbai. 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 kms from his office in the suburbs. For running the new office, he has employed a retired Income Tax Commissioner who is not a Chartered Accountant. Examine the above with respect to the Chartered Accountants Act, 1949. (May-19 Old)

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
- ✓ is located within **a distance of 50 kms from municipal limits of a city**, in which first office is located.

In given case, Mr. A, Chartered Accountant in practice as a sole proprietor at Mumbai has an office in suburbs of Mumbai 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. A will be in-charge of both the offices. However, he is bound to declare which of the two offices is the main office.

34. CA. P is a newly qualified Chartered Accountant in practice and in order to increase his professional practice and client base, entered into an agreement with Mr. A, a qualified and experienced registered valuer, to share 20% professional fees for all cases of valuation referred to him by CA. P. Based on this, CA. P received ₹ 1,20,000 during the year 2018-19 from Mr. A. Is CA. P guilty of misconduct under the Chartered Accountants' Act, 1949?

(Nov-19 Old)

Sharing Professional Fees with Registered Valuer: As per **Clause (3) of Part I of the First Schedule to the Chartered Accountants Act, 1949**, a chartered accountant will be guilty of professional misconduct if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute.

A member **cannot share his fees with a non-member.** Similarly he is also not permitted to receive and share the fees of others except for sharing with Member of such professional body or other person having such qualification as may be prescribed (Regulation 53A of the Chartered Accountants Regulations, 1988) by the Council. Under the Regulation 53-A of the Chartered Accountants Regulations, 1988, registered valuer is not included.

In the instant case Mr. P, who is a newly qualified Chartered Accountant in practice entered into an agreement with Mr. A, a qualified and experienced registered valuer, to share 20% professional fees for all case of valuation referred to him by CA. P. CA. P also received rupees 1,20,000 for the same from Mr. A. Thus, CA P will be held guilty for misconduct under **clause (3) of Part I of the First Schedule to the Chartered Accountants Act, 1949.**

35. A firm of Chartered Accountants was appointed by a company to evaluate the costs of the various products manufactured by it for its information system. One of the partners of the firm was a Non-Executive Director of the company. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. (Nov-20 Old)

Evaluation of Cost of Products: Clause (4) of Part I of the Second Schedule to Chartered Accountants Act, 1949, states that expressing an opinion on financial statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest would constitute misconduct.

Also, the **Council of the Institute of Chartered Accountants of India** has stated that in cases where a member of the Institute is a director of a company, or the firm in which the said member is a partner, he should not express any opinion on its financial statements.

As per facts of the case, the firm has been retained to evaluate the cost of products manufactured by it for its information system. It is a **part of management consultancy service of the firm** and, moreover, its partner was on the Board.

Hence, the firm can perform this assignment and it will not constitute misconduct. However, the firm while accepting the position as auditor in future would have to consider whether it would be possible to act in an independent manner and express opinion on financial statements.

36. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:
(a) OPAQ & Associates, a firm of Chartered Accountants responded to a tender issued exclusively for Chartered Accountants by an organisation in the area of tax audit. However no minimum fee was prescribed in the tender document. (RTP May-20)

Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. It states that a member may respond to tenders or enquiries issued by various users of professional services or organizations from time to time and secure professional work as a consequence.

However, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for Chartered Accountants, such as audit and attestation services.

Though, such **restriction shall not be applicable where minimum fee of the assignment is prescribed** in the tender document itself or where areas are open to other professionals along with Chartered Accountants.

In instant case, OPAQ & Associates responded to a tender of tax audit which is exclusively reserved for Chartered Accountants even though no minimum fee was prescribed in the tender document.

Therefore, OPAQ & Associates **shall be held guilty of professional conduct** for responding to such tender in view of above-mentioned guideline.

(b) Agarwal Pvt Ltd. approached CA. Prem, a Chartered Accountant in practice, for debt recovery services. CA Prem accepted the work and insisted for fees to be based on 2% of the debt recovered.

Charging of Fees based on Percentage: Clause (10) of Part I to First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.
However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed **Regulation 192 which exempts debt recovery services where fees may be based on a percentage of the debt recovered.**

In the given case, CA. Prem has insisted for fees to be based on percentage of the debt recovered (which is exempted under Regulation 192).

Hence, CA. Prem will **not be held guilty for professional misconduct.**

(C) Mr. P and Mr. Q are running a firm of Chartered Accountants in the name of PQ & Co. On 23.05.2019, they included the name of Mr. R, a practicing Chartered Accountant, without his knowledge, as a partner while submitting an application for empanelment as auditor for branches of a public sector bank, to the Institute. However, they added Mr. R as a partner to their firm offering a share of 25% of the profits, on 25.05.2019.

Submitting Wrong Information to the Institute: As per **Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949**, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct if **he includes in any information, statement, return or form** to be submitted to the Institute, Council or any of its committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority **any particulars knowing them to be false**.

In the instant case, Mr. P and Mr. Q, partners of PQ & Co., included the name of Mr. R, another Chartered Accountant, as partner in their firm, without his knowledge, in their application for empanelment as auditor of branches of Public Sector Banks submitted to the Institute. However, such a member was not a partner of the said firm as on the date of application submitted. Here, Mr. P and Mr. Q have submitted wrong information to the Institute.

Therefore, Mr. P and Mr. Q, both, **would be held guilty** of professional misconduct under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

37. C.A. Ajitnath is Special Executive Magistrate. He also took over as the Executive Chairman of Software Company on 1.4.2020. He is also a leading income tax practitioner and consultant for derivative products. He resides in Chennai near to the ION commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 40% of his time to settle the commodity transactions. He has not taken any permission for becoming Special Executive Magistrate. However, he has got special permission of Council of ICAI for becoming Executive Chairman. Is C.A. Ajitnath liable for professional misconduct?

(RTP May-21)

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, C.A. Ajitnath is Special Executive Magistrate, engaged in the occupation of trading in commodity derivatives and also took over as the Executive Chairman on 01.04.2020.

In this context, it may be noted that the **Special Executive Magistrate which is generally permitted** for Members of the Institute in practice, further **specific permission is required for holding the position of Executive Chairman and getting engaged in the occupation of trading in commodity derivatives**.

In the given situation, C.A. Ajitnath is acting as Special Executive Magistrate which is generally permitted for Members of the Institute in practice. Further, He is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission. He also took over as the Executive Chairman for which specific permission is required. CA. Ajitnath got the permission for the same from the Council of ICAI.

Conclusion: Hence, **CA. Ajitnath is not guilty for acting as Special Executive Magistrate** as it is covered under the general permission. He is also not guilty for holding the position of Executive Chairman after getting specific permission of the Institute.

However, he is **guilty** of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949 for **getting engaged in the occupation of trading in commodity derivatives** which is not covered under the general permission.

38 (a) Loans were given out of the funds of an Employees Provident Fund to the employer company in contravention of the applicable rules. As the auditor of the said Provident Fund, M discloses the contraventions to the Trustees of the fund, but failed to do so to the members of the fund. Comment. (PM)

Failed to Report Material Misstatement: As per **Clause (5) of Part I of Second Schedule to the Chartered Accountants 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).

Further, **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, CA M has contravened Clause (5) of Part I of Second Schedule as it is duty of a CA in practice to disclose material facts known to him so that the financial statement does not become misleading. Further the auditor CA should disclose such facts to beneficiaries of a fund in applicable cases. Technically, appointment of an auditor could be done by a company through its directors, but in substance the auditor in such cases addresses to the beneficiaries just like he gives his report to the shareholders of a company.

Therefore, in the instant case **Mr. M is found guilty of professional misconduct**.

(b) M/s Amudhan & Co., a firm of Chartered Accountants, received ₹ 2.8 lakhs in January, 2019 on behalf of one of their clients, who has gone abroad and deposited the amount in their Bank account, so that they can return the money to the client in July, 2019, when he is due to return to India.

Money of Clients to be Deposited in Separate Bank Account: Clause (10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended".

In the given case, M/s Amudhan & Co. received the money in January, 2019 which is to be paid only in July 2019, hence, it should be deposited in a separate bank account. Since in this case M/s Amudhan & Co. has failed to keep the sum of ₹ 2.8 lakhs received on behalf of their client in a separate Bank Account, it amounts to **professional misconduct** under Clause (10) of Part I of Second Schedule.

(c) CA Raman who is contesting Regional Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period.

Other Misconduct: CA Raman has engaged his Articled Assistant for his own election campaigning for the Regional Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work. This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'. Hence, **CA Raman is guilty of 'Other Misconduct'.**

(d) Mr. Anil, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements. (Oct-20 MTP)

Not Exercising Due Diligence: According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard, he was guilty of professional misconduct under Clause (7).

Since, Mr. Anil has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, the **auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule** to the Chartered Accountants Act, 1949.

39. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

(RTP Nov-20)

(a) CA. Srishti and CA. Mishti are two partners of the CA firm 'Srishti Mishti & Associates'. Being very pious, CA. Srishti organised a religious ceremony at her home for which she instructed her printing agent to add her designation "Chartered Accountant" with her name in the invitation cards. Later on, the invitations were distributed to all the relatives, close friends and clients of both the partners.

(a) Printing of Designation "Chartered Accountant" on Invitations for Religious Ceremony: 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 professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the Council of the ICAI is of the view that the **designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards**, invitations for marriages, religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are **sent only to clients, relatives and close friends of the members concerned**.

In the given case, CA. Srishti has instructed to write designation "Chartered Accountant" on invitation cards for a religious ceremony and distributed the same to all the relatives, close friends and clients of both the partners.

In this context, it may be noted that the Council has allowed using designation "Chartered Accountant" in invitations for religious ceremony, provided these are sent to clients, relatives and close friends of the members concerned only.

Therefore, CA. Srishti would be held **guilty of professional misconduct** under the said clause for sending such invitations to the relatives, close friends and clients of CA. Mishti as well.

(b) Ms. Preeto, a CA, had an account with a bank. The normal balance in this account remained at a level below ₹ 5,000. The bank inadvertently credited this account with a cheque of ₹ 2,70,000 belonging to another account holder. When CA. Preeto came to know about this she withdrew the amount of ₹ 2,75,000 and closed the bank account. After 1 year the bank noticed the mistake and claimed ₹ 2,75,000 with interest. CA. Preeto contested this claim. Can the bank approach the Institute of Chartered Accountants of India for disciplinary action against CA. Preeto?

Disrepute to the Profession: As per **Clause 2 of Part IV of First Schedule of the Chartered Accountant Act, 1949,** a Chartered Accountant will 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.

In the instant case, CA. Preeto, a CA, had an account with a bank from which she withdrew the amount of ₹ 2,75,000 and closed the account. This amount of ₹ 2,75,000 was pertaining to ₹ 5,000 minimum balance and ₹ 2,70,000 belonging to other account holder and inadvertently credited to his account by the bank. The said act of CA. Preeto to withdraw the money which does not belongs to her will bring disrepute to the profession. Hence under this clause the bank can file a suitable complaint under Clause 2 of Part IV of First Schedule of the Chartered Accountant Act, 1949 with the Institute of Chartered Accountants of India.

(c) CA. Moni is practicing since 2009 in the field of company audit. Due to her good practical knowledge, she was offered editorship of a 'Company Audit' Journal which she accepted. However, she did not take any permission from the Council regarding such editorship. (+ Apr 21 MTP)

Permission from the Council: 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.

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 the instant case, CA. Moni accepted editorship of a journal for which she did not take any permission from the Council. In this context, it may be noted that the **editorship of professional journals is covered under the general permission and specific permission is not required**.

Therefore, CA. Moni shall **not be held guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule** to the Chartered Accountants Act, 1949.

40. M/s SS limited is a partly owned subsidiary of M/s HH limited. For the upcoming financial year, M/s DD & Co., Chartered Accountants, were appointed as the statutory auditors of SS limited. The CEO of the holding company was impressed with the knowledge and experience of Mr. D, one of the partners of the firm and hence, he offered Mr. D to take up the position of Director (not MD/ wholetime director) of HH limited. At the same time, Mr. D's friend approaches him with an assignment to act as a Recovery Consultant for a bank. Mr. D is now confused whether to accept or reject the offers. He approaches you and seeks your advice on the same. Advise what Mr. D

about what he can do with the offers with reference to the Chartered Accountants Act, 1949 and Schedules thereto. (MTP Mar'21)

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.

Provided nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being MD or whole-time director) unless he or his partners is interested in such company as auditor.

The **Ethical Standards Board (ESB)** noted that **Public conscience is expected to be ahead of law**. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence. In the view of the above, the Board, via a clarification, decided that the auditor of a Subsidiary company cannot be a Director of its Holding company, as **it will affect the independence of the auditor**.

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. **'acting as Recovery Consultant in the banking sector' is covered under general permission**.

In the given situation, M/s SS limited is a partly owned subsidiary of M/s HH limited. For the upcoming financial year, M/s DD & Co., Chartered Accountants, were appointed as the statutory auditors of SS limited. The CEO of the holding company was impressed with the knowledge and experience of Mr. D, one of the partners of the firm and hence, he offered Mr. D to take up the position of Director (not MD/ whole-time director) of HH limited. Further, Mr. D's friend approached him for an assignment for acting as a Recovery Consultant for a bank.

Therefore, in view of above in the given case, **Mr. D should not accept the offer to be appointed as director of HH Limited.**

However, he can accept the assignment offered by his friend and can act as a recovery consultant for a bank.

41. A letter is sent by Mr. Raja, a Chartered Accountant in practice, to the Ministry of Finance inquiring whether a panel of auditors is being maintained by the Ministry and if so to include his name in the panel. He also enclosed his CV. Comment on the above with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

(MTP Mar'21)

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 judgement and may be able to command respect from their prospective clients.

In case of making an application for the empanelment for the allotment of audit and other professional work, the Council has opined that, "where the existence of such a panel is within the knowledge of the member, he is free to write to the concerned organization with a request to place his name on the panel. However, it would **not be proper for the member to make roving inquiries** by applying to any such organization for having his name included in any such panel."

Accordingly, **Mr. Raja is guilty of misconduct** in terms of the above provision as he has solicited professional work from the Finance Ministry, by inquiring about the maintenance of the panel.

42. Mr. Z, a newly qualified chartered accountant started his practice in February 2018 by setting up an office in the hill station Kodaikanal. Initially, since he was getting very less assignments, he decided to set up a temporary office in the nearby city Marudai, situated at about 100 kms from the main office. As planned, he took an office space on rent for the months of April, May & June. During these months, his regular office was not closed and Mr. Z was in-charge for both the offices. Mrs. A, another newly qualified chartered accountant who is also in practice in Marudai came to know about the new office of Mr. Z. Thinking that he could be a potential competitor, she informed the institute stating that Mr. Z had violated the provisions of the Chartered Accountant Act. As a member of the Board of Discipline of ICAI, you are requested to analyse this complaint. (MTP Mar'21)

As per **section 27 of Chartered Accountants Act 1949**, if a Chartered Accountant in practice or a Firm of Chartered Accountants has more than one office in India, each one of such offices should be in the separate charge of a member of the Institute. Failure on the part of a member or a firm to have a member in charge of its branch and a separate member in case of each of the branches, where there is more than one, would constitute professional misconduct. This condition applies to any additional office situated at a place beyond 50 kms from the municipal limits in which any office is situated.

However, **exemption has been given to members in practicing in hill areas** subject to certain conditions such as:
- Such member/ firm be allowed to open temporary offices in a city in the plains for a limited **period not exceeding 3 months in a year**.
- The **regular office need not be closed** during this period and all correspondence can continue to be made at the regular office.
- The **name board of the firm in temporary office** should not be displayed at times other than the period such office is permitted to function.
- The **temporary office should not be mentioned in letter head, visiting card**, any other documents as a place of business of the member/ firm.
- Before commencement of every winter, it shall be obligatory on the member/firm to **inform the Institute that he/it is opening the temporary office** from a particular date and after the office is closed at the expiry of the period of permission, an intimation to that effect should also be sent to the office of the Institute by registered post.

In the given case, Mr. Z has set up his regular office in the hill area of Kodaikanal , he decided to set up a temporary office in the nearby city Marudai, situated at about 100 kms from the main office. As planned, he took an office space on rent for the months of April, May & June. During these months, his regular office was not closed. Further he was in-charge for both the offices. In view of abovementioned criteria's, he is eligible to avail the benefits of the above exemptions. Also, it is given that the temporary office was open in Madurai for only 3 months and not beyond that. The fact that Mr. Z is in-charge for both the offices, the temporary office being set-up in the plains which is 100 kms away and the regular office kept open during the 3 months does not constitute any violation of the provisions of the Chartered Accountant Act. Assuming Mr. Z has informed the Institute regarding such temporary office in the prescribed manner.

Therefore, in the given case, **no penal action needs to be taken** on the basis of complaint registered by Mrs. A, as Mr. Z is not guilty of professional misconduct.

43. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: CA D, a practicing Chartered Accountant, was appointed as a simplicitor Director in a Pvt. Ltd. company on 01-01-2020. After serving 18 months, Mr. D resigned as the Director. He accepted the appointment as the Statutory Auditor of the company with effect from 01-10-2021. Is CA D right in accepting the audit?

(Dec-21 New)

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 Pvt. Ltd. Company. Mr. D resigned as the Director and after 18 months of resignation accepted the Statutory Auditor position of the Company. In view of above provisions Mr. D cannot accept the Directorship of the company as tenure of two years after his resignation is yet to be completed.

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.

44. CA. Nikhil, in practice, started project consultancy work as a part of his practice and to advance the same, sent mail to all the CAs in the country informing them of his services and for securing professional work. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. (MTP May'20)

As per **Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949**, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he solicit clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, 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 accountants in practice.

In the instant case, CA. Nikhil has written email to all the CA for securing professional work from them and has not approached any other person or professional or communicated with any client,

Thus, as per exception to the Clause (6), CA. Nikhil is well within the regulation of the act and has **not committed any professional misconduct.**

45. Mr. Vinod a practicing chartered accountant acting as liquidator of XYZ & Co. charged his professional fees on percentage of the realization of assets. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. (MTP May'20)

Chartered Accountant in Practice Acting as Liquidator: 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. Vinod, a practicing Chartered Accountant, has acted as liquidator of XYZ & Co. and charged his professional fees on percentage of the realisation of assets.

Therefore, **Mr. Vinod 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.

46. Mr. Yuvi, a Chartered Accountant in practice, is the auditor of Prime Ltd. He advised the Managing Director of the company to include 'orders under negotiation' in sales, to reflect higher profit and better financial position for obtaining bank loans in future. Mr. Yuvi, thereafter, gave clean reports on the balance sheet prepared accordingly without examining the accounts. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. (MTP May'20)

Grossly Negligent and Bringing Disrepute to the Institute: Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Furthermore, **Clause (2) of Part IV of the First Schedule** to the said Act states that 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.

In the given case, Mr. Yuvi, a Chartered Accountant in practice, is grossly negligence in conduct of his professional duties by issuing clean reports on the balance sheet without examining the accounts. Further, he has also brought disrepute to the profession by advising unethical practice to the managing director of the company. Therefore, **Mr. Yuvi will be held guilty for professional and other misconduct** under abovementioned Clauses to the Chartered Accountants Act, 1949.

Author's note: Most students here confuse Clause (2), its Other Misconduct as he knew he's doing wrong. It isn't clause (2) Part I of Second Schedule

47. Mr. Aniket, a Chartered Accountant was the auditor of 'Alpha Limited' for the year 2018-19 and 2019-20. During the financial year, the investment appeared in the Balance Sheet of the company amounting ₹ 11 lac and was the same amount as in the last year 2018-19. Later on, it was found that the company's investments were only for ₹ 45,000, however, the value of investments was inflated for the purpose of obtaining higher amount of Bank loan. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. (MTP Oct-20)

Gross Negligence 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. Aniket, 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.**

48. Mr. Chintamani, a Chartered Accountant in practice has been elected as the treasurer the Regional Council of the ICAI. The Regional Council had organized an international tour through a tour operator during the year for its members. During the audit of the Regional Council, it was found that Mr. Chintamani had received a personal benefit of ₹ 40,000 from the tour operator. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. (MTP Oct-20)

Section 21 of the Chartered Accountants Act, 1949 provides that a member is liable for disciplinary action if he is guilty of any professional or "Other Misconduct." Other misconduct has been defined in part IV of the First Schedule and part III of the Second Schedule. These provisions empower the Council to inquire into any misconduct of a member even it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action. The Council has also laid down that among other things "misappropriation by an office-bearer of a Regional Council of the Institute of a large amount and utilization thereof for his personal use" would amount to "other misconduct".

In the instant case, receipt of personal benefit of ₹ 40,000 from the tour operator by Mr. Chintamani for organising an international tour as treasurer of a Regional Council of the Institute would amount to other misconduct as per section 21. Therefore, Mr. Chintamani would be held guilty for other misconduct.

49. Mr. Mohan is a practising Chartered Accountant. He issued a certificate of consumption which did not reflect the correct factual position of the consumption of raw material by the concerned entity. It is found that the certificate is given on the basis of data appearing in the minutes of meeting of the Board of Directors. Comment on above with reference to the Chartered Accountants Act, 1949, and Schedules thereto. (MTP Oct 18)

According to **Clause (2) of Part I of Second Schedule to the Chartered Accountants Act, 1949 a** chartered accountant is held guilty of professional misconduct if he certifies or submits a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or employee in his firm or any other chartered accountant in practice.

Mr. Mohan has issued a certificate of consumption which does not reflect the correct factual position of the consumption of raw material by the concerned entity. He has failed in his duty of examining the record. He has relied on the minutes of Board of director's meeting which is not proper evidence to show the consumption of raw material. The relevant record of production and stock register should have been scrutinized thoroughly and properly.

Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 also applies to this case which states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

Mr. **Mohan will be held guilty of Professional Misconduct under Clause (2) & (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.**

50. CA. X, a practicing Chartered Accountant, failed to return the books of account and other documents of ABC Ltd. despite many reminders from the company. The company had settled his entire fees dues also. Comment with reference to the Chartered Accountants Act, 1949. (MTP Oct 18)

Bringing Disrepute to the Profession: A member is liable to disciplinary action under **section 21 of the Chartered Accountants Act, 1949,** if he is found guilty of any professional or "Other Misconduct". As per **Clause (2) of Part IV of the First Schedule** to the said Act, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he , in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

A member may be found guilty of "Other Misconduct" as per Clause (2) under the aforesaid provisions rendering himself unfit to be member if he retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.

In the given case, CA. X failed to return the books of accounts and other documents of his client without any reasonable cause, therefore, he would be **guilty** of other misconduct under the aforesaid provisions.

51. ENI Ltd; a company registered under the Companies Act, 2013 has created a separate Trust "ENI Employees Gratuity Fund Trust". Both the Company and Trust are under the same management. Mr. A is the auditor of both the entities. Mr. A has observed that some part of the expenditure was not applied towards the objects of the Trust. He informed the matter to the Board of Trustees through a separate report but did not qualify the Audit Report of the Trust. (Nov-18 Old)

Disclosure of Material Facts: A Chartered Accountant in practice is deemed to be guilty of professional misconduct under **Clause (5) of Part I of the Second Schedule** if he "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".

In this case, the Chartered Accountant was aware of some part of the expenses not applied towards the object i.e. contraventions and irregularities committed by the trust as these were referred to in the separate report given by the Chartered Accountant to the Board of Trustees of the company. However, he issued audit report without any qualification which is not in order.

Therefore, CA A is deemed to be **guilty** of professional misconduct.

52. Mr. M, a Chartered Accountant in practice, has printed visiting cards which besides other details also carries a Quick Response (QR) code. The visiting card as well the QR code contains his name, office and residential address, contact details, e-mail id and name of the firm's website. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. (MTP Aug 18)

Printing of QR Code on Visiting Cards: As per **Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949,** a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he advertises his professional attainments or services.

Ethical Standards Board has also clarified that a member in practice is **allowed to print Quick Response Code (QR Code)** on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card.

In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id

and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice.

Thus, **Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.**

53. X, a practicing Chartered Accountant in an application for permission to study submitted by his Articled Assistant to the council had confirmed that the normal working hours of his office were from 11 A.M. to 6 P.M. and the hours during which the Articled Assistant was required to attend classes were 7.00 A.M. to 9.30 A.M. According to the information from College, the Articled Assistant attended the College from 10 A.M. to 1.55 P.M. on all week days. About the Articled Assistant attending the classes even during office hours, X pleaded ignorance. (PM)

Failure to Observe the Regulations: As per **Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949** a member shall be held guilty of professional misconduct if he contravenes any of the provisions of the Act or the regulations made thereunder or any guidelines issued by the Council.

The chartered accountant, as per Regulations also, is expected to impart proper practical training. There is a specific circular issued which guides on timing for training for articleship. In the instant case, the articled clerk must have not been attending office on a regular basis and the explanation of the Chartered Accountant cannot be accepted. It is also quite likely that the articled clerk would be availing leave quite often and coming late to the office. Under the circumstances, the Chartered Accountant is guilty of misconduct for making a misstatement to the institute in regard to the discharge of his professional duties.

Note: Alternative Solution is possible as per Schedule II, Part II, Clause (3), a member is deemed to be guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false. In the instant case, X knew about the college timing of his articled assistant and he had given false information to the institute knowing them to be false and hence he will be deemed to be guilty of professional misconduct.

54. Z, a practicing Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e. by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printers bills and by not caring to ascertain how many copies were sold and paid for. (PM)

Failure to Obtain Information: Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that if a Chartered Accountant in practice fails to obtain sufficient information to warrant the expression of an opinion or his exceptions are sufficient material to negate the expression of an opinion, the chartered accountant shall be deemed to be guilty of a professional misconduct. In the instant case Mr. Z, a practicing Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e, by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printers bills and by not caring to ascertain how many copies were sold and paid for. The chartered accountant **should not express his opinion before obtaining the required data and information**. As an auditor, Mr. Z ought to have verified the basic records to ensure the correctness of circulation figures.

Thus, in the present case **Mr. Z will be held guilty of professional misconduct** as per Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Alternative Solution is possible on the basis of Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

55. Mr. B is a practising Chartered Accountant holding a valid certificate of practice. He accepted the appointment as Director of the Green World Co. Ltd. Mr. C, a partner of Mr. B is statutory auditor of the said company. (PM)

Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949 prohibits a member to engage in any business or occupation other than the profession of chartered accountants unless permitted by the Council so to engage. It does not prohibit a Chartered Accountant from being a director of a company, except managing director or a whole time director. But if any of the partners is interested in such company as an auditor then he cannot be director of the said company.

In the present case **Mr. B has accepted the directorship in a Company, where his partner Mr. C is an auditor, without obtaining specific permission of the council.** Hence, Mr. B will be held **guilty for professional misconduct under Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.**

Further, the Council of the Institute of Chartered Accountants of India has categorically stated that in cases where a member is a director of a company, the firm, in which the said member is a partner, should not express any opinion on its financial statements. **Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949** states that expressing an opinion on financial statements of any business or enterprise in which he, his firm or a partner of his firm has a substantial interest would constitute misconduct.

Additionally, **Section 141(3)(c) of the Companies Act, 2013** also disqualifies a person to be appointed as an auditor if he **is a partner of an officer of the company**. Furthermore, **section 141(4) of the Companies Act, 2013 requires the appointed auditor to vacate his office if he incurs any of the disqualifications mentioned under sub-section (3).**

Therefore, in cases, where a member of the Institute is a director of a company, or the firm, in which said member is a partner, should not express any opinion on its financial statements. Hence **Mr. C, a partner of Mr. B, should vacate the office.**

56. CA D, a Chartered Accountant prepared a project report for one of his clients to obtain bank finance (long-term) of ₹ 50 lakhs from a Commercial Bank. Consequent to the sanction of the loan by the bank CA D raised a bill for his services @ 2% of the loan sanctioned.(Nov-08)

Charging of Fees based on Percentage: Clause (10) of Part I to First Schedule to the Chartered Accountants Act prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.
However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed regulation 192 which exempts certain professional services from the operation of Clause (10).

The services rendered by CA. D are not covered under the said exemption and hence CA. D is **liable for professional misconduct.**

57. XYZ Ltd. appoints you as the auditor of the company. You observe that previous auditors A & Co., resigned. Also Balance Sheet as at 31-03-2010 shows an audit fee payable of ₹ 25,000. What precautions you will take before commencing the audit work? (4 Marks, November, 2010)

Precautions before Commencing the Audit Work: In the instant case, before accepting the appointment as well as commencing the audit work, the auditor should see the following-

(i) Check whether a statement, in the prescribed form, has been **filed by the resigning auditor within a period of 30 days from the date of resignation,** to the company and the registrar (or the Comptroller and Auditor-General of India, as the case may be), indicating the reasons and other facts as may be relevant with regard to the resignation, for the compliance of **Section 140(2) of the Companies Act, 2013 (herein after referred as the Act).**

(ii) Ascertain that the appointment of new Auditor is in **compliance with Section 139(8) of the Act** as mentioned above i.e. the resolution appointing the new auditor has been approved by the company in the general meeting as in the case of casual vacancy by resignation.

(iii) The auditor **must obtain the NOC from previous auditor.** He should also refer the resignation statement file by the previous auditor and communicate with him (previous auditor) to ascertain the circumstances which led up him to retire.

(iv) The auditor must ascertain whether there **existed any circumstances on account of which he should not accept the appointment.**

(v) As per Section 139 of the Act, the auditor must ensure that before any appointment or reappointment of auditors is made at an annual general meeting, **a written certificate** has been provided by him to the company that his appointment is in accordance with the limits specified in Section 141(3)(g).

(vi) He should also satisfy himself that the **notice provided for under Sections 139 and 140** has been effectively served on the outgoing auditor.

Further, **Clause (8) 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 a position as auditor previously held by another chartered accountant without first communicating with him in writing.

Moreover, **Clause (9) of Part I of the same Schedule,** 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 Sections 224 and 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.

58. M, a practicing Chartered Accountant sent a letter to another firm of Chartered Accountants, claiming himself to be a pioneer in liasoning with Central Government Ministries and its allied Departments for getting various Government clearances for which he had claimed to have expertise and had given a list of his existing clients and details of his staff etc. (May'12)

Soliciting Work Directly or Indirectly: As per **Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949,** a member shall be held guilty if a Chartered Accountant in practice solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Further, as per Central Council Guidelines for Advertisement for the members in practice, **write up** of the members should **not claim superiority over any other Member(s)/Firm(s)** and should **also not include the names of the clients.**

In the present case, Mr. M, a practicing Chartered Accountant sent the letter to another firm of Chartered Accountants, claiming himself to be a pioneer in liasoning with Central Government Ministries and its allied

Departments for getting various Government clearances for which he had claimed to have expertise and had also given a list of his existing clients and details of his staff etc. which seems to be indirect methods to adventure their professional practice with a view to gain publicity and thereby solicit clients or professional work.

Hence, **Mr. M was guilty of professional misconduct as per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.**

59. M/s PQR & Co. is a partnership firm of 3 partners P, Q and R. All partners are exclusively associated with the firm in practice and are not doing practice in individual capacity. For the year ended 31st March, 2019, the partners have undertaken audits and signed audit reports under section 44AB / 44AD of the Income Tax Act 1961 as under :

Under section →	44AB	44AD
P	10	15
Q	60	5
R	100	5

Discuss whether there is any professional misconduct by the partners of the firm in regard to the aforesaid audits.

Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961 : As per the **Council General Guidelines 2008, under Chapter VI, 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.

For the above purpose, "the specified number of tax audit assignments" means (a) in the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, **60 tax audit assignments,** in a financial year, whether in respect of corporate or non - corporate assesses. (b) in the case of firm of Chartered Accountants in practice, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

In computing the "specified number of tax audit assignments", the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.

Where any partner of the firm is also a partner of any other firm or firms of Chartered Accountants in practice, the number of tax audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the "specified number of tax audit assignments" in the aggregate.

In addition, 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.

It may be noted that the audits conducted under Section 44AD, 44AE and 44AF of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments".

In the instant case, M/s PQR & Co., is a partnership firm of Partner P, Q and R. All the partners are exclusively associated with the firm and are not doing practice in individual capacity. Here, in the instant case, 60 tax audit assignments per partner in the firm, in a financial year will be considered for "specified number of tax audit assignments" i.e.180 tax audits = 3 Partners x 60 tax audits.

In the given situation, number of tax audit reports signed under section 44AB are 170 (i.e.10 reports signed by Mr. P, 60 reports signed by Mr. Q and 100 reports were signed by Mr. R). and number of tax audit reports signed under

section 44AD are 25 (i.e.15 reports signed by Mr. P, 5 reports signed by Mr. Q and 5 reports were signed by Mr. R). It may be noted that the 25 audits conducted under Section 44AD, of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments".

In view of above provisions, partner **Mr. P, Mr. Q and Mr. R of PQR & Co. have undertaken 170 audits which is not more than 180 tax audits** i.e. "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961. Therefore, there is **no professional misconduct in regard to the abovesaid audits.**

60. MNC Pvt. Ltd. appointed CA. Moksh for some professional assignments like company's ROC work, preparation of minutes, statutory register etc. For this, CA. Moksh charged his fees depending on the complexity and the time spent by him on each assignment. Later on, MNC Pvt. Ltd. filed a complaint against CA. Moksh to ICAI that he has charged excessive fees for the assignments comparative to the scale of fees recommended by the Board as well as duly considered by the Council of ICAI. Comment with reference to the Chartered Accountants Act, 1949.

(MTP Apr'18)

Charging Excess Fees: The prescribed scale of fees for the professional assignments done by the chartered accountants is recommendatory in nature. Charging an excessive fee for a professional assignment does not constitute any misconduct in the context of the provisions of the Chartered Accountants Act, 1949 and regulation made thereunder since the matter of fixation of actual fee charged in individual cases depends upon the mutual agreement and understanding between the member and the client.

In the given case, CA. Moksh has charged excess fees compared to the scale of fees recommended by the Board as well as duly considered by the Council of ICAI. In this context, it may be noted that the **scale of fees is the minimum prescribed scale of fees.**

From the above facts and provisions, it may be concluded that **CA. Moksh is not liable for any misconduct** under the Chartered Accountants Act, 1949. Therefore, the contention of MNC Pvt. Ltd. is not tenable.

61. During the opening ceremony of a new branch office of CA. Young, his friend CA. Old introduced to CA. Young, his friend and client Mr. Rich, the owner of an Export House whose accounts had been audited by CA. Old for more than 15 Years. After few days, Mr. Rich approached CA. Young and offered a certification work which hitherto had been done by CA. Old. CA. Young undertook the work for a fee which was not less than fee charged by CA. Old in earlier period. Comment whether CA. Young had done any professional misconduct. (Nov-18 New)

Acceptance of original professional work by a member emanating from the client introduced to him by another member: As per **Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949**, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.

Further, some forms of the soliciting work which the Council has prohibited include that a member should **not accept the original professional work emanating from a client introduced to him by another member**. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.

In the given case, CA Old introduced his friend CA. Young to his friend and client Mr. Rich, the owner of an Export House whose accounts has been audited by CA. Old for more than 15 years. After a few day Mr. Rich approached CA. Young and offered a certification work which hitherto had been done by CA. Old. Fees charged by CA. Young is also not less than fee charged by CA. Old.

In view of above decision CA Young should ask the client to come through CA Old. However, CA Young undertook the work without informing CA. Old. Thus, CA. Young is held **guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act,1949.**

62. XYZ Associates, a Chartered Accountants Firm is having a relationship with a multinational accounting firm in India. The ICAI required that all firms having networking relationship with any other entity need to furnish information online within the stipulated time. XYZ Associates failed to respond. Comment on this with reference to Professional misconduct, if any. (Nov-18 New)

Failed to Supply Information Called For: As per **Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949,** a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Thus, in the given case, Mr. XYZ Associates, a chartered accountant firm is failed to furnish the information of its relationship with multi-national accounting firm in India. The ICAI required this information to be submitted online within the stipulated time. XYZ Associates failed to respond and submit the required information. Therefore, XYZ Associates is held guilty of professional misconduct as per **Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.**

63. CA R, a Chartered Accountant in practice is specializing in the field of Information Systems Audit. He is considered to be one of the experts of this field because of his command over the subject. HKC Limited, a Company engaged in rendering management consultancy offered him to appoint as its managing director. CA R accepted the position of managing director without obtaining prior permission from the Institute. One of his friends , CA S informed him that now he cannot retain full time certificate of practice, thus cannot do attest function and train articled assistants. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto. (July-21 New)

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.

The Council decided to **allow members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate** within the meaning of the Companies Act, 2013 provided that the body corporate is engaged **exclusively in rendering Management Consultancy and Other Services** permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard. The **name of the Management Consultancy Company is required to be approved by the Institute** and such Company has to be **registered with the Institute.**

The members can retain full time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company. There will be no **restriction on the quantum of the equity holding** of the members , either individually and/ or along with the relatives, in such Company. Such members shall be regarded as being in full- time practice and therefore can continue to do attest function either in individual capacity or in Proprietorship/Partnership firm in which capacity they practice and wherein they are also entitled to train articled/audit assistants.

Thus, **the action of CA R is valid.**

64. M/s. SR & Associates is one of the three firms shortlisted by ARG Cooperative Bank for assignment of Statutory Audit for the F.Y 2020-2021. Bank mailed the list of branches to the audit firms along with the maximum fee per branch and asked them to submit the quotations. SR & Associates responded to the bank and submitted their quotation. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto. (July-21 New)

As per **Clause (6) 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 Solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Provided that nothing herein contained shall be construed as preventing or prohibiting –
(i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or
(ii) A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.

However, as per the guideline issued by the Council of the Institute of Chartered Accountants of India, a **member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants**, such as audit and attestation services.

However, such **restriction shall not be applicable where *minimum fee* of the assignment is prescribed** in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.
In the given case of ARG Cooperative Bank, Bank mailed the list of branches to the audit firms along with maximum fees per branch, in response to which SR & Associates responded and submitted their quotation.

Keeping in view the facts, clause 6 and guideline issued by the council, it can be concluded that **SR & Associates is guilty of Professional misconduct.**

65. CA B, is appointed to carry out internal audit of Stock brokers, AKA Finstock Ltd., listed with NSE. CA B started his work and submitted his first monthly report. CA Z, a partner of AZA & Co., statutory auditors of AKA Finstock Ltd., during his first visit got to see the internal audit report of CA B. CA Z feels that since CA B did not inform about his appointment as an internal auditor to AZA & Co., this is violation of professional ethics. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. (July-21 Old)

As per **Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949**, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been Issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

This clause is applicable in situation of replacing of one auditor by another auditor. **Internal auditor and statutory audition are parallel positions and not replacement positions.** The management generally appoints the internal auditor whereas the statutory auditor will be appointed by the shareholders in the AGM.

In this situation there is no need for communication by one to other. In the given situation CA. B, is appointed as internal auditor of AKA Finstock Ltd., listed with NSE submitted his first month internal audit report. CA, Z, a partner of AZA & Co., and statutory auditors of AKA Finstock Ltd. came to know about appointment of internal auditor and raised an issue regarding violation of professional ethics as CA. B did not informed about his appointment to the statutory auditors of AZA & Co.

In view of above the **contention of the statutory auditor is not correct and there is no question of communicating in writing by CA. B.**

66. M/s. AWE & Co, Chartered Accountants were appointed as Auditors of WOW Ltd. for the F.Y. 2019-20. Since they declined to accept the appointment, the Board of Directors appointed M/s GDC & Co., a CA firm as the auditor in the place of M/s. AWE & Co. This was accepted by M/s GDC & Co. Discuss this with reference to Chartered Accountants Act, 1949 and Companies Act, 2013. (July-21 Old)

Compliance of Statutory Requirements Before Accepting Appointment: Clause (9) of Part I of the First Schedule to 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 Sections 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 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. Where the auditor other than the retiring auditor is proposed to be appointed, the incoming auditor should ascertain whether the provisions of Sections 139 and 140 have been complied with.

In the given case, M/s. AWE & Co., Chartered Accountants were appointed as auditor of WOW Ltd., however, they declined to accept the appointment. Therefore, Board of Directors appointed M/s. GDC & Co. as the auditor in place of M/s. AWE & Co.

Under Sections 139(8)(i) and Section 139(6) of the Companies Act, 2013 Board can appoint the auditor in the case of casual vacancy. The non-acceptance of appointment or decline to accept appointment by M/s. AWE Ltd does not constitute a casual vacancy to be filled by the Board. In this case, it will be deemed that no auditor was appointed in the AGM.

Further, **as per Section 139(10)** of the Companies Act, 2013 **when at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.** The appointment of the auditor by the Board is defective in law. Hence **M/s GDC & Co. is guilty of professional misconduct as per Clause (9) of the First Schedule** as M/s GDC & Co. being incoming auditor accepted the appointment without verification of compliance of statutory requirements.

67. CA. Ritu is a leading Income Tax Practitioner in Delhi. She is very much fond of cooking. Due to this passion of her, she also wrote a cookery book "Delight your tummy" during the year. But, she didn't take any permission from the Council of the Institute for engaging herself into authorship of such book. Comment. (MTP Apr-18)

Engaging into Business/Profession Other Than the Profession of CA: As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in Practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

Further, the Chartered Accountants Regulation, 1988 provides that a Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. According to the same, **general permission has been granted for authorship of books and articles.**

In the given case, CA. Ritu has written a cookery book without obtaining specific or prior approval of the Council.

On this context, it may be noted that **no specific permission is required to be obtained for authorship of books and articles.** Therefore, CA. Ritu would **not be held guilty** of professional misconduct under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

68. As a Chartered Accountant in practice, you are asked to conduct a review of the "Profit Forecast" prepared by a Company in connection with its application for a Term loans from a bank.

Certification of Financial Forecast: Under **Clause (3) of Part I of Second Schedule to The Chartered Accountants Act, 1949,** a CA in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm, to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes.

Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.

Hence, the offer can be accepted if the above requirements are complied with.

69. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto: A practicing Chartered Accountant was appointed to represent a company before the tax authorities. He submitted on behalf of his clients certain information and explanations to the authorities, which were found to be false and misleading. (PM)

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.

Hence the Chartered Accountant would not be held liable for professional misconduct.

70. Mr. SP, a Chartered Accountant, obtains registration as category IV Merchant Banker under the SEBI's Rules and Regulations and act as Advisor to a capital issue of MB Co. Ltd. He designates himself under the caption "Merchant Banker" in client offer documents and 'Advisor to issue' in his own letterheads, visiting cards and professional documents. (PM)

Use of Designation other than Chartered Accountant: **Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949** restrains a Chartered Accountant in practice from advertising his professional attainments or services. It also prohibits a member from using any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognized by the Central Government or a title indicating membership of the Institute of Chartered Accountants or of any other institution that has been recognized by the Central Government or may be recognized by the Council.

It may be noted that, in Client Companies' offer documents and advertisements regarding capital issue, name and address of the Chartered Accountant acting as Advisor or Consultant to the Issue could be indicated under the caption "Advisor/ Consultant to the Issue". Further, **such members should not use the designation of either 'Merchant Banker' or 'Advisor/Consultant to Issue' in their own letterheads, visiting cards, professional documents, etc.**

In the given case, Mr. SP, a Chartered Accountant, has obtained registration as category IV Merchant banker and acted as advisor to a capital issue of MB Co. Ltd. He has designated himself under the caption "Merchant Banker" in client offer documents and "advisor to issue' in his own letterheads, visiting cards and professional documents.

Therefore, Mr. SP shall be **held guilty** of professional misconduct as per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

71. A Chartered Accountant having CoP entered into partnership with persons, who are not the members of the institute, for the purpose of carrying on business. The share of the chartered account in the profit and losses was 25%. He was to take part in the business and was entitled to represent the firm before Govt. authorities etc. He was operating the bank account of the firm, was receiving moneys from the customers and was also looking after the affairs of the Partnership.

Practicing CA Entering into Partnership and Carrying on Business: As per **Clause (4) 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 enters into partnership, in or outside India, with any person other than Chartered Accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub-section (1) of section 4 or whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships. It may be noted that the Council has prescribed the list of person qualified and the professional bodies for the purpose of entering into partnership under the Chartered Accountants Regulations, 1988.

Further, **according to Clause (11) of Part I of First Schedule to the said Act**, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. It may also be noted that a member in practice is required to apply for specific and prior approval of the Council for entering into any business. In the given case, a chartered accountant in practice has entered into partnership with persons who were not the members of the Institute, for the purpose of carrying on business. The question is silent about with whom the partnership has been entered into and whether the prior permission for entering into such business has been obtained.

Conclusion: It is **assumed** that the persons with whom the partnership has been entered into has not been allowed under the Regulations and the prior approval of the Council has not been obtained for entering into such business. Hence, **the Chartered Accountant shall be held guilty of professional misconduct under Clause (4) and Clause (11).**

72. Mr. Hopeful, an aspiring student of ICAI, approached Mr. Witty, a practicing Chartered Accountant, for the purpose of articleship. Mr. Witty, the principal, offered him stipend at the rate of ₹ 2,000 per month to be paid every sixth month along with interest at the rate of 10% per annum compounded monthly to compensate such late payment on plea that cycle of professional receipts from clients is six months. Mr. Hopeful agreed for such late payment in the hope of getting extra stipend in the form of interest. Mr. Witty, however, used to disburse salary to all of his employees on time.

Contravening Provisions of the Act: A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct under **Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949**, if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

In the given case, Mr. Witty has **failed to make the payments of stipend to articled assistant every month in accordance with Regulation 48.** The fact that the articled assistant will be compensated with extra sum in the form of interest on late payment is not relevant and the plea that cycle of professional receipts from clients is six months is not acceptable as Mr. Witty has disbursed salary to all of his employees on time.

Therefore, Mr. Witty is guilty of professional misconduct under Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 as he has contravened Regulation 48 by not making the payment every month.

73. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:
(a) Mr. Raj, a renowned practicing Chartered Accountant, decided to tie his knot with Ms. Anjani. While giving order for marriage invitation cards, Mr. Raj instructed to add his designation "Chartered Accountant" with his name. Later on, the cards were distributed to all his relatives, close friends and clients.

Printing of Designation "Chartered Accountant" on Marriage Invitations: 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 professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the Council of the ICAI is of the view that the **designation "Chartered Accountant" as well as the name of the firm** may be used in **greeting cards, invitations for marriages and religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned.**

In the given case, Mr. Raj instructed to write designation "Chartered Accountant" on his marriage invitation cards and distributed the same to all his relatives, close friends and clients. On this context, it may be noted that the Council has allowed using designation "Chartered Accountant" in invitations for marriages, provided these are sent only to clients, relatives and close friends of the members concerned.

Therefore, Mr. Raj **would not be held guilty of professional misconduct** under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(b) CA Ram is practicing in the field of financial management planning for over 12 years. He has gained expertise in this domain over others. Mr. Ratan, a student of Chartered Accountancy course, is very much impressed with the knowledge of CA. Ram. He approached CA. Ram to take guidance on some topics of financial management subject related to his course. CA. Ram, on request, decided to spare some time and started providing private tutorship to Mr. Ratan along with some other aspirants. However, he forgot to take specific permission for such private tutorship from the Council.

Permission for Providing Private Tutorship: As per **Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949,** a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.

Further, regulation 190A of the Chartered Accountants Regulation, 1988 provides that a Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. According to the same there is no specific permission from the council would be necessary in the case of private tutorship.

In the given case, CA. Ram has started providing private tutorship to Mr. Ratan along with some other aspirants, without obtaining specific or prior approval of the Council. On this context, it may be noted that the **Council has provided general permission for providing such private tutorship.**

Therefore, CA. Ram would **not be held guilty of professional misconduct** under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(c) The manager of ZedEx (P) Ltd. approached CA. Vineet in the need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA. Vineet issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute.

Issuing Certificate without having Certificate of Practice: As per **Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949,** a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct. In the given case, CA. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, **CA. Vineet will be held guilty of professional misconduct in terms of Clause (1) of Part II of Second Schedule** to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

74. 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. (SM)

As per **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.

75. Mr. Shanti, a Chartered Accountant, employed as a paid Assistant with a Chartered Accountant firm, leaves the services of the firm on 31st December, 2020. Despite many reminders from ICAI he fails to reply regarding the date of leaving the services of the firm. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. [MTP Mar-22]

Failed to Supply Information Called For: As per **Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949**, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Thus, in the given case, Mr. Shanti has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant. Therefore, he is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

76. Sanyam, a chartered accountant in practice is owner of three agriculture lands. He lost his father due to Covid Pandemic. After death of his father, he started carrying out agricultural activities. His neighbour Raja who is a farmer, filed a complaint against him to ICAI that being a member he is carrying out agricultural activities, therefore, he is liable for misconduct. You are required to examine the same with reference to the Chartered Accountants Act, 1949 and Schedules thereto. [MTP-Apr-22]

Engaging into Agricultural Activity: 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. Sanyam is owner of 3 agriculture lands, and he is **carrying out agricultural activities which is covered under the general permission.**

Therefore, CA Sanyam is **not guilty** of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949 and complain of neighbor to the Institute is not correct.

77. CA Ravi, a practising Chartered Accountant, was proprietor of M/s Ravi & Associates. CA Ravi died on 15th September, 2020 due to cardiac arrest. Only family member left behind CA Ravi was his wife, Roohi. On 30th September, 2021, Roohi sold the practice of her husband to CA Balwan for ₹ 25 Lacs along with right to use the firm name i.e., M/s. Ravi & Associates and requested the Institute to consider the effect of such sale. Give your comments on the following issues with reference to the Chartered Accountants Act, 1949 and Schedules thereto:
(i) Whether Roohi can sell the practice to CA Balwan?
(ii) Can CA Balwan continue to practice as proprietor in name of M/s Ravi & Associates? [May-22]

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 is being 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.

It further lays down that the sale is permitted subject to certain conditions like such a **sale is completed/effected in all respects and the Institute's permission to practice in deceased's proprietary firm name is sought within a year of the death of such proprietor concerned**. In respect of these cases, the name of the proprietary firm concerned would be kept in abeyance (i.e. not removed on receipt of information about the death of the proprietor as is being done at present) only upto a period of one year from the death of proprietor concerned as aforesaid.

In the given case, Mrs. Roohi, widow of Mr. Ravi, proprietor of M/s. Ravi & Associates, has sold the practice along with right to use the firm name after one year of his death for ` 25 lakhs. This sale is in effect the sale of goodwill.

From the discussion given above it can be concluded that:

(i) Mrs. Roohi **cannot sell the practice** of CA. Balwan with right to use the firm name.

(ii) CA Balwan **cannot continue to practice** in the name of the firm M/s. Ravi & Associates as a proprietor because the name of the firm M/s. Ravi & Associates would be kept in abeyance only up to a period of one year from the death of the proprietor.

78. CA K qualified as Chartered Accountant and started practice as proprietor in the name of M/s K & Associates in the year 2015-16. LST Limited, a listed entity, appointed M/s K & Associates as Statutory Auditor for the year ended 31st March, 2022. CA K signed the balance sheet of LST Limited for the year ended 31st March, 2022 on 14th May, 2022. M/s K & Associates never subjected themselves to the Peer Review process of the Institute since its inception of practice. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. [May-22]

Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available in general terms from the various pronouncements of the Institute is issued by way of Engagement and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers.

Audit of Listed Companies: Pursuant to SEBI Notification, statutory audit of listed companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s. K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, CA K, the proprietor signed the balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. CA K would be held guilty of professional misconduct under clause (9) of Part I of Second Schedule of the Chartered Accountants Act, 1949. Also, CA K did not comply with the SEBI Notification which was required to be complied with.

Alternative Solution

Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of misconduct if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. It requires every member of the institute to act within the framework of the Chartered Accountants Act, 1949 and the regulations and guidelines made by Council thereunder.

The Statement on Peer Review shall be deemed to be a guideline of the Council under Clause (1) of Part II of Second Schedule to the Act and it is obligatory for the Practice Unit to comply with the provisions contained in this Statement. As per the Statement every Practice Unit including its branches who has conducted Statutory Audit of Enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI(LODR) regulations, 2015, will be subject to Peer Review in accordance with this statement.

Audit of Listed Companies: Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, Mr K, the proprietor signed the Balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. Hence, CA K would be held guilty of professional misconduct under clause (1) of Part II of Second Schedule of the Chartered Accountants Act, 1949.

79. Mr. Shreyansh, a Chartered Accountant in practice was invited to deliver a seminar on Amendments in Schedule III and CARO 2020 which was attended by professionals as well as by representatives of various Industries. One section of audience raised a particular issue unique to the industry to which it pertains. Mr. Shreyansh enthusiastically explained the issue and elaborated how he solved this, for his client facing the same issue with worked out examples from the computer storage device using the actual data of one of his clients with full identification of client details being displayed to the group for the sake giving clarity on a topic in a real-life situation. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. [Nov-22]

Disclosure of Information to third Party: Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force.

SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired during his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

In the instant case, Mr. Shreyansh is a Chartered Accountant in practice and he was invited to deliver a seminar on Amendments in Schedule III and CARO 2020 which was attended by professional as well as by representatives of various industries. During his session, a query was raised on particular issue and Mr. Shreyansh used the actual data of one of his clients with full identification of client details displayed to explain and elaborate such query. Applying the above provision, the auditor cannot disclose the information in his possession without specific permission of the client.

Thus, CA. Shreyansh will be liable for professional misconduct under clause 1 of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

80. The Cashier of a company committed a fraud and absconded with the proceeds thereof. The Chief Accountant of the company also did not know when the fraud had occurred. In the course of the audit, the auditor failed to discover the fraud. After the audit was completed, however, the fraud was discovered by the Chief Accountant. Investigation made at that time indicates that the auditor did not exercise proper skill and care and performed his work in a desultory and haphazard manner. With this background, the Directors of the company intend to file disciplinary proceedings against the auditor. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. [Nov-22]

In the given case, in the course of audit, auditor failed to discover the fraud. It is clearly given that investigation indicated that the auditor did not exercise reasonable skill and care and performed his work in a casual and unmethodical manner.

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".

As per **SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements",** it can be concluded that the auditor did not plan and perform the audit with an attitude of professional skepticism.
Thus, having regard to this and a fraud has actually taken place during the year, committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.
From the facts given in the case and by applying Clause (7) and SA 240, it is clear that the auditor is guilty of professional misconduct and the directors can file disciplinary proceedings against the auditor.

81. CA Mehta was appointed as the Auditor of CS Ltd. for the year 2020-21 in the place of retiring auditor CA Gupta. CA Mehta accepted the appointment after obtaining a certificate from the management that the provisions of the Sections 139 and 140 of the Companies Act, 2013 have been complied with. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. [Nov-22]

In the given case, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management that the provisions of the Sections 139 and 140 of the Companies Act, 2013 have been complied with.

Clause (9) of Part I of the First Schedule to 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 Sections 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 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.

Under Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, the incoming auditor has to ascertain whether the Company has complied with the provisions of the above sections. The word "ascertain" means "to find out for certain". This would mean that the incoming auditor should find out for certain as to whether the Company has complied with the provisions of Sections 139 and, 140 of the Companies Act, 2013. In this respect, it would not be sufficient for the incoming auditor to accept a certificate from the management of the Company that the provisions of the above sections have been complied with. It is necessary for the incoming auditor to **verify the relevant records of the Company** and ascertain as to whether the Company has, in fact, complied with the provisions

of the above sections. If the **Company is not willing to allow the incoming auditor** to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor should **not accept the audit assignment**.

Applying the above clause to the given case, the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor, **CA Mehta should not have accepted the audit assignment**. But on the other hand, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management which is not enough and hence CA Mehta is deemed to be guilty of professional misconduct.

82. Mr. Joe, a practicing chartered accountant, has accepted an appointment as auditor of cooperative society and agreed to charge fees @ 7% of the profits of the society during the financial year 2020-21. Comment on action of Mr. Joe with reference to the Chartered Accountants Act, 1949 and Schedules thereto. [Dec-21 Old]

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, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed **regulation 192** which exempts certain professional services from the operation of Clause (10).

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 an auditor of a co-operative society, the fees may be based on a percentage of the paid-up capital or the working capital or the gross or net income or profits.

In the given case, Mr. Joe, a practicing Chartered Accountant, has acted an appointment as auditor of co-operative society and agreed to charge his professional fees on percentage of the profits of the society.

Therefore, Mr. Joe shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the profits of the co-operative society.

83. AJ & Associates and PK & Co., chartered accountant firms have joined the Network firm A to Z & Affiliates registered with Institute. AJ & Associates was statutory auditor of B Ltd. for last 10 years. Due to rotation of auditor as per section 139 (2) of Companies Act, 2013, B Ltd. retires AJ & Associates and appoints PK & Co., as auditor for the year 2020-21. Comment as per Chartered Accountant Act, 1949 - Guidelines for Networking.

[May-22 + MTP Sep-22]

As per **Council General Guidelines, 2008, Chapter XV, Guidelines for Networking,** once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular in those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.

In the given situation, AJ & Associates was statutory auditor of B Ltd. For last 10 years and due to rotation of auditor as per section 139(2) of the Companies Act, 2013 B L td., retires AJ & Associates and appoints PK & Co. as auditor for the year 2020-21.

It may be considered that AJ & Associates and PK & Co., chartered accountant firms have joined the network firm namely A to Z & Affiliates registered with Institute. In view of above Guidelines for Networking PK & Co., is disqualified for appointment as an auditor of B Ltd.

84. Comment on the following with reference to the with reference to the Chartered Accountants Act, 1949 and Schedules thereto: [RTP Nov-22]

(a) CA Dev started practice in Punjab in the year 2019. CA Dev issued 'Turnover Certificate' for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of availing cash credit facility and machinery term loan. Brother of CA Dev was proprietor of M/s. ASAUS Traders.

As per **Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949**, a Chartered Accountant in practice is deemed to be guilty 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.

Further, it is not permissible for a member to undertake the assignment of certification, wherein the client is relative of the member. The "relative" for this purpose would refer to the definition mentioned in Accounting Standard (AS) - 18.

In the given situation, CA Dev started practice in Punjab in the year 2019. CA Dev issued Turnover certificate for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of obtaining Loan. Brother of CA Dev is proprietor of M/s. ASAUS Traders. Brother is very well covered in the definition of relative mentioned in Accounting Standard (AS)-18.

Hence, CA Dev is **guilty** of professional misconduct.

(b) Aagam Private Limited requested CA Sheetal, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied and pasted by another Director of Aagam Private Limited. CA Sheetal, without verifying the genuineness of the resignation letter, digitally signed the form and the said form was uploaded on the website of Registrar of Companies.

As per **Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949**, a Chartered Accountant in practice is deemed to be guilty if he does not exercise due diligence or is grossly negligent in the conduct of this professional duties.

In the given case, Aagam Private Limited requested CA Sheetal, a practicing chartered accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied and pasted by another Director of Aagam Private Limited.

CA Sheetal, without verifying the genuineness of the Resignation Letter, digitally signed the Form and the said form was uploaded on the website of Registrar of Companies.

Due to forged resignation letter, the resignation of Mr. Rohit from directorship of the Aagam Private Limited had been occurred. It was noted that CA Sheetal had not taken any step to verify forged signature on resignation letter which anyone would have taken in normal circumstances.

Consequently, CA. Sheetal would be held liable for professional misconduct as per Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

85. CA Praful has recently qualified and has obtained certificate of practice. In the initial years, it is taking time to set up his clientele base. He is also conducting audit of few entities. Simultaneously, he plans to provide coaching to CA students online taking advantage of his fresh reservoir of knowledge. Therefore, he advertises his classes on various social media platforms. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. [MTP Nov-22]

Regulation 190A of CA Regulations, 1988 provides that a CAiP shall not engage in any business or occupation other than profession of accountancy except with permission of Council. Council has passed a resolution under Regulation 190A granting **general permission for private tutorship and part time tutorship under coaching organization of the Institute.**

Such general permission is subject to condition that direct teaching hours devoted to such activities **not exceed 25 hours a week** in order to perform attest functions.

However, **Clause 6 of Part I of First Schedule** to CA Act, 1949 states that CAiP shall be deemed to be guilty of professional misconduct, if he solicits clients or professional work either directly or **indirectly** by circular, advertisement, personal communication or interview or by any other means; Further, **advertisement of online coaching activities through social media platforms amounts to indirect solicitation** as well as solicitation by another means and violative of Clause 6/I/First.

Therefore, although a member in practice **can engage in private tutorship subject to Council Guidelines but cannot advertise coaching activities** as it amounts to indirect solicitation of clients and professional work.

In given case, CA Praful is providing coaching to CA students online and also advertising his classes on various social media platforms.

In view of above, CA. Praful is **guilty** of professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act 1949 for advertising his classes on various social media platforms.

86. Mr. P, a Chartered Accountant did not maintain books of account for his professional work on the ground that his income is assessed under Section 44ADA of the Income Tax Act, 1961. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. [Nov-22]

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. P is **guilty** of professional misconduct.

87. Mr. X is a practising Chartered Accountant. Mr. Y is a practising advocate representing matters in the court of law. X and Y decided to help each other in matters involving their professional expertise. Accordingly, Mr. X recommends Mr. Y in all litigation matters in the court of law and Y consults X in all matters relating to finance and

other related matters, which come to him in arguing various cases consequently they started sharing profits of their professional work. Is Mr. X liable for professional misconduct ? [Nov-22]

Sharing fees with Advocates: According to **Clause (2) of Part I of the First Schedule to the Chartered Accountants Act, 1949,** a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representati ve of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Furthermore, **Clause (3) of Part I of the First Schedule to the said Act** states that a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute.

However, a practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having suc . qualifications as prescribed by the Council under **Regulation 53-A** of the Chartered Accountants Regulations, 1988. Under the said regulation, the **member of "Bar Council of India" (Advocate) is included.**

Therefore, Mr. Y, a practicing advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Mr. X. Hence, Mr. X, a practicing Chartered Accountant, will **not be held guilty** under any of the abpve-mentioned clauses for paying and accepting part of profits to/from Mr. Y.

88. 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). [RTP/MTP May-23]

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**.

Test your Understanding

1. 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?

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.

2. 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?

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.

Past Exams/RTPs/MTPs/SM Questions

1. Key phases in the audit execution stage are Execution Planning, Risk and Control Evaluation, Testing and Reporting. Explain. (RTP Nov-18)

Key phases in the audit execution stage are: Execution Planning, Risk and Control Evaluation, Testing and Reporting.

1. Execution Planning: Prior to commencement of an audit engagement, it is important to lay down the roadmap for audit execution to ensure timely and quality audit results. The auditors need to plan their work in order to carry out the audit in an effective, efficient and timely manner. A detailed audit program is prepared laying down the audit objectives, scope and audit approach. The manpower requirement, audit team qualifications, and the time element, etc. are some of the important considerations during execution planning. In order to plan effectively, the auditor may need some more information about the audit area. A preliminary survey would help in gathering the required information.

2. Risk and Control Evaluation: For each segment of audit, the auditors should conduct a detailed risk and control assessment i.e. list the risks that must be reviewed in that segment, capture for each risk the controls that exist or those that are needed to protect against the risk and show for each control, the work steps required to test the

effectiveness of the controls. While making Risk & Control assessment it is necessary to borne in mind Materiality levels as the same is linked with Audit Risks.

3. Testing: Once a comprehensive understanding is gained of the key risks and the controls to be evaluated in a given audit area, the auditors should test the operating effectiveness of the controls to determine whether controls are operating as designed. There are multiple test methods which can be used to arrive at the conclusions on the effectiveness of the controls

4. Reporting: SA 700, "Forming an Opinion and Reporting on Financial Statements" establishes standards on the form and content of the auditor's report issued as a result of an audit performed by an auditor of the financial statements of an entity. The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements such as compliance of Provisions & Enactments of the Company Law, Accounting Standards framed by ICAI, latest Guidelines etc.

The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole. A measure of uniformity in the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur. A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report.

5. Other Important Considerations: In addition to above, there are certain other consideration which auditor is required to take care while executing the audit such as using the work of other auditor, using the work of an auditor's expert etc.

2. Cineplex, a movie theatre complex, is the foremost theatre located in Delhi. Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe, shops, pubs etc. located in the complex. Its other income includes advertisements exhibited within/outside the premises such as hoardings, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises. Cineplex appointed your firm as the auditor of the entity. Being the head of the audit team, you are, therefore, required to draw an audit programme initially in respect of its revenue and expenditure considering the above mentioned facts along with other relevant points relating to a complex. (Nov'19 New, MTP Apr'18)

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 accounted.

(2) Verify the system of relating to online booking of various shows and the system of realization of money.

(3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.

(iv) Verify the internal control system and its effectiveness relating to the **income from café, shops, pubs, game zone etc.**, located within the multiplex.

(v) Verify the system of control exercised relating to the **income receivable from advertisements exhibited within the premises** and inside the hall such as hoarding, banners, slides, short films etc.

(vi) Verify the **system of collection from the parking areas** in respect of the vehicles parked by the customers.

(vii) In the case of **payment to the distributors** verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
(viii) Verify the system of **payment of salaries and other benefits to the employees** and ensure that statutory requirements are complied with.
(ix) Verify the payments effected in respect of the **maintenance of the building** and ensure the same is in order.
(x) Verify the **insurance premium** paid and ensure it covers the entire assets.

3. As an auditor of garment manufacturing company for the last five years, you have observed that new venture of online shopping has been added by the company during current year. What factors would be considered by you in formulating the audit strategy of the company? (May'15 + SM)

Formulation of Audit Strategy: While formulating the audit strategy for a company, following factors may be considered –

General Factors:
(i) Determination of Characteristics of Audit: Identify the characteristics of the engagement that define 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) Preliminary Work: 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. BSA & Company, Chartered Accountants are duly appointed auditors of ASB LTD engaged in manufacturing of various FMCG products and having its manufacturing facilities spread across India. Senior partner CA B has called meeting of audit staff to plan the conduct of audit for the year 2019-20 and at the meeting he addresses as under: "SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing", states that to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit in an efficient and timely manner". In view of above, you are required to analyse and explain the benefits of Planning in an Audit of Financial Statements. (May'09)

SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing" states that to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit in an efficient and timely manner.

Benefits/Advantages of Planning in an Audit of Financial Statements: Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways described hereunder-

(i) **Attention to Important Areas** - Planning would help the auditor to devote appropriate attention to important areas of the audit.

(ii) **Timely resolution of Potential Problems** - It would also help the auditor identify and resolve potential problems on a timely basis.

(iii) **Proper Organisation and Management of Audit Engagement** - Adequate planning would help the auditor in properly organizing and managing the audit engagement so that it is performed in an effective and efficient manner.

(iv) **Proper Selection of Engagement Team** - Planning would assist the auditor in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.

(v) **Direction and Supervision of Engagement** Team - It would further facilitate the direction and supervision of engagement team members and the review of their work.

(vi) **Easy Coordination** - Also, planning would be helpful to the auditor in coordination of work done by auditors of components and experts.

6. "The auditor shall document (i) The overall audit strategy; (ii) The audit plan; and (iii) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes." Explain.

Documenting the Audit Plan

The auditor shall document-

(i) The **overall audit strategy**;

(ii) The **audit plan**; and

(iii) Any **significant changes made during the audit engagement** to the overall audit strategy or the audit plan, and the reasons for such changes.

(a) **Record of Key Decisions**: The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

(b) **Record of Nature**: Timing and Extent of Risk Assessment Procedures: 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. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

(c) **Record of reasons for Change in Audit Plans**: A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

7. You have been appointed as auditor of Bahubali Ltd. for the first time. Enumerate the factors to be considered while establishing an overall audit strategy and its benefits.

Factors while establishing Overall Audit Strategy:
Overall audit strategy would involve-
(i) Determination of Characteristics of Audit: Identify the characteristics of the engagement that define 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) Preliminary Work: 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 Resources: Ascertain the nature, timing and extent of resources necessary to perform the engagement.

Benefits of Overall Audit Strategy: The process of establishing the overall audit strategy assists the auditor to determine such matters as-
(i) Employment of Qualitative Resources: The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters.
(ii) Allocation of Quantity of Resources: The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas.
(iii) Timing of Deployment of Resources: When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates.
(iv) Management of Resources: How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.

8. Write a short note on Contents of an audit plan. (RTP Nov'20)

Contents of an Audit Plan: The auditor shall develop an audit plan that shall include a description of-

i. The **nature, timing and extent of planned risk assessment procedures**, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
ii. The nature, timing and extent of **planned further audit procedures** at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".
iii. **Other planned audit procedures** that are required to be carried out so that the engagement complies with SAs. The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.

Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

9. Discuss the relationship between overall audit strategy and audit plan. (Nov'16)

Relationship between the Overall Audit Strategy and the Audit Plan:

- The audit strategy provides the guidelines for developing the audit plan. It establishes the scope and conduct of the audit procedures and thereby works as basis for developing a detailed audit plan.
- Detailed audit plan would include the nature, timing and extent of the audit procedures to obtain sufficient appropriate audit evidence.
- The audit strategy is prepared before the audit plan.
- The audit plan contains more details than the overall audit strategy. • Audit strategy and audit plan are inter-related because change in one would result into change in the other.

10. As an internal auditor for a large manufacturing concern, you are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above. (MTP Apr'18)

The Internal Audit Programme in connection with Plant and Machinery and Tools and dies may be on the following lines:

(i) **Internal Control Aspects:** The following may be incorporated in the audit programme to check the internal control aspects-

a. Maintaining **separate register** for hired assets, leased asset and jointly owned assets.
b. Maintaining **register of fixed asset** and **reconciling to physical inspection** of fixed asset and to nominal ledger.
c. All **movements of assets are accurately recorded**.
d. **Authorisation** be obtained for –
    i. a declaring a **fixed asset scrapped**.
    ii. **selling** a fixed asset.
e. Check whether **additions to fixed asset register are verified and checked** by authorised person.
f. Proper **recording of all additions and disposal**.
g. Examining **procedure for the purchase of new fixed assets**, including written authority, work order, voucher and other relevant evidence.
h. **Regular review** of adequate security arrangements.
i. **Periodic inspection of assets** is done or not.
j. **Regular review of insurance cover requirements** over fixed assets

(ii) **Assets Register:** To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.

(iii) **Cost Report and Journal Register:** To review the cost relating to each plant and machinery and to verify items which have been capitalised.

(iv) **Code Register**: To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.

(v) **Physical Verification:** To see physical verification has been conducted at frequent intervals.

(vi) **Movement Register:** To verify

a. whether Movement Register for movable equipments and
b. log books in case of vehicles, etc. are being maintained properly.

(vii) **Assets Disposal Register:** To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.

(viii) **Spare Parts Register:** To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.

(ix) **Review of Maintenance:** To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.

(x) **Review of Obsolescence:** To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.

(xi) **Review of R&D:** To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

11. XY Ltd. is a manufacturing company, provided following details of wastages of raw materials in percentage, for various months. You have been asked to enquire into causes of abnormal wastage of raw materials. Draw out an audit plan. Wastage percentage are July 2017 2.5% Aug 2017 2.7% Sep 2017 2.4% Oct 2017 8.1%. (MTP Apr'18)

Audit Plan to locate the Abnormal Wastage of Raw Material: To locate the reasons for the abnormal wastage, the auditor should first of all assess the general requirements as under:

i. Procure a **list of raw materials**, showing the names and detailed characteristics of each raw material.
ii. Obtain the **standard consumption figures**, and ascertain the basis according to which **normal wastage figures** have been worked out. Examine the break-up of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.
iii. Examine the various records maintained for **recording separately the various lots purchased and identification of each lot with actual material consumption** and for ascertaining actual wastage figures therein.
iv. Obtain reports of **Preventive Maintenance Programme** of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrappage work.
v. Assess whether **personnel employed are properly trained and working efficiently**.
vi. See whether **quality control techniques** have been consistent or have undergone any change.
vii. Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.
viii. Examine whether the **basis adopted for calculating wastage** for September is the same as was adopted for the other three months.
ix. Obtain a **statement showing break up of wastage figures** in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

12. Mr. S & Mr. J are a senior and junior articled assistant respectively, in a renowned audit firm. Both were assigned statutory audit of a manufacturing company. Mr. S instructed his junior to draft an audit plan by taking reference from a similar client (a partnership firm) who was engaged in the same business. Mr. J was confused as to how that reference could suit in this case, since the nature and extent of planning would vary for both clients. After few days, the audit work commenced. During the course of the audit, certain events took place, which made Mr. J to rethink about the audit plan initially designed. He approached Mr. S and enquired about when would an audit plan require a change. Comment about both the situations face by Mr. J in the above situation. (MTP Oct-21)

SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing" states that in order to achieve the overall objectives of the audit, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit, in an efficient and timely manner. So far as the nature of planning is concerned, it would vary according to-

(i) Size and Complexity of the Auditee - If the size and complexity of organization of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small.

(ii) Past Experience & Expertise - The key engagement team members' previous experience & expertise also contributes towards variation in planning activities.

(iii) Change in Circumstances - Another factor contributing towards variation in planning activities is change in circumstances.

Changes to Audit Planning: The auditor should update and change the overall audit strategy and audit plan as necessary during the course of the audit. The auditor may need to modify the overall audit strategy and audit plan due to the factors such as

(i) **result of unexpected events,**
(ii) **changes in conditions**, or
(iii) the **audit evidence obtained** from the results of audit procedures.

Further, the auditor would also have to modify the nature, timing & extent of further audit procedures, based on the revised considerations of assessed risks. This may be the case when information coming to the auditor differs significantly from the information when he planned the audit process.

In addition to the above, there may be possibilities of change in law, notifications, government policies, which warrants updation of overall audit strategy and audit plan.

13. CA. Raj is the auditor of a multiplex cinema house. He has observed during the course of the audit, that the existing venue has undergone renovation. The auditorium was split into smaller ones and additional auditoriums were constructed. CA. Raj, who finalised the audit plan and audit programme wanted to reconsider the same during the course of the audit. Discuss a few circumstances where the audit programme would have to be suitably altered by the auditor. [Nov-22]

Given below are a few circumstances where in the audit programme would have to be suitably altered:

(1) If audit procedures were **designed for a certain volume of turnover and subsequently the volume have substantially increased**. Also, when there have been **significant changes in the accounting organisation, procedures and personnel** subsequent to the audit procedures.

(2) Where during the course of an audit, it has been discovered that **internal control procedures were not as effective as assumed** at the time the audit programme was framed.

(3) Where there has been an **extraordinary increase in the amount of book debts** or that **in the value of stocks** as compared to that in the previous year.

(4) When a **suspicion has aroused during the course of audit or information has been received** that **assets** of the company have been **misappropriated**.

It may be noted that the audit plan and related programme should be reconsidered as the audit progresses. Such re-consideration is based on the auditor's review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures.

Case Scenario

1. 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.

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

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.

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 crowdfunding 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?

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?

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.

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.

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.

Past Exams/RTP/MTPs/SM Questions

1. 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. (SM)

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.

2. 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? (SM)

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**.

3. New Life Hospital is a multi-speciality hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. According to you, which basis system of control has been violated? Also list down the other general conditions pertaining to such system which needs to be maintained and checked by the management. (Nov-15)

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.

4. 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. (MTP Oct-20)

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 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%

5. PADHAM Ltd is engaged in the business of manufacturing of carpets. The company is planning to expand and diversify its operations. The management has increased the focus on internal controls to ensure better governance. The management discussed 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.
(a) Name the key steps and phases involved in Risk Based Audit.
(b) Also, discuss the steps to be taken for the risk assessment phase of the audit. [RTP May-22]

(a) The auditor's objective in a risk-based audit is to obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist in the financial statements.

This involves the following three key steps:

- Assessing the risks of material misstatement in the financial statements
- Designing and performing further audit procedures that respond to assessed risks and reduce the risks of material misstatements in the financial statements to an acceptably low level; and
- Issuing an appropriate audit report based on the audit findings.

The risk-based audit process is presented in three distinct phases:

- Risk assessment.
- Risk response; and
- Reporting.

(b) The risk assessment phase of the audit involves the following steps:

- Performing **client acceptance or continuance procedures**;
- Planning the **overall engagement**;
- Performing **risk assessment procedures** to understand the business and identify inherent and control risks;
- Identifying **relevant internal control procedures** and assessing their design and implementation (those controls that would prevent material misstatements from occurring or detect and correct misstatements after they have occurred);
- **Assessing the risks of material misstatement** in the financial statements;
- **Identifying the significant risks** that require special audit consideration and those risks for which substantive procedures alone are not sufficient;
- **Communicating any material weaknesses** in the design and implementation of internal control to management and those charged with governance; and
- **Making an informed assessment of the risks of material misstatement** at the financial statement level and at the assertion level.

6. 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? (RTP Nov 19)

Points of general condition as discussed in Q3 +

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.

7. In the use of standardized Internal Control Questionnaire (ICQ), certain basic assumptions about elements of a good internal control system are taken into account. List down few such assumptions. (Nov 18 New)

In the use of standardized internal control questionnaire, **certain basic assumptions about elements of good control are taken into account.**

These are -
(i) Certain procedures in general used by most business concerns are essential in achieving reliable internal control. This is a time-tested assumption. **Deposit into bank of the entire receipts of a day** or **daily balancing of the cash book** and ledgers or **periodic reconciliation** with the control accounts are examples of widely used practices which are considered good internal control practices. Besides, basic operations giving rise to these practices exist in all businesses irrespective of their nature.
(ii) Organisations are such that permit an **extensive division of duties and responsibilities**. The larger the organisation, the greater is the scope of such division.
(iii) Employees concerned with **accounting function are not assigned any custodial function**.
(iv) **No single person is thrust with the responsibility** of completing a transaction all by himself.
(v) There should always be **evidence to identify the person who has done the work** whether involving authorisation, implementation or checking.

8. A newly qualified professional has received his first appointment as auditor of a large company and is very much concerned about the effectiveness of internal control and wants to assess and evaluate the control environment as part of his audit program. Towards achieving his objective, he seeks your help in knowing the Standard Operating Procedures (SOPs) of assessment and evaluation of control. (May'19 + Nov-21 + RTP May-23)

Standard Operating Procedures (SOPs): A well-defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover.

(i) **Enterprise Risk Management:** An organization,which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.

(ii) **Segregation of Job Responsibilities:** A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person.

(iii) **Job Rotation in Sensitive Areas:** Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example, if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.

(iv) **Delegation of Financial Powers Document:** As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.

(v) **Information Technology based Controls:** With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example, at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

9. Explain the concept of Integrated framework issued by Committee of the Sponsoring Organisations of the Treadway Commission (COSO Framework) duly mentioning its four out of five components and discuss the three category of objectives that can be achieved as per COSO framework. (Jan'21 New)

COSO's Internal Control – Integrated Framework was introduced in 1992 as guidance on how to establish better controls so companies can achieve their objectives. COSO categorizes entity-level objectives into operations, financial reporting, and compliance. The framework includes more than 20 basic principles representing the fundamental concepts associated with its five components: control environment, risk assessment, control activities, information and communication, and monitoring. Some of the principles include key elements for compliance, such as integrity and ethical values, authorities and responsibilities, policies and procedures, and reporting deficiencies.

Five Components of COSO are as follows:

(i) Control Environment
(ii) Risk Assessment
(iii) Control Activities
(iv) Information and Communication

The COSO Framework is designed to be used by organizations to assess the effectiveness of the system of internal control to achieve objectives as determined by management. The Framework lists three categories of objectives as below:

1 **Operations Objectives** – related to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.

2 **Reporting Objectives** – related to internal and external financial and non-financial reporting to stakeholders, which would encompass reliability, timeliness, transparency, or other terms as established by regulators, standard setters, or the entity's policies.

3 **Compliance objectives** – In the Framework, the compliance objective was described as "relating to the entity's compliance with applicable laws and regulations." The Framework considers the increased demands and complexities in laws, regulations, and accounting standards.

10. During process of extracting exception reports, auditor noted numerous purchase entries without valid purchase orders. In terms of percentage, about 40% of purchases were made without valid POs and also few POs were validated after actual purchase. Also there was no reconciliation between goods received and goods ordered. You are required to briefly explain audit procedures to address validity of account balance level. (MTP Apr-21)

In the given scenario, the auditors noted numerous purchase entries without valid purchase orders during the process of extracting the exception reports. Further, in terms of percentage, about 40% of purchases were made without valid purchase orders and also few purchase orders were validated after the actual purchase. Also there was no reconciliation between the goods received and the goods ordered.

Audit Procedures: The following procedures may address the validity of the account balance:

- Make a **selection of the purchases**, review correspondence with the vendors, purchase requisitions (internal document) and reconciliations of their accounts.
- **Review Vendor listing** along with the **ageing details**. Follow up the material amounts paid before the normal credit period and analyse the reasons for exceptions.
- **Meet with the company's Purchase officer** and obtain responses to our inquiries regarding the purchases made without purchase orders.
- Discuss the **summary of such issues with the client**.

11. Your engagement team is seeking advice from you as engagement partner regarding steps for risk identification. Elaborate. [SM]

Steps for Risk Identification

- **Assess the significance of the assessed risk**, impact of its occurrence and also revise the materiality accordingly for the specific account balance.
- Determine the **likelihood for assessed risk** to occur and its impact on our auditing procedures.
- Document the assertions that are effected.
- Consider the **impact of the risk** on each of the assertions (completeness, existence, accuracy, validity, valuation and presentation) relevant to the account balance, class of transactions, or disclosure.
- Identify the **degree of Significant risks** that would require separate attention and response by the auditor. Planned audit procedures should directly address these risks.
- Enquire and **document the management's response**.
- Consider the **nature of the internal control system** in place and its possible effectiveness in mitigating the risks involved. Ensure the controls :
  - Routine in nature (occur daily) or periodic such as monthly.

- ❖ Designed to prevent or detect and correct errors.
- ❖ Manual or automated.

➢ Consider **any unique characteristics of the risk.**

➢ Consider the **existence of any particular characteristics (inherent risks)** in the class of transactions, account balance or disclosure that need to be addressed in designing further audit procedures.
Examples could include high value inventory, complex contractual agreements, absence of a paper trail on certain transaction streams or a large percentage of sales coming from a single customer.

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

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 overutilizing 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].

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

Test Your Understanding

1. 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?

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.**

2. 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.

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.

Past Exams, MTPs, RTPs & SM Questions

1. CA. Vimal is the auditor of Excellent Ltd., a parent company which presents Consolidated Financial Statements. The management of Excellent Ltd. has provided the list of the components included in the Consolidated Financial Statements. As an auditor of Consolidated Financial Statements, CA Vimal has to verify that all the components have been included in the Consolidated Financial Statements and review the information provided by the management in identifying the components. State the procedures to be followed by CA. Vimal in respect of completeness of this information. (Nov 20 + RTP May-23)

A parent which presents consolidated financial statements is required to consolidate all its components in the consolidated financial statements other than those for which exceptions have been provided in the relevant accounting standards under the applicable financial reporting framework.

The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion.

In the given case, Excellent Ltd has provided the list of components included in the consolidated financial statements (CFSs). CA Vimal shall verify that all the components have been included in the CFS.

Further, in respect of completeness of this information, CA Vimal should perform the following procedures:

i. review his **working papers for the prior years** for the known components;
ii. review the **parent's procedures** for identification of various components;
iii. make **inquiries of the management** to identify any new components or any component which goes out of consolidated financial statements;
iv. review the **investments** of parent as well as its components to determine the shareholding in other entities;
v. review the **joint ventures** and **joint arrangements** as applicable;
vi. review the **other arrangements** entered into by the parent that have not been included in the consolidated financial statements of the group;

vii. review the **statutory records** maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013;

viii. Identify the **changes in the shareholding** that might have taken place during the reporting period.

2. 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. (Nov 18 New)

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 no 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 SI 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**.

3. H Co. Ltd., is a holding company with two subsidiaries R Co. Ltd., and S Co. Ltd. The H Co. Ltd., adopts straight line method of depreciation for its assets whereas S Co. Ltd., follows written down value or diminishing value method. Though R Co. Ltd., follows straight line method of depreciation, it does not give effect to component accounting of depreciation in respect of high value assets. While consolidating the financials of the R Co. Ltd., and S Co. Ltd., with those of H Co. Ltd., determine the possible issues that you have to ensure for compliance in the light of above facts. (May-18)

When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework is Different than that of the Parent: A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the **group accounting manual**, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally **contain all accounting policies, including relevant disclosure requirements**, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared.
Thus, using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements.

It may be noted that **change in the selection of the method of depreciation is an accounting estimate and not an accounting policy as per Ind-AS 8**. Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, **there can be different methods for calculation of depreciation** for its assets, if their expected pattern of consumption is different. The method once selected in the standalone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

In the given case, assets of R Co. Ltd. (subsidiary company) is depreciated using straight line method, assets of S Co. Ltd. (subsidiary company) are depreciated using written down value method and assets of parent company (H Co. Ltd.) are depreciated using straight line method, is in order. However, each part of an item of Property Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately under Component Method of Depreciation as per AS 10 on Property, Plant and Equipment.

Thus, R Co. Ltd., though adopting straight line method but does **not giving effect to component accounting of depreciation in respect of high value assets , is not in compliance with Ind AS 16/ Accounting Standard 10 Property Plant and Equipment.**

4. Before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. What are the important aspects that an auditor should consider in audit plan? (Jan'21 New)

Before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. **The auditor should make plans, among other things, for the following:**

i) Understanding of the **group structure and group-wide controls** including assessment of Information Technology (IT) system and related general and applications IT related controls (manual and automated) for consolidation process;
ii) Understanding of **accounting policies** of the parent and its components as well as of the consolidation process including the process of translation of financial statements of foreign components;
iii) Determining and programming the **nature, timing, and extent of the audit procedures** to be performed based on the assessment of the risk of material misstatement in the consolidation process;
iv) Determining the **extent of use of other auditor's work in the audit**; and
v) **Coordinating** the work to be performed.

A parent which presents consolidated financial statements is required to consolidate all its components in the consolidated financial statements other than those for which exceptions have been provided in the relevant accounting standards under the applicable financial reporting framework.

The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion.

5. R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its financial statements since 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 the Statutory Auditor of R Ltd, how would you deal when the consolidated financial statements are to be drawn up in compliance with Ind AS? (May 19 Old)

As per **Ind AS 110, there is no exemption for temporary control** where the shares are held as stock in trade, even though there is an exemption under AS 21. Hence consolidation is mandatory for Ind AS compliant financial statement in this case.

Therefore, R Ltd. is required to prepare Consolidated Financial Statements including S Ltd. as a subsidiary company in accordance with Ind AS 110. The auditor is required to ensure the compliance of the same. In case the **management does not agreed for the same the auditor may modify the report accordingly.**

6. M Ltd. acquired 51 % shares of S Ltd. on 01-04-2018 and sold 25% of these shares during the financial year 2018-19. M Ltd. did not prepare Consolidated Financial Statements for the financial year 2018-19 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. (Nov-19)

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 01.04.2018 and sold 25% shares during the year ended 2018-19. M Ltd did not consolidate the financial statements of S Ltd for the year ended 31.03.2019 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.

7. Atishaya Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of Neenu Ltd. While planning the statutory audit of Atishaya Ltd., what factors would be considered by you as the statutory auditors of Atishaya Ltd for the audit of its consolidated financial statements prepared under Ind AS?

10% Voting Power and Control over the composition of Board of Directors:

- In this case, Atishaya Ltd holds only 10 percent of the voting power but has control over the composition of Board of Directors of Neenu Ltd. In such a case, Atishaya Ltd shall be considered as parent of Neenu Ltd and, therefore, it would consolidate Neenu Ltd in its consolidated financial statements as a subsidiary.
- The auditor should **verify Atishaya Ltd's management's assessment of having control** in Neenu Ltd despite having only 10% voting power as per the requirements of Ind AS 110. Auditor would need to verify as to how Atishaya Ltd controls composition of Board of Directors or corresponding governing body of Neenu 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 Neenu 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 Atishaya Ltd and Neenu Ltd and determining and programming the **nature, timing, and extent of 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).

8. Responsibility of holding company for preparation of Consolidated Financial Statements. (RTP Nov 21)

Responsibility of holding company for preparation of Consolidated Financial Statements: The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent.

This includes:

a. **identifying components,** and including the financial information of the components to be included in the consolidated financial statements;
b. where appropriate, identifying **reportable segments** for segmental reporting;
c. identifying **related parties and related party transactions** for reporting;
d. obtaining **accurate and complete financial information** from components;
e. making appropriate **consolidation adjustments**;
f. harmonization of **accounting policies and accounting framework**; and
g. **GAAP conversion**, where applicable.

Apart from the above, parent ordinarily issues instructions to management of component specifying requirements relating to financial information of components to be included in consolidated financial statements. Instructions ordinarily cover accounting policies to be applied, statutory and other disclosure requirements applicable to the parent, including the identification of and reporting on reportable segments, and related parties and related party transactions, and a reporting timetable.

9. Auditor's objectives in an audit of consolidated financial statements. (RTP Nov-19)

The auditor's objectives in an audit of consolidated financial statements are:

i) to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of **applicable financial reporting framework**;
ii) to enable himself to express an **opinion on the true and fair view** presented by the consolidated financial statements;
iii) to **enquire into the matters as specified in section 143(1)** of the Companies Act, 2013; and.
iv) to **report on the matters** given in the clauses (a) to (i) of section 143(3) of the Companies Act, 2013, for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014.
v) The auditor should also **validate the requirement of preparation of CFS** for the company as per applicable financial reporting framework.

10. The adjustments required for preparation of consolidated financial statements are made in memorandum records kept for the purpose, by the Parent. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements. Elucidate the other points, apart from reviewing the memorandum records, the auditor should verify while consolidation of adjustments for current period. (July-21 Old)

The adjustments required for preparation of consolidated financial statements are made in memorandum records kept for the purpose by the parent. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements.

Apart from reviewing the memorandum records, the auditor should inter alia:

i) verify that the **intra group transactions and account balances have been eliminated**;
ii) verify that the consolidated financial statements have been prepared using **uniform accounting policies** for like transactions and other events in similar circumstances;
iii) verify that adequate disclosures have been made in accordance with AS 21 in the consolidated financial statements of **application of different accounting policies** in case, it was impracticable to harmonize them. Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so but while preparing CFS under Ind AS, auditors should ensure that appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies in accordance with Ind AS 110;
iv) verify the adjustments made to **harmonise the different accounting policies** including adjustments made by management to convert a component's financial statements prepared under the component's GAAP to the GAAP under which the consolidated financial statements are prepared;
v) verify the calculation of **minorities/non-controlling interest**;
vi) verify **adjustments relating to deferred tax** on account of temporary differences arising out of elimination of profit and losses resulting from intergroup transactions (where the parent's accounts are maintained in Ind AS);
vii) verify that **income and expenses of the subsidiary** are included in consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognised in consolidated financial statements at the acquisition date (where the consolidated financial statements are prepared under Indian Accounting Standards.)

The auditor should gain an understanding of the procedures adopted by the management of the enterprise to make the abovementioned adjustments. This helps the auditor in reducing the audit risk to an acceptably low level.

11. You are appointed as an auditor of Azad Limited, a listed company which is a main supplier to the USA building and construction market. With a turnover of Rs.1.6 billion, the company operates through 9 business units and has nearly 135 branches across the countries. As an auditor, how will you draft the report in case
(i) When the Parent's Auditor is also the Auditor of all its Components? and
(ii) When the Parent's Auditor is not the Auditor of all its Components? (MTP Nov-20)

(i) When the Parent's Auditor is also the Auditor of all its Components: While drafting the audit report, the auditor should report whether principles and procedures for preparation and presentation of consolidated financial statements as laid down in the **relevant accounting standards have been followed**. In case of any departure or deviation, the auditor should make adequate disclosure in the audit report so that users of the consolidated financial statements are aware of such deviation. Auditor should issue an audit report expressing **opinion whether the consolidated financial statements give a true and fair view** of the state of affairs of the Group as on balance sheet date and as to whether consolidated profit and loss statement gives true and fair view of the results of consolidated profit or losses of the Group for the period under audit. Where the consolidated financial statements also include a cash flow statement, the auditor should also give his opinion on the true and fair view of the cash flows presented by the consolidated cash flow statements.

(ii) When the Parent's Auditor is not the Auditor of all its Components: In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should **also consider the requirement of SA 600 "Using the Work of Another Auditor".**
As prescribed in **SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report"**, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should **disclose clearly the magnitude of the portion** of the financial statements **audited by the other auditor**(s). This may be done by **stating aggregate rupee amounts or percentages of total assets, revenues and cash flows** of components included in the consolidated financial statements not audited by the parent's auditor. Total assets, revenues and cash flows not audited by the parent's auditor should be presented **before giving effect to permanent and current period consolidation adjustments**. Reference in the report of the auditor on the consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is **not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility** between the auditors of the parent and its subsidiaries.

12. M & B Investments Ltd. is a company having paid up share capital of 1 Crore. It has a subsidiary, Investors Fund Management Ltd. Major business of M & B Investments Ltd. is to pool money from investors on a collective basis and invest this money in various funds. This company pooled = 10 Crore from a number of clients, which represent the Company's shareholders. While auditing books of accounts of M & B Investments Ltd. CA. X observed that whole amount of 10 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company. Performance of all of its investments is measured on fair value basis. Now, CA X raised an issue while auditing financial statements of M & B Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013 ? Analyse the above issue and give your opinion.

[Dec-21 New + RTP Nov-22]

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.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder.

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**.

An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to **measure all of its subsidiaries at fair value through profit or loss**.

A parent shall determine whether it is an investment entity. However, as per paragraph 33 of Jnd AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Applying the above to the given case of M&B Investment Ltd, which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 and 33 of Ind AS 110, it can be concluded that **M&B Investment Ltd is not required to consolidate** as per Section 129 (3) of the Companies Act, 2013.

13. CAH was appointed as a Statutory Auditor of MNL Limited, a listed 5 company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India. Auditors are duly appointed for the subsidiaries and branches as well. With regard to the determination of materiality during the audit of consolidated financial statements what should be the considerations of CA H ?

How he should deal in his report if there are observations (for instance modification and/or emphasis of matter in accordance with SA 705/706) made by component auditors ? [May-22]

With regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

- The auditor is required to **compute the materiality for the group as a whole**. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.
- The parent auditor can also use the **materiality computed on the group level to determine whether the component's financial statements are material** to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.
- The principal auditor also computes **materiality for each component and communicates to the component auditor**, if he believes is required for true and fair view on CFS.
- The principal auditor **also obtains certain confirmations from component auditor** like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 needs to be considered. ICAI issued an announcement dated May 25, 2017 which amended paragraph 17 of Guidance Note and states that while considering the observations (for instance modification and /or emphasis of matter/other matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor".

14. ABC Limited holds 51% equity of BBB Limited, 63% equity of TTT Limited. There are different information and explanations which are disclosed by the respective companies in the notes to their financial statements. At time of

consolidation, management of ABC Limited has consolidated all the information and explanations disclosed in the notes as well. The principal auditor is of the view that only those information and explanations should form part of the notes to the consolidated financial statements which are relevant at group level. Please mention any five aspects which are given in the notes to the separate financial statements of the parent and the subsidiaries, need not be included in the consolidated financial statements. [Nov-22]

In case of companies, information such as following given in notes to the separate financial statements of the parent and/or the subsidiary, need not be included in the consolidated financial statements.

i) **Source from which bonus shares are issued**, e.g., capitalisation of profits or reserves or from securities premium account.

ii) **Disclosure of all unutilised monies** out of the issue indicating the form in which such unutilised funds have been invested.

iii) **Disclosure required under Micro, Small and Medium Enterprises Development Act**, 2006.

iv) A **statement of investments** (whether shown under "financial assets or non-financial assets as stock-in-trade) separately classifying trade investments and other investments, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate.

v) Value of **imports calculated on C.I.F. basis** by the company during the financial year in respect of:
   a. raw materials;
   b. components and spare parts;
   c. capital goods.

vi) **Expenditure in foreign currency** during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters.

vii) Value of all **imported raw materials, spare parts and components consumed** during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.

viii) The **amount remitted during the year in foreign currencies** on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.

ix) **Earnings in foreign exchange** classified under the following heads, namely:
   (a) export of goods calculated on F.O.B. basis;
   (b) royalty, know-how, professional and consultation fees;
   (c) interest and dividend;
   (d) other income, indicating the nature thereof.

However, notwithstanding the above, the auditor needs to ensure compliance with disclosure requirements of applicable accounting standards and other applicable laws for consolidated financial statements.

Case Scenario

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 Rs.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.

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

Test Your Understanding

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?

An account becomes **NPA when it ceases to generate income for bank**. In given situation, all 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.

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.

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.

Past Exam/RTP/MTPs/SM Questions

1. CA K have been doing audit of branch of LUD Bank Ltd. The principal business of the branch is lending advances to large corporates. Since last one year, many large accounts have become Non-Performing Asset (NPA) as per guidelines. The Management of the Bank decided to sell one of the NPA account and consequently one NPA namely DEF Ltd. amounting to ₹ 10.00 Crores was sold to Asset Reconstruction Company. What audit points CA K should keep in mind while doing audit of this transaction? (Jan 21 New + MTP Sep-22)

CA K conducting audit of branch of LUD Bank Ltd. whose principal business is lending money to large corporates. Many large accounts of this branch have turned NPA category and Management sold DEF Ltd.'s NPA account amounting to ₹ 10 Crores to Asset Reconstruction Company.

CA K should proceed as under: In case of Sale of NPA by Bank, the auditor should examine

i) the **policy laid down by the Board of Directors** in this regard relating to procedures, valuation and delegation of powers.
ii) only such NPA has been sold which has **remained NPA in the books of the bank for at least 2 years**.
iii) the assets have been sold **"without recourse'** only.
iv) subsequent to the sale of the NPA, the bank **does not assume any legal, operational or any other type of risk** relating to the sold NPAs.
v) the NPA has been sold at **cash basis** only.
vi) on the sale of the NPA, the same has been **removed from the books** of the account.
vii) the **short fall in the net book value** has been charged to the profit and loss account.
viii) where sale is for a value higher than the NBV, **no profit is recognised** and the **excess provision has not been reversed but retained to meet the shortfall**/ loss because sale of other non-performing financial assets.

2. In the course of statutory Branch audit of KS Bank Ltd, you observe that some borrower accounts have been regularised before Balance sheet date by payment of overdue amount. Narrate the audit procedures to be carried out with special focus on the Classification of advances and Provisioning for Non-Performing assets of the Branch. (Nov 20 New)

The Audit procedures that need to be carried out with special focus on classification of advances and provisioning for NPAs of KS Bank Ltd, in which the auditor has observed that some borrower accounts have been regularized before balance sheet date by payment of overdue amount shall be carried out as under :

i) As per the Reserve Bank guidelines, if an account has been **regularised before the balance sheet** date by payment of overdue amount through genuine sources, the account need **not be treated as NPA**.

ii) Where **subsequent to repayment** by the borrower (which makes the account regular), the branch has **provided further funds to the borrower** (including by way of subscription to its debentures or in other accounts of the borrower), the auditor should **carefully assess** whether the repayment was out of genuine sources or not.

iii) Where account indicates **inherent weakness** based in the data available, the account shall be **deemed as a NPA.**

Classification and Provision

a. Examine whether the **classification made by the branch is appropriate**. Particularly, examine the classification of advances where there are **threats to recovery**.

b. Examine whether the **secured and the unsecured portions of advances have been segregated** correctly and provisions have been calculated properly.

c. It is to be ensured that the **classification is made as per the position as on date** and hence classification of **all standard accounts be reviewed as on balance sheet date**.

d. The date of NPA is significant to determine the classification and hence specific care be taken in this regard.

e. NPA should be recognized **only based on concept of Past Due/ Overdue concept**, and not based on the Balance Sheet date.

3. 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? (Nov-19/22)

Evaluation of the Internal Control System in the area of Credit Card Operations of a bank:

i) There should be **effective screening of applications** with reasonably good credit assessments.

ii) There should be **strict control over storage and issue of cards**.

iii) There should be a **system whereby a merchant confirms the status of unutilised limit** of a credit-card holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.

iv) There should be a **system of prompt reporting by the merchants** of all settlements accepted by them through credit cards.

v) **Reimbursement to merchants** should be made only after verification of the validity of merchant's acceptance of cards.

vi) All the reimbursement (gross of commission) should be **immediately charged to the customer's account**.

vii) There should be a system to ensure that **statements are sent regularly and promptly to the customer**.

viii) There should be a system to **monitor and follow-up customers' payments**.

ix) Items **overdue beyond a reasonable period should be identified and attended to carefully**. Credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.

x) There should be a system of **periodic review of credit card holders' accounts**. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

4. 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. (May 19 New)

Special audit considerations arise in the audit of banks because of:

i) the **particular nature of risks** associated with the transactions undertaken;

ii) the **scale of banking operations and the resultant significant exposures** which can arise within short period of time;

iii) the **extensive dependence on IT** to process transactions;

iv) the **effect of the statutory and regulatory requirements**;

v) the **continuing development of new products and services** and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices;

vi) **Evolution of technology** and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk.

The auditor should consider the effect of the above factors in designing his audit approach.

5. You are the Concurrent Auditor of a Branch of Nationalized Bank which deals in foreign exchange transactions. Give focus areas of your checking in this respect. (Nov 18 New + Nov-21 New)

Focus Areas in case of Foreign Exchange Transactions:

- Check foreign bills negotiated under **letters of credit**.
- Check **FCNR and other non-resident accounts** whether the debits and credits are permissible under rules.
- Check whether **inward/outward remittance** have been properly accounted for.
- Examine **extension and cancellation of forward contracts** for purchase and sale of foreign currency. Ensure that they are duly authorised and necessary charges have been recovered.
- Ensure that **balances in Nostro accounts** in different foreign currencies are within the limit as prescribed by the bank.
- Ensure that the **overbought/oversold position** maintained in different currencies is reasonable considering the foreign exchange operations.
- Ensure adherence to the **guidelines issued by RBI/HO** of the bank about dealing room operations.
- Ensure **verification/reconciliation of Nostro and Vostro account** transactions/ balances.

6. INDO Bank appointed your firm of Chartered Accountants as a branch auditor for the financial year 2018-19. Being head-in-charge of the assignment, while planning, you distributed the work among your team members and assigned Mr. Pary for verification of bills payable. However, Mr. Pary, being fresh to the bank audits, needs your guidance. Kindly guide. (MTP Oct 19)

Bills Payable: Evaluate the **existence, effectiveness and continuity of internal controls** over bills payable.

Such controls should usually include the following-

- Drafts, mail transfers, traveller's cheques, etc. should be made out in **standard printed forms**.
- **Unused forms** relating to drafts, traveller's cheques, etc. should be kept under the custody of a responsible officer.
- The bank should have a **reliable private code** known only to the responsible officers of its branches, coding and decoding of the telegrams should be done only by such officers.
- The **signatures on a demand draft** should be checked by an officer with the specimen signature book.
- All the **telegraphic transfers and demand drafts issued** by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch.

Examine an **appropriate sample of outstanding items** comprised in bills payable accounts **with the relevant registers. Reasons for old outstanding debits** in respect of drafts or other similar instruments paid without advice should be ascertained.

Correspondence with other branches after the year-end (e.g., responding advices received from other branches, advices received from other branches in respect of drafts issued by the branch and paid by the other branches without advice) should be examined specially in so far as large value items outstanding on the balance sheet date are concerned.

7. Gupta & Co. has been appointed as a statutory auditor of TCB Bank Ltd., a private sector bank, registered with RBI. Mr. Kaival Gupta, the engagement partner, while performing the audit as per the checklist, noted down the following points, which would be part of the audit queries, as tabulated below:

Queries

1. Interest on State Government Guaranteed advance has been taken to income even though such advance has remained overdue for more than 90 days.

2. There is an account for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction and such account has been treated as a performing asset in the books.

3. One of the NPAs was sold for a value higher than the net book value. Profit was not recognized but the excess provision in respect of the same has been reversed.

4. In case of one of the accounts, an additional temporary limit has been sanctioned for 25% of the existing limit and for 120 days tenure.

You are required to provide the reasons due to which such queries would have been raised by Mr. Kaival and describe the actions that may be taken by the person responsible on behalf of TCB Bank Ltd. for solving such queries. (RTP Nov.21)

S No.	Reason for query	Action that may be taken in response to query
1	A State Government Guaranteed advance has to be treated as NPA even if it remains overdue for more than 90 days and in case of NPA, for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized.	Interest income recognized on such advance would be **reversed** and would be taken to **income only when it is realized**.
2	Accounts for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction, should be considered as NPA.	It's treatment in the books would be changed **from performing asset to a non-performing asset** from the date when such change in the treatment was required.
3	In case of sale of NPA, where the sale is for a value higher than the NBV, the auditor is required to ensure that no profit is recognized, and the excess provision has not been reversed but retained to meet the shortfall/ loss that may arise because of the sale of other nonperforming financial assets.	The entry for reversal of the excess provision would be cancelled in the books and such **excess provision would be retained to meet the shortfall/ loss that may arise** because of the sale of other non-performing financial assets.
4	Additional temporary limit may be sanctioned, for a maximum of 20% of the existing limit and 90 days maximum tenure.	The terms of additional temporary limit in case of such account would be **revised to 20% of the existing limit and for 90 days maximum** tenure.

8. You are auditing a small bank branch with staff strength of the manager, cashier and three other staff Peter, Prem and Pran. Among allocation of work for other areas, Peter 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. Prem has possession of all bank forms (e.g. Cheque books, demand draft/pay order books, travellers' 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. (RTP May-21 + SM)

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, Peter 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, Prem 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.

9. 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. (RTP Nov 19)

Contingent Liabilities for Banks: The Third Schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet-

(A) Contingent liabilities

i. Claims against the bank not acknowledged as debts.
ii. Liability for partly paid investments.
iii. Liability on account of outstanding forward exchange contracts.
iv. Guarantees given on behalf of constituents-
    1. In India.
    2. Outside India.
v. Acceptances, endorsements and other obligations.
vi. Other items for which the bank is contingently liable.

(B) Bills for collection.

10. 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. (SM)

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.

Author's Comment: A conceptual question on AS 9, if income certain, recognise on accrual basis. Otherwise not.

11. In course of audit of Good Samaritan Bank as at 31st March, 19 you observed the following: (SM)

(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?

(a) Government Guaranteed Advance: If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.
Since the bank has not 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 revers ed.

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.

(b) 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**.

Author's Note: This topic isn't covered in ICAI SM but given in Back questions, so just read through it.

12. 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. (SM)

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.**

Author Summary: Since no payment received > 90 days, it shall be classified as NPA. Certificate of lead bank is given in question just to confuse students.

13. ABC Bank had sanctioned credit limits of Rs.100 lakh to M/s Volkart Ltd on 1st September 2018. The renewal of limits was due on 1st September 2019. While doing the statutory branch audit for the year ended 31st March 2020, you find that the renewal has not been done even though 180 days are over. The bank says that the renewal process has been initiated on time and most of the document are received. The account is operated regularly and is in order; balance is maintained within drawing power. It also shows a letter from Volkart stating that due to a sudden death of their auditor, a new auditor had to be appointed. Procedure for appointment took some time and the new auditor was doing the audit all over again. The limit was not renewed till 31/3/2020. However, the audited financials are received on 10th April 2020 and the renewal letter was issued immediately. Your assistant is insisting that the account must be classified as NPA since the limit was not renewed as on 31/3/2020. What is your opinion? (SM)

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.

14. Your firm has been appointed as an auditor of a nationalised bank. You allocated the task of verifying Telegraphic Transfers and Demand Draft to your Audit Assistant. While verifying, the Audit Assistant informed you that there are a lot of irregularities in Telegraphic Transfers and Demand Drafts. What guidance would you give him? (MTP Apr-18)

In respect of Telegraphic Transfers and Demand Drafts, the audit assistant would be given the following guidance-

i. The bank should have a **reliable private code** known only to responsible officers of its branches, coding and decoding of telegrams should be done only by such officers.
ii. The **signatures** on a demand draft should be checked by an officer with the Signature Book.
iii. All the T.Ts and D.Ds. sold by a branch should be **immediately confirmed by the advices to the branches concerned.**
iv. If the **paying branch does not receive proper confirmation** of any T.T. or D.D. from the issuing branch or does not receive credit in its account with that branch, it should take **immediate steps to ascertain the reasons.**

15. M/s GH & Associates have been appointed as Central Statutory Auditors of BNB Bank, a nationalized bank, headquartered in New Delhi for the F.Y 2020-2021. Bank functions in automated environment using "FLC Software". While preparing audit report, one of the partner highlighted that some matters covered by Companies Act, 2013 and the requirements of Companies (Auditor's Report), Order, 2016 reporting:
You are required to answer the following:

i. **To which authority auditors should submit their audit report?**
ii. **List the matters covered under Companies Act, 2013 and**
iii. **Reporting under Companies (Auditor's Report), Order, 2020. (July-21 New)**

Ans: (i) Authority to whom Auditors to submit their Audit Report - In the case of a **nationalised bank,** the auditor is required to make a **report to the Central Government.**

So, GH & Associates, Central Statutory Auditors of BNB Bank- a nationalized bank, would be required to submit their report to Central Govt.

(ii) The auditor of a banking company is also required to state in the report the matters covered by Section 143 of the Companies Act, 2013.

1. Report on **adequacy and operating effectiveness of Internal Controls over Financial Reporting** in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.
2. Report on whether any **serious irregularity** was noticed in the working of the bank which requires immediate attention (in accordance with sec 143(12) of the Companies Act, 2013.)
3. As per **reporting requirements cast through Rule 11** of the Companies (Audit and Auditors) Rules, 2014 the auditor's report shall also include their views and comments on the following matters, namely:
   a) Whether the bank has disclosed the impact, if any, of the pending litigations on its financial position in its financial statements.
   b) Whether the bank has made provision, as required under the law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts.
   c) Whether there has been any delay in transferring amounts, required to be transferred to the Investor Education and Protection Fund by the bank.

(iii) Reporting requirements relating to the **Companies (Auditor's Report) Order, 2020 are not applicable** to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

16. M/s Aadi & Co., Chartered Accountants, have been allotted the branch audit of a nationalized bank for the year ended 31st March, 2021. You are part of audit team and have been instructed by your partner to verify the following areas:

(i) Fulfilment of the criteria prescribed for NPA norms for government guaranteed advance.

(ii) Fulfilment of the criteria prescribed for NPA norms for the advances given for agricultural purposes.

(iii) Drawing power calculation from stock statements in respect of working capital accounts.

(iv) Accounts where regular/ad hoc limits are not reviewed within 180 days from the due date/date of ad hoc sanction. What may be your areas of concern as regards matters specified above? (MTP Oct-21)

Govt Guaranteed Advance	• If 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. 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.
Agricultural Advances	• Ensure that NPA norms have been applied in accordance with the **crop season determined by the State Level Bankers' Committee** in each State. Depending upon the duration of crops – short term/ long term - raised by an agriculturist, the NPA norms would also be made applicable to agricultural term loans availed of by them. Also ensure that these norms are made **applicable to all direct agricultural advances listed in Master Circular on lending to priority sector**.

	• In respect of agricultural loans, other than those specified in the circular, ensure that identification of NPAs has been done on the same basis as non-agricultural advances.
Drawing Power Calculation	• Ensure that the drawing power is calculated **as per the extant guidelines** (i.e. the Credit Policy of the Bank) formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors. Special consideration should be given to **proper reporting of sundry creditors** for the purposes of calculating drawing power. • The **stock audit should be carried out by the bank for all accounts** having **funded exposure of more than stipulated limit**. The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power. The drawing power needs to be **calculated carefully in case of working capital advances to companies engaged in construction business**. The valuation of work in progress should be ensured in consistent and proper manner. It also needs to be ensured that **mobilization advance being received by the contractors is reduced** while calculating drawing power.
Limits not reviewed	Accounts where regular/ad hoc limits are **not reviewed within 180 days from the due date/date of ad hoc sanction, should be considered as NPA.** Auditors should also ensure that the ad hoc/short reviews are not done on repetitive basis. In such cases, auditor can consider the classification of account based on other parameters and functioning of the account.

17. ABN Bank was engaged in the business of providing Portfolio Management Services to its customers, for which it took prior approval from RBI. Your firm has been appointed as the statutory auditors of the Bank's financial statements for the year 2019-20. Your senior has instructed you to verify the transactions of Portfolio Management Services (PMS). While verifying the transactions you noticed that the bank has not maintained separate record for PMS transactions from the Bank's own investments. As a statutory auditor what methodology will be adopted by you for verification of PMS transactions? (RTP Nov-20)

Separation of Investment Functions: The auditor needs to examine whether the bank, as required by the RBI, is maintaining **separate accounts for the investments** made by it on their

- **own** Investment Account,
- **PMS clients'** account, and
- on behalf of **other Constituents** (including brokers).

As per the RBI guidelines, banks are required to get their **investments under PMS separately audited by external auditors**.

Thus, in the instant case, ABN Bank is required to prepare separate records for PMS and as per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions and advise the bank to segregate the PMS transactions from its own investments and provide the certificate of external auditor as described above. In case ABN Bank does not provide the same the auditor may report accordingly.

18. While doing the audit of a Nationalised bank branch, your audit assistant informed you that he suspects some irregularities in Guarantees issued by the Bank. What should be your guidance in the matter to check the same? (May-18 Old)

Guarantees Given on Behalf of Constituents:

1. The auditor should ascertain whether there are **adequate internal controls** over issuance of guarantees, e.g., whether guarantees are issued under proper sanctions, whether adherence to limits sanctioned for guarantees is ensured, whether margins are taken from customers before issuance of guarantees as per the prescribed procedures, etc.

2. The auditor should ascertain whether there are **adequate controls over unused guarantee forms**, e.g., whether these are kept under the custody of a responsible official, whether a proper record is kept of forms issued, whether stock of forms are periodically verified and reconciled with the book records, etc.
3. The auditor should **examine the guarantee register** to seek evidence whether the prescribed procedure of **marking off the expired guarantees** is being followed or not.
4. The auditor should check the **relevant guarantee registers** with the list of outstanding guarantees to obtain assurance that all outstanding guarantees are included in the amount disclosed in this behalf.
5. The auditor should also examine that **expired guarantees are not included in this head**. He should verify guarantees with the copies of the letters of guarantee issued by the bank and with the counter-guarantees received from the customers.
6. He should also **verify the securities held as margin**. If a claim has arisen, the auditor should consider whether a provision is required in terms of the requirements of AS 29, "Provisions, Contingent Liabilities and Contingent Assets".
7. The auditor should obtain a **written confirmation from the management** that all obligations in respect of guarantees have been duly recorded and that there are no guarantees issued upto the year-end which are yet to be recorded.

19. BOT Limited is enjoying cash credit facility sanctioned from Nariman Point, Mumbai branch of KNB Bank for ₹250 crore. However, for practical considerations, various sub-limits have been fixed for the borrower company for operation at Solapur, Pune and Nashik branches of the same bank.
The manager of the Solapur branch notices that there are no credit transactions in sub - limit account being operated at the Solapur branch for more than 90 days as on 31st March,2022. Discuss the approach of CA. Muni, statutory branch auditor of Nariman Point branch, Mumbai of KNB Bank, in the matter of asset classification of the above borrower account.
Also discuss considerations for classifying said account at the Solapur branch. [RTP May-23]

Sometimes, a customer is sanctioned a cash credit limit at one branch but is authorised to utilise such overall limit at several other branches also, for each of which a sub-limit is fixed.

In such a case, the **determination of status of the account as NPA or otherwise should be determined at the limit-sanctioning branch with reference to the overall sanctioned limit/drawing power** and not by each of the other branches where a sub-limit has been fixed.

The auditor of the limit-sanctioning branch should examine whether it receives particulars of all transactions in the account at sub-limit branches and whether status of the account has been determined considering the total position of operation of the account at all concerned branches. The standalone matter of no credit transactions for more than 90 days as on 31st March,2022 at Solapur branch is irrelevant.

Hence, keeping in view above, CA. Muni should **consider asset classification considering the total position of operation of the account at all concerned branches.**

Regarding sub-limit at branches, the classification adopted by the limit-sanctioning branch should be followed. Hence, the **Solapur branch has to follow asset classification made by the limit-sanctioning branch.**

20. Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank for the FY 2023-24. During the course of audit your audit team observed that a lump sum amount has been disclosed as Contingent Liability collectively though the components are correctly identified. In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all the contingent liabilities are identified and properly valued and the audit firm intend to obtain a representation from the management. Highlight the points/checklists that are to be covered in the management representation. [May-22]

The auditor should obtain representation from mgt that:-

i) all **off-balance sheet transactions** have been **accounted in books** of a/cs as and when such transaction has taken place;
ii) all off balance sheet transactions have been **entered into after following due procedure laid down**;
iii) all off balance sheet transactions are **supported by the underlying documents**;
iv) all year end contingent liabilities have been **disclosed**;
v) disclosed contingent liabilities **don't include any crystallised liabilities** which are of nature of loss/ expense and which require creation of a provision/adjustment in F.S;
vi) estimated amounts of **financial effect** of contingent liabilities are based on best estimates in terms of AS 29, including consideration of possibility of any reimbursement;

21. CA Prachi was conducting statutory audit of branch of a nationalized bank for the year 2023-24. While reviewing operations and documents/papers of a borrower enjoying overdraft credit facilities of ₹ 50 crore (availed against security of stocks and book debts), following observations were jotted down by her:

i) The balance in overdraft credit facility as on 31st March,2024 was ₹ 55.65 crore. The balance in account exceeded sanctioned limit during the whole month of March 2024.
ii) As per terms of sanction letter, stock/book debt statements were required to be submitted monthly. Latest available stock/book debt statement for the month of February, 2024 showed drawing power of ₹ 48.50 crore only. However, stock/book debt statements of previous months showed adequate drawing power.
iii) Stock audit of borrower was also conducted during the year by one of empanelled stock auditors of the bank. Stock audit report dated 31st December,2023 placed on the record showed adequate drawing power in the account. However, it has commented adversely on the declining turnover of borrower in year 2023-24(till the date of stock audit report) as compared to proportionate turnover in preceding year.
iv) The renewal of overdraft facilities was due on 20th October,2023. The account was short renewed by competent authority for a period of 3 months pending submission of complete papers.

However, borrower has not submitted complete renewal papers till 31st March,2024. There is a request letter from borrower on record stating that valuation report of a property located at a faraway location was taking time.
The branch has classified the account as 'Standard Asset'. Considering above, CA Prachi is in dilemma relating to proper classification of above advance. Guide her. [RTP Nov-22]

Borrower was enjoying overdraft credit facilities of ₹ 50 crore against security of stocks and debts. Further, though latest available stock statement for the month of February, 2024 showed inadequate drawing power, there was **adequate drawing power available throughout the year**. Stock audit report dated 31.12.2023 also reflected adequate drawing power. Hence, it shows that borrower had adequate drawing power during the year. Further, **comment on declining sales is of general informative value to management** for making credit decisions.

The fact of over drawings in account during the month of March, 2024 and inadequate drawing power in a month are in **nature of temporary deficiencies** and **do not require account to be classified as NPA** in accordance with asset classification and provisioning norms of RBI.

RBI instructions lay down that **ordinarily credit limits need to be reviewed not later than three months from the due date**. As per Guidance note on Audit of Banks, in case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is underway and would be completed soon. In any case, **delay beyond six months is not considered desirable as a general discipline**. Hence, **an account where the credit limits have not been reviewed/ renewed within 180 days from the due date will be treated as NPA**.

It would be pertinent to note that the counting of 180 days would be required to be done from the date of original due date for renewal and not from the date of expiry of short reviews / technical reviews. In the instant case, the original date of renewal was 20th October, 2023 and period of 180 days has still not expired as on balance sheet date.

Keeping in view all above factors, **CA Prachi should accept classification of account as 'Standard Asset' made by branch.**

22. You are part of engagement team conducting statutory audit of a branch of nationalized bank. During the course of audit, it has come to your notice that there are large number of cash credit accounts in the branch. Many of the cash credit accounts are only partially utilized during substantial part of year. However, in the month of March, the accounts are fully utilized.
On further scrutiny, it is observed that these account holders have made fixed deposits from these utilized amounts at the end of year. These deposits have been liquidated in first week of April of next financial year.
Comment upon how this situation would be dealt by you as a statutory branch auditor? [MTP Nov-22]

In given case, many of cash credit accounts are only partially utilized during substantial part of year. However, in month of March, accounts are fully utilized. On further scrutiny, it is observed that these account holders have made fixed deposits from these utilized amounts at the end of year. These deposits have been liquidated in first week of April of next financial year.

This is an example of **window dressing**. Branch is resorting to window dressing by **artificially boosting** its advances and deposits. Utilization of advances and placing of fixed deposits at end of year in branch and again liquidation of deposits early next year indicate that branch is resorting to window dressing to **inflate its advances as well as deposits artificially**.

Auditor has to verify whether unavailed portion of credit facilities (overdraft, cash credit) are used to boost loans and deposits which might tantamount to window dressing. Relevant regulatory guidelines also prohibit such type of practices and these might **involve penal action in terms of Banking Regulation Act, 1949**. Same needs to be suitably **reported in audit report and commented in LFAR** also. In appropriate cases, making a **suitable qualification in the main audit report** has also to be considered.

Integrated Scenario 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.

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

Integrated Scenario II

While planning the audit, all joint auditors mutually decided that responsibility of verification of cash book will be entrusted with Mr. Pas. But Mr. Pas failed to detect the fraud committed by the cashier which he could have detected if he had properly checked the cash book. This fraud was revealed in the special audit which was conducted on the directions of RBI. Responsibility for verifying compliance with SLR requirement was entrusted with Mr. Das. While performing audit on compliance with SLR requirements Mr. Das used 12 odd dates in different months of fiscal year. Mr. Das with his professional judgement used the below mentioned days:

Month	Day of month	Day
April	2nd	Thursday
May	5th	Saturday
June	5th	Friday
July	31st	Friday
August	31st	Monday
September	1st	Tuesday
October	30th	Friday
November	1st	Sunday
December	1st	Tuesday
January	10th	Sunday
February	8th	Monday
March	7th	Tuesday

1. List down all the months whose date has been selected inappropriately by CA Das for calculation of SLR compliance?
(a) January, February and March.
(b) July, August and October.
(c) June, July and October.
(d) May and November.

2. Mr. Tas was entrusted with responsibility for calculation of Demand and time liability. On 31st March total liability stood at ₹ 200 crore. It includes Margin held for funded facilities of ₹ 3 crore, credit balance for one branch of ₹ 4 crore, adverse balance of nostro Mirror account of ₹ 2 crore and unadjusted deposit for agency business of ₹ 6 crore. Papa Limited has total 12 directors including 3 women directors. Out of them, Mr. Right was non executive chairman as well as promoter of bank. Papa Limited has a total of 5 independent directors in their board.
While calculating SLR compliance of Papa Limited, what will be value of demand and time liability as on 31st March?
(a) 191 crore.
(b) 200 crore.
(c) 197 crore.
(d) 185 crore.

1. (c) 2. (a)

Test your Understanding

1. "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.

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**

2. 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?

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.

3. 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.

Particulars	Note No.	Figures for year ended 31st March, 2023 (in ₹ Crores)
Revenue from Operations		
(i) Interest income	15	9500
(ii) Dividend income		-
(iii) Rental Income		150
(iv) Fees and commission income	16	100
(v) Net gain on fair value changes	17	150
(vi) Net gain on derecognition of financial instruments under amortised category		-
(I) Total revenue from operations		9900
(II) Other Income	18	100
(III) Total Income		10000

On going through details of head "other expenditure" in expenses side of statement of profit and loss, it is noticed that there is an expenditure relating to manpower outsourcing cost amounting to ₹ 99.50 crores included under "other expenditure". Does it meet the requirements of Division III of Schedule III of Companies Act, 2013?

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.

Past Exam/RTP/MTP Questions

1. CA Nadar is conducting the statutory audit of RHL Ltd., a non-banking financial company. It has branches in various parts of India. The company with a focus on housing finance, has outstanding non-convertible debentures worth ₹ 150 Crores. The company reportedly missed interest payments of INR 15 Crores on its debts because of inadequate liquidity. As a result, RHL Ltd. faced a series of downgrades by rating agencies on its debts over the past two months. Rating was cut to D from A4 implying that the company was in default or expected to be in default soon. What aspects CA Nadar should look into in relation to the activity of mobilization of public deposits (particularly in relation to downgrading of credit facilities) by RHL Ltd? (Nov 20 New + MTP Apr-23)

CA Nadar has to ascertain whether the company has complied with the following aspects in relation to the activity of mobilization of public deposits:-

i. The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will **have to increase/reduce its public deposits in accordance with the revised credit rating** assigned to it within a specified time frame and should ensure that the NBFC has informed about the same to the RBI in writing.

ii. In the event of downgrading of credit rating below the minimum specified investment grade, a non-banking financial company, being an investment and credit company or a factor, shall regularise the excess deposit as provided hereunder:

a. with immediate effect, **stop accepting fresh public deposits and renewing existing** deposits;

b. all **existing deposits shall run off to maturity**; and

c. **report the position within 15 working days,** to the concerned Regional Office of the RBI where the NBFC is registered.

d. No matured public deposit shall be renewed without the express and **voluntary consent of the depositor**.

2. 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. (Nov-19 + May-23)

The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

(a) NBFCs have been allowed to present the **items of the balance sheet in order of their liquidity** which is not allowed to companies required to follow Division II.
(b) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which **exceeds 1 per cent of the total income**. Division II, on the other hand, requires disclosure for any item of income or expenditure which **exceeds 1 per cent of the revenue from operations or ₹10 lakhs**, whichever is **higher.**
(c) NBFCs are required to separately disclose under **'receivables'**, the **debts due from any Limited Liability Partnership (LLP)** in which its director is a partner or member.
(d) NBFCs are also required to **disclose items comprising 'revenue from operations' and 'other comprehensive income'** on the **face of the Statement of profit and loss** instead of showing those only as part of the notes.
(e) Separate disclosure of **trade receivable** which have **significant increase in credit risk & credit impaired.**
(f) The **conditions or restrictions for distribution attached to statutory reserves** have to be separately disclose in the notes as stipulated by the relevant statute

3. R and Associates, a firm of chartered accountants, is appointed as auditor of NBFC. During the audit, audit team comes across various observations / exceptions and Mr. A, a junior member of audit team, due to his limited understanding about exceptions which are required to be reported in the audit report, would like to understand in detail, the obligations on the part of an auditor in respect of exceptions in the audit report so that he can conclude his work. Discuss. (MTP Oct-20/Sep-22 + July-21 Old)

OR

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? (SM)

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 :

Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 'Matters to be included in the Auditor's Report', is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:
(a) the **provisions of Chapter III B** of RBI Act (Act 2 of 1934); or
(b) **Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions**, 2016; or

(c) Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

It shall be the obligation of the auditor to make a report containing the details of such **unfavourable or qualified statements** and/or about the non-compliance, as the case may be, in respect of the company to the **concerned Regional Office** of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

(II) The duty of the Auditor under sub-paragraph (I) shall be to report **only the contraventions** of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

4. Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC).

(RTP Nov-19)

Some points that may be covered in the audit of NBFC - Investment and Credit Company (NBFC-ICC):

i) **Physically verify all the shares and securities held** by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.

ii) Verify whether the NBFC has **not advanced any loans against the security of its own shares**.

iii) Verify that **dividend income** wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.

iv) **Test check bills/contract notes received from brokers** with reference to the prices visà-vis the stock market quotations on the respective dates.

v) Verify the **Board Minutes for purchase and sale of investments**. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.

vi) Check whether the **investments have been valued** in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.

vii) Obtain a **list of subsidiary/group companies** from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.

viii) Check whether **investments in unquoted debentures/bonds** have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.

ix) An auditor will have to ascertain whether the requirements of **AS 13 "Accounting for Investments"** or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.

x) In respect of shares/securities held through a depository, obtain a **confirmation from the depository** regarding the shares/securities held by it on behalf of the NBFC.

xi) Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

5. Classification of frauds by NBFC. (RTP Nov-20 + PM)

Classification of Frauds by NBFC: In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

i) Misappropriation and criminal breach of trust.
ii) **Fraudulent encashment** through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
iii) **Unauthorised credit facilities** extended for reward or for illegal gratification.
iv) **Negligence and cash shortages**.
v) **Cheating and forgery**.
vi) **Irregularities in foreign exchange** transactions.
vii) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

(I) cases of **cash shortages more than ₹ 10,000/-** and

(II) cases of **cash shortages more than ₹ 5000/- if detected** by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

6. Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the requirements related to registration and regulation of NBFCs which an auditor needs to keep in his mind while planning the audit of NBFC which would help this firm. (SM)

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 ₹ ₹ 2 crore.

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.

7. 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? (SM)

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.

8. Karma Pvt Ltd is a Non-Deposit Taking Non-Systemically Important NBFC registered with Reserve Bank of India. The Statutory Auditor of the company is required to give a report to the Board of Directors. What shall be the content of the Auditor's Report to the Board. (SM)

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), 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.

9. You are the auditor of ABC Ltd., a NBFC registered with RBI. How would you proceed to ensure the compliance of Prudential Norms directions by it. (MTP Apr-18)

i) The auditor has to **verify the compliance of prudential norms** relating to (income recognition; Income from investments; Asset classification; Provision for bad and doubtful debts; Capital adequacy norm; Prohibition of granting loans against its own shares;
ii) The auditor shall ensure that Board of the NBFC shall **frame a policy for granting demand/call loans and implement the same.**
iii) The auditor should **verify the classification of advances and loans** as standard/ substandard/doubtful/loss and that proper **provision** has been made in accordance with the directions.
iv) Auditor should ensure that **unrealised income from non-performing assets** has **not been taken to Statement of Profit and Loss.**
v) Check whether all accounts which have been **classified as NPAs in the previous year also continue to be shown as such in the current year also.** If the same is not treated as an NPA in the current year, the auditor should specifically examine such accounts to ascertain whether the account has become regular and the same can be treated as performing as per the Directions.

10. OM & Co. is the statutory auditor of OTAPS NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was a difference of opinion between Mr. O and his partner Mr. M. Mr. O is of the opinion that evaluation of internal control system and verification of registration with RBI should not be the part of audit procedure, as it is the part of interna l audit only. Briefly state what broad areas should mandatorily become part of the audit procedure of OM & Co. for conducting the audit of OTAPS NBFC Ltd.? Also comment whether contention of Mr. O is correct? [MTP Apr-22 + Dec-20 Old]

Following are broad areas that should be mandatorily part of the audit procedure for conducting the audit of NBFC:

(1) Ascertaining the Business of the Company - The first step in carrying out the audit of a NBFC is to scan through the Memorandum and Articles of Association of the company, so as to acquaint oneself with the type of business that the company is engaged into. The task of ascertaining the principal business activity of any NBFC is of paramount importance since the very classification of a company as a NBFC and its further classification would all depend upon its principal business activity. Based on the classification of a company, it will be required to comply with the provisions relating to limits on acceptance of public deposits as contained in the NBFC Public Deposit Directions.

(2) Evaluation of Internal Control System - An auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed. In particular, an auditor should review the effectiveness of the system of recovery prevalent at the NBFC. He should ascertain whether the NBFC has an effective system of periodical review of advances in place which would facilitate effective monitoring and follow up. The absence of a periodical review system could result in non-detection of sticky advances at their very inception which may ultimately result in the NBFC having an alarmingly high level of NPAs.

(3) Registration with the RBI - Section 45-IA of the RBI Act, 1934, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds. An auditor should obtain a copy of the certificate of registration granted by the RBI or in case the certificate of registration has not been granted, a copy of the application form filed with the RBI for registration. It may particularly be noted that NBFCs incorporated after 9th January, 1997 are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. The auditor should ascertain whether investment in prescribed liquid assets have been made and whether quarterly returns as mentioned above have been regularly filed with the RBI by the concerned NBFC.

(4) The auditors must ascertain whether the company properly classified as per the requirements of various regulations. In case, the NBFC has not been classified by the RBI, the classification of a company will have to be determined after a careful consideration of various factors such as particulars of earlier registration granted, if any, particulars furnished in the application form for registration, company's Memorandum of Association and its financial results.

(5) NBFC Prudential Norms Directions - Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans and investments for failure to repay public deposits and norms for concentration of credit/investments.

In the given situation, OM & Co., is the statutory auditor of OTAPS NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was difference of opinion between O and his partner M regarding evaluation of internal control and verification of registration with RBI.

As discussed above NBFCs are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. Further, auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed. Accordingly, contention of Mr. O regarding evaluation of internal control system and verification of registration with RBI should not be part of the audit procedure as it is part of internal audits only, is not correct.

11. ABC Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures / securities issued by Government or local authorities. For the year ended 31' March, 2021 following are some extracts from the financial statements :
(i) Paid-up share capital = 40.53 Cr.
(ii) Non-Current Assets - Loans & Advances = 55.90 Cr.
(iii) Current Assets - Loans and advances = 344.47 Cr.
(iv) Total assets of the company = 530 Cr.
(v) Intangible assets = 3 Cr.
(vi) Profit for the Year =125 Cr.
(vii) Income from interest and dividends = 52 Cr.
(viii) Gross income 102.57 Cr.
Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise. [Dec-21 New + RTP Nov-22]

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
(i) Financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and

(ii) 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 RBI.

In the given case of ABC Ltd, its Financial Assets are =₹ 55.90 + ₹ 344.47= ₹ 400.37 Cr

Total Assets (netted off by intangible assets) = ₹ 527 Cr

Income from financial assets = ₹ 52 Cr

Gross Income = ₹ 102.57 Cr

From the above, it is clear that ABC Ltd.'s financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitutes more than 50 per cent of the gross income. Hence, ABC Ltd. fulfills both these criteria to qualify as an NBFC.

Thus ABC Ltd. can apply for registration under Section 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

12. Write a short note on Categorisation of NBFCs carrying out specific activity. [RTP May-23]

Categorisation of NBFCs carrying out specific activity: As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs

i) NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure.
ii) NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer.
iii) The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework.
iv) Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice.

Case Scenario

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.

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

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.

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 and efficiency of public undertakings** and to see whether they are being managed in accordance with sound business principles and 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.

Examination of public enterprises by 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.

i) **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.**

ii) **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?**

iii) **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?

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 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.

Past Exams/RTPs/MTPs/SM Ques

1. 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?

- Understanding the entity/programme
- Defining the objectives and the scope of audit
- Determining audit criteria
- Deciding audit approach
- Developing audit questions
- Assessing audit team skills and whether outside expertise required
- Preparing Audit Design Matrix
- Establishing time table and resources
- Intimation of Audit programme to audit entities

2. 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.

(Jan'21 New + MTP Sep-22 + SM)

Some of the issues examined in comprehensive audit are:

a. How does the **overall capital cost of the project** compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?
b. Have the **planned production or operational outputs** been achieved? Has there been underutilisation of installed capacity or shortfall in performance and, if so, what has caused it?
c. Has the planned rate of return been achieved?
d. Are the **systems of project formulation and execution** sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
e. Are **cost control measures adequate and are there inefficiencies**, wastages in raw materials consumption, etc.?
f. Are the **purchase policies adequate**? Or have they led to piling up of inventory resulting in redundancy in stores and spares?
g. Does the enterprise have **research and development programmes**? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?
h. If the enterprise has an adequate **system of repairs and maintenance**?
i. Are **procedures effective and economical**?
j. Is there any **poor or insufficient or inefficient project planning**?

3. Ceta Ltd. is a company in which 54% of the paid up share capital is held by Rajasthan Government. The company is engaged in the business of providing consultancy services in relation to construction projects. The audit of the financial statements of Ceta Ltd. for the financial year ended 31 March 2020 got completed with lot of intervention of Comptroller & Auditor General of India, wherein C&AG was giving directions to the auditors on the manner in which audit should be conducted in respect of certain areas. Further, it also received comments from C&AG on the audit report of the auditors. Ceta Ltd is seeking advice to go against C&AG so that they can avoid unnecessary interference of C&AG. You are required to advise Ceta Ltd. with respect to role of C&AG in the audit of a Government company.

Role of C&AG in the Audit of a Government company: Role of C&AG is prescribed under **sub section (5), (6) and (7) of section 143 of the Companies Act, 2013.**

In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under **Sec 139(5)/(7)** i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The Comptroller and Auditor-General of India shall **within sixty days** from the date of receipt of the audit report have a right to:
(i) conduct a **supplementary audit** of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
(ii) **comment upon or supplement such audit report**.

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

Test Audit: Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under **Sec 139(5)/(7)**, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of **section 19A** of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

4. "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. (RTP May-20)

According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:
(i) Economy- It is **minimising the cost of resources** used for an activity, having regard to appropriate quantity, quality and at the best price. Judging economy implies forming an opinion on the resources (e.g. human, financial and material) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

(ii) Efficiency- It is the **input-output ratio**. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

Auditing efficiency embraces aspects such as whether:
a. **sound procurement** practices are followed;
b. resources are **properly protected and maintained;**
c. **human, financial and other resources** are efficiently used;

d. **optimum amount of resources** (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;
e. **public sector programmes,** entities and activities are efficiently managed, regulated, organised and executed;
f. **efficient operating procedures** are used; and
g. the **objectives of public sector programmes are met cost-effectively**.

(iii) Effectiveness- It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

In auditing effectiveness, performance audit may, for instance:

a. assess whether the **objectives of and the means provided** (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;
b. determine the extent to which a program achieves **a desired level of program results**;
c. assess and **establish with evidence** whether the observed direct or indirect social and economic impacts of a policy are due to implementation of the policy or to other causes;
d. identify **factors inhibiting satisfactory performance** or goal-fulfilment;
e. assess the **effectiveness of the program** and/or of individual program components;
f. assess **compliance with laws and regulations** applicable to the program;

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.(SM)

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? [SM]

The audit criteria may be sought to be obtained from the following sources:

i) **procedure manuals** of the entity.
ii) **policies, standards,** directives and guidelines.
iii) **criteria used by the same entity or other entities** in similar activities or programmes.
iv) **independent expert opinion** and know how.
v) **new or established scientific knowledge** and other reliable information.
vi) **general management and subject matter literature** and research papers.

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

approach of the directors of Sunlight Ltd. correct? Guide the company with the provisions related to supplementary audit. (May-19 New)

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

(i) conduct a supplementary audit under section 143(6)(a), of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

(ii) comment upon or supplement such audit report under section 143(6)(b): It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

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

8. 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. (Nov-21 New)

To facilitate a proper consideration, the reports of the C&AG on the audit of PSUs are presented to the Parliament in several parts consisting of the following:

a) **Introduction** containing a general review of the working results of Government companies, deemed Government companies and corporations;
b) **Results of comprehensive appraisals** of selected undertakings conducted by the Audit Board;
c) **Resume of the company auditors' reports** submitted by them under the directions issued by the C&AG and that of comments on the accounts of the Government companies; and
d) **Significant results** of audit of the undertakings not taken up for appraisal by the Audit Board.

For certain specified states, the C&AG submits a separate audit report (commercial) to the legislature, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, and a general review of the working results of Government companies and corporations.

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.

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

Internal Audit

Test your Understanding

1. After an illustrious career in Indian Audit & Accounts Service for about 25 years, Parteek, 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?

As per Sec 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?

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.

Past Exams/RTPs/MTPs & SM Questions

1. Internal auditor makes an appraisal of organization structure to ensure that it is in harmony with the objectives of the entity, besides checking of financial transactions and operational activities of the entity- Elaborate.

(Nov-18 New)

Review of the Organisation Structure - The internal auditor should conduct an appraisal of the organisation structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith. For this purpose:

- He should review the **manner in which the activities of the enterprise are grouped** for managerial control. It is also important to review whether responsibility and authority are in harmony with the grouping pattern.
- The internal auditor should **examine the organization chart** to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others.
- He should particularly see that the **responsibilities of managerial staff at headquarters do not overlap with those of chief executives** at operating units. He should examine whether there is a satisfactory balance between authority and responsibility of important executives.

- The internal auditor should **examine the reasonableness of the span of control** of each executive (the number of sub-ordinates that an executive controls). He should examine whether there is a unity of command i.e., whether each person reports only to one superior.
- Where **dual responsibilities cannot be avoided**, the primary one should be specified and the specific responsibility to each senior fixed. This must be made known to all concerned.
- Finally, he should evaluate the **process of managerial development** in the enterprise. This is a vital aspect in a fast growing enterprise.

2. You have been appointed as an internal auditor of a company RSM Ltd. The Managing Director Rakesh is worried about employee attrition in large number. Rakesh requests you to analyse the causes for high employee attrition rate in his company. What factors would you consider in such analysis? (MTP Oct-20)

The factors to be considered to analyse causes for high employee attrition rate are as under:

i) Job Stress & work life imbalance.
ii) Wrong policies of the Management.
iii) Unbearable behaviour of Senior Staff.
iv) Safety factors.
v) Limited opportunities for promotion.
vi) Low monetary benefits.
vii) Lack of labour welfare schemes.
viii) Whether organization has properly qualified and experienced personnel for the various levels of works?
ix) Is the number of people employed at various work centres excessive or inadequate?
x) Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?

3. State the important aspects to be considered by the External auditor in the evaluation of the Internal Audit Function. [SM]

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 free of any other operating responsibility.
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.
c. **Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency.
d. **Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented.

4. One of the independent directors sought information regarding the appointment of internal auditors for following Group Companies in accordance with the Companies Act, 2013 of which certain Financial Information are given below:

Figures are in ₹ crore and correspond to the previous year

Name	Nature	Equity Share Capital	Turnover	Loan from Bank and PFI	Public Deposits
AADI Ltd	Listed	100	190	50	24
AJIT Ltd	Unlisted Public	60	190	50	24

Nemi Ltd	Unlisted Pvt	60	190	50	-

You are required to evaluate the requirements of the Companies Act, 2013 regarding the appointment of internal Auditors for the Group Companies. Discuss. [RTP May-22]

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act,2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

(A) every listed company;

(B) every unlisted public company having-

1. paid up share capital of fifty crore rupees or more during the preceding financial year; or
2. turnover of two hundred crore rupees or more during the preceding financial year; or
3. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
4. outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year and

(C) every private company having-

(1) turnover of two hundred crore rupees or more during the preceding financial year; or

(2) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, AADI Ltd. is a listed company. As per section 138 of the Companies Act, 2013, every listed company is required to appoint an internal auditor or a firm of internal auditors. Thus, in view of the above, AADI Ltd. is required to appoint an internal auditor.

Further, AJIT Ltd. is unlisted public company. The company is having ₹ 60 crore as equity share capital which is exceeding the prescribed limit of rupees fifty crore as per section 138. Thus, AJIT Ltd. is required to appoint an internal auditor as per section 138 of the Companies Act, 2013.

NEMI Ltd. is unlisted private company and having ₹ 60 crore as equity share capital, ₹ 190 crore as turnover and ₹ 50 crore loan from Bank and PFI. In view of provisions of section 138 of the Companies Act, 2013 discussed above, all the limits are below the prescribed limit for a private company. Therefore, NEMI Ltd. is not required to appoint an internal auditor.

It can be concluded that AADI Ltd. and AJIT Ltd. is required to appoint the internal auditor as per the provisions of the Companies Act, 2013 whereas NEMI Ltd. is not required to do the same.

5. 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? [SM]

HR Head need to evaluate multiple options and identify most suitable option in light of relevant provisions, guidance and overall governance of 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 BOD, Audit Committee, MD, CEO or CFO.

As per Sec 138 of the Companies Act 2013, 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".

Internal Auditor shall be free from any undue influences which force him to deviate from truth. This **independence shall be not only in mind but also in appearance**. Also, 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 requirement of above provision, **Chief Internal Auditor need to be independent of the operational activities** and report to 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**.

6. 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? [SM]

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

7. 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? [SM]

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.

8. 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? [SM]

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, responsibility of Internal Auditor is usually in 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

SA 610: Using the Work of Internal Auditor

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

(MTP Oct-18 + ICAI SM)

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

(a) The extent to which internal audit function's organizational status and relevant policies and procedures support **objectivity** of internal auditors;

(b) The **level of competence** of internal audit function; and

(c) Whether IA function applies a **systematic and disciplined approach,** including quality control.

Further, external auditor shall **not use the work of Internal Audit function** if external auditor determines that:

(a) The function's organizational status and relevant policies and procedures **do not adequately support objectivity** of internal auditors;

(b) The function **lacks sufficient competence**; or

(c) The function **does not apply a systematic and disciplined approach**, including quality control.

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

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

2. Moon Ltd. of which you are Statutory Auditor, have internal audit being conducted by outside agency. State factors that weigh considerations in opting to make use of direct assistance of internal auditors for purpose of statutory audit. (May 18 New)

As per **SA 610 'Using the work of Internal Auditor'** in determining nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, external auditor shall consider:

(1) The **amount of judgment involved** in:

(i) Planning and performing relevant audit procedures; and

(ii) Evaluating audit evidence gathered;

(2) The **assessed risk of material misstatement;** and

(3) The external auditor's **evaluation of existence and significance of threats to objectivity and level of competence** of internal auditors who will be providing such assistance.

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

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

3. Mr. Sheetal is appointed as statutory auditor of Mahi Ltd. Mahi Ltd is required to appoint an internal auditor as per statutory provisions given in Companies Act, 2013 and appointed Mr. Kunthu as its internal auditor. The external auditor Mr. Sheetal asked internal auditor to provide direct assistance to him regarding evaluating the sufficiency of tests performed and the adequacy of disclosures in the financial statements and other matters affecting the auditor's report. Discuss whether Mr. Sheetal, statutory auditor, can ask direct assistance from Mr. Kunthu, internal auditor as stated above in view of relevant Standard on Auditing. (MTP Apr'21)

As per **SA 610 "Using the Work of Internal Auditor"**, EA shall not use internal auditors to provide direct assistance to perform procedures that Involve making significant judgments in the audit.
Since external auditor has sole responsibility for the audit opinion expressed, 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 adequacy of **disclosures in F.S.**, and other matters affecting the auditor's report.

In view of above, **Mr. Sheetal cannot ask direct assistance** from internal auditors regarding evaluating sufficiency of tests performed and adequacy of disclosures in F.S. and other matters affecting auditor's report.

4. OPQ Ltd is in software consultancy business. The company had large balance of accounts receivables in past years which have been assessed as area of high risk. For year ended 31 March 2019, in respect of valuation of accounts receivable, statutory auditor was assigned with checking of accuracy of aging of accounts receivables and provision based on ageing, to internal auditor providing direct assistance to him. Comment. (MTP Oct-19 + Nov-22)

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

(i) Involve making **significant judgments** in the audit;
(ii) Relate to **higher assessed risks of material misstatement** where judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
(iii) **Relate to work** with which **internal auditors have been involved** and which has already been, or will be, reported to management or TCWG by Internal Audit function; or
(iv) Relate to **decisions external auditor makes** in accordance with this SA regarding the internal audit function and use of its work or direct assistance.

In given case where **valuation of accounts receivable is assessed as an area of higher risk,** statutory auditor could **assign the checking of accuracy of the aging to internal auditor** providing direct assistance.
However, because **evaluation of adequacy of provision based on the aging would involve more than limited judgment, it would not be appropriate to assign** that latter procedure to an internal auditor providing direct assistance.

5. Mr. Anand is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhola as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.
(a) Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhola, internal auditor as stated above in view of Standards on Auditing.

(b) Will your answer be different, if Mr. Anand ask direct assistance from Mr. Bhola, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures? (RTP May-20)

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

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

Significant judgments include the following:

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

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

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

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

6. Smart Ltd is a manufacturing unit and you are External Auditor of the company. Internal auditors are also appointed as per the provisions of the Companies Act, 2013. As an external auditor you want to use the internal auditors to provide direct assistance for the purposes of audit. State the circumstances where the internal auditors cannot be used to provide direct assistance. What would you include in the audit documentation? (July-21 Old)

In the given case of Smart Ltd, a manufacturing unit, an external auditor shall not use internal auditors to provide direct assistance as per **SA 610, Using the work of Internal Auditor**, to perform procedures that:

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

Further, **if the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:**

(1) The **evaluation of the existence and significance of threats to the objectivity** of the internal auditors, and the level of **competence** of the internal auditors used to provide direct assistance;

(2) The basis for the decision regarding the **nature and extent of the work** performed by the internal auditors;

(3) **Who reviewed the work performed** and the date and extent of that review in accordance with SA 230, Audit Documentation;

(4) The **written agreements** obtained from an authorized representative of the entity and the internal auditors; and

(5) The **working papers** prepared by the internal auditors who provided direct assistance on the audit engagement.

7. 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? [SM]

- 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.

8. **CA. Keshavraj is conducting statutory audit of a listed company "Live with Nature Limited". 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, on going 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 rely upon inventory valuation work performed by internal auditor?**

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.

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.

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.

Past exam/RTP/MTPs/SM 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.? [SM]

If a full-fledged financial due diligence is conducted, it would include the following matters,inter alia, in its scope:
(a) Brief history of the target company and background of its promoter;
(b) Accounting policies;
(c) Review of financial statements;
(d) Taxation;
(e) Cash flow;
(f) Financial Projection;
(g) Management and employees;
(h) Statutory Compliance.

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. [SM]

Example of Headings of a Due Diligence Report

- Executive Summary
- Introduction
- Background of Target company
- Objective of due diligence
- Terms of reference and scope of verification
- Brief history of the company
- Assessment of financial liabilities
- Assessment of valuation of assets
- Assessment of net worth
- SWOT Analysis

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. (May-18 New)

Over-Valued Assets:

- ✓ Uncollected/uncollectable receivables.
- ✓ Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- ✓ Underused or obsolete Plant and Machinery and their spares; asset values which have beenimpaired due to sudden fall in market value etc.
- ✓ Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- ✓ Litigated assets and property.
- ✓ Investments carried at cost though realizable value is much lower.Investments carrying a very low rate of income / return.
- ✓ Infructuous project expenditure/deferred revenue expenditure etc. Group Company balances under reconciliation etc.
- ✓ Intangible assets of no value.

4. "Due diligence is different from audit" – Explain the difference between due diligence and audit. [SM]

It needs be underlined that due diligence is different from audit. Audit is an independent examination and evaluation of the financial statements on an organization with a view to express an opinion thereon. Whereas, due diligence refers to an examination of a potential investment to confirms all material facts of the prospective business opportunity. It involves review of financial and non-financial records as deemed relevant and material. Simply put, due diligence aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party.

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? [SM + MTP May-22]

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 available funds?
e. What is the **investment pattern** of the company and are they easily realizable?

6.K Ltd. is intending to acquire M Ltd. Your firm of Chartered Accountants is appointed to conduct due diligence. While reviewing hidden liabilities list out any five areas which will be specifically examined by you in your due diligence exercise. (Jan-21 Old)

In the given situation K Ltd. is intending to acquire M Ltd., in order to review hidden liabilities, firm of Chartered Accountants should pay attention to the following areas:

- The company may not show any **show cause notices which have not matured** into demands, as contingent liabilities. These may be material and important.
- The company may have given **"Letters of Comfort" to banks** and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- **Tax liabilities** under direct and indirect taxes.
- Long pending **sales tax assessments**.
- **Pending final assessments of customs duty** where provisional assessment only has been completed.
- Agreement to **buy back** shares sold at a stated price.
- Future **lease liabilities**.

7. 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. [RTP May-23 + SM]

(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

Bonus:-

Refer this youtube video for discussion of above question: https://youtu.be/XfuVWTfKk1s

Test Your Understanding

1. **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?

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.

Past Exam/RTPs/MTPs/SM Questions

1. What are the services rendered by forensic accountants? [RTP Nov-22]

An indicative list of services that can be provided by the Professional in this area are as follows:

- Financial Statement manipulations
- Fund diversions/Asset tracing
- Anti-Money laundering
- Licence Fees/Dues/Tax Evasion
- Related party transactions/valuations
- Valuations/Estimations of loss/damage
- Suspicious transactions under IBC (Insolvency and Bankruptcy Code)

Forensic auditor is often involved in:

1. **Fraud Detection:** Investigating and analyzing financial evidence, detecting financial frauds and tracing misappropriated funds.
2. **Computer Forensics:** Developing computerized applications to assist in recovery, analysis and presentation of financial evidence.
3. **Fraud Prevention:** Either reviewing internal controls to verify their adequacy or providing consultation in development & implementation of internal control framework aligned to organization's risk profile.

4. **Providing Expert Testimony:** Assisting in legal proceedings, including testifying in court as expert witness and preparing visual aids to support trial evidence.

2. ACT Silk Industries is a leading textile manufacturing listed company. In the course of evidence collection and analysis, it was observed that the company is involved in siphoning of funds through payments to shell companies. Hence, SEBI appointed B & S Associates, Chartered Accountants, as forensic accountants of the company. Enumerate in brief the steps to be taken by B & S Associates in forensic accounting process. (Nov-21 New + SM)

Step 1. Initialization

It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand. A conflict check should be carried out as soon as the relevant parties are established. It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. Develop Plan

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event. In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis (May-19)

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- calculating economic damages;
- summarizing a large number of transactions;
- performing a tracing of assets;
- performing present value calculations utilizing appropriate discount rates;
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model; and
- utilizing charts and graphics to explain the analysis.

Step 5. Reporting

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

3. Briefly discuss the key content of Forensic Accounting and Investigation Report. [SM]

Key Elements of the Report: The Professional shall consider the inclusion of the following key elements in the report (indicative list):

- Title, addressee and distribution list (if any)
- Scope and objectives of the assignment
- Approach and broad work procedures undertaken
- An Executive Summary of the results, covering all important aspects and the essence of the findings
- Reference to use of an expert, where applicable
- The fact that the assignment has been conducted in accordance with FAIS, or any material departures therefrom
- List of findings supported by key evidences, sources of evidences, and other relevant matter;
- Assumptions, limitations and disclaimers of the assignment
- Conclusions (if any) drawn from the assessment undertaken.

4. You have been requested to carry out a forensic accounting of a listed entity by Board of Directors, based on a whistle blower complaint received. Before the commencement of the forensic accounting, you and your team, are discussing the various aspects relating to the scope and the procedures to be carried out. What would be the items of discussion with respect to the differences between forensic accounting and other audit ? [Nov-22]

S No.	Particulars	Other Audits	Forensic accounting
1	**Objectives**	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually taken place in books
2	**Techniques**	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
3	**Period**	Normally for a particulars accounting period.	No such limitations
4	**Verification of stock, Estimation realisable value of assets, provisions, liability etc.**	Relies on the management certificate/Management Representation	Independent/verification of suspected/ selected items where misappropriation in suspected
5	**Off balance sheet items (like contracts etc.)**	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6	**Adverse findings if any**	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

5. You have been appointed as a forensic accountant in M/s Secure Ltd. to carryout various analysis as a part of your assignment to arrive at a particular result. Specify the various analysis which might have to be carried out by you to arrive at your result. [May-19]

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

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

Test your Understanding

1. 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.

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.

Past Exam/RTP/MTP/SM Questions

1. A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

List out the points you will cover in your investigation before submitting your report to the General Manager.

A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under-mentioned points:

i) The **purpose for which the loan is required** and the manner in which the borrower proposes to invest the amount of the loan.
ii) The **schedule of repayment** of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-adays rely more, for repayment of loans, on the annual profits and loss, and on the values of assets mortgaged to them.
iii) The **financial standing and reputation** for business integrity enjoyed by directors and officers of Co.
iv) Whether **company is authorised by the Memorandum or the Articles of Association** to borrow money for the purpose for which the loan will be used.
v) The **history of growth and development of the company** and its performance during the past 5 years.
vi) How the **economic position of the company** would be affected by economic, political and social changes that are likely to take place during the period of loan. **[Write only till here for a Question of 4-5 Marks]**

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

(a) Prepare a **condensed income statement from the Statement of Profit and Loss for the previous five years**, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years.

The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.

(b) Compute the **under-mentioned ratios** separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:

i. Sales to Average Inventories held.
ii. Sales to Fixed Assets.
iii. Equity to Fixed Assets.
iv. Current Assets to Current Liabilities.
v. Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
vi. Equity to Long Term Loans.
vii. Sales to Book Debts.
viii. Return on Capital Employed.

(c) Enter in a separate part of the statement the **break-up of annual sales product-wise** to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank - The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

(a) Fixed assets - A full description of each asset its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.

(b) Inventory - The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued. Details as regards the nature and composition of finished goods should be disclosed. Slowmoving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.
If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

(c) Trade Receivables, including bills receivable - Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.
Further, the total amount outstanding at the close of the period should be segregated as follows:
(i) debts due in respect of which the period of credit has not expired;
(ii) debts due within six months; and
(iii) debts due but not recovered for over six months.
If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

(d) Investments - The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.

(e) Secured and Unsecured Loans - Debentures and other secured loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed. Details of loans proposed to be obtained from Promoters/ Directors/ Related Parties should be stated separately. In case any unsecured loan is to be repaid prior to repayment of Bank loan, its terms and conditions should be verified.

(f) Provision of Taxation - The previous year's up to which taxes have been assessed or assessment order received should be ascertained. If provision for taxes not assessed appears to be inadequate, the fact should be stated along with the extent of the shortfall.

(g) Other Liabilities - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.

(h) Insurance - A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.

(i) Contingent Liabilities - By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced for example, those of machinery suppliers and the legal adviser. The investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.

2. 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. [SM]

Areas to be covered:

(i) **Reasons for the sale of the business** and the effect on turnover and profits that there would be on retirement of the present proprietor (or partners).

(ii) The **length of lease** under which the premises are held; the prospects of its renewal or extension.

(iii) The **unexpired period of any patents** owned by the vendors.

(iv) The **age of the present managerial staff** and the prospects of continuing in service under the new proprietorship and the possible liability, not already provided for that would arise as regards payment of pensions or gratuities in case of old and aged employees/ retrenched employees.

(v) If **bulk sales are made to customers whose number is small**, the profitability of business would be greatly shaken on withdrawing their support. This would be an element of weakness which should be investigated as it might affect future profitability.

(vi) The **valuation that could be placed on goodwill** to determine whether that appearing in the book is less or more; if none is included to determine the amount that should be included, if at all.

3. What are the important steps involved while conducting Investigation on behalf of an Incoming Partner?
(MTP Oct-20)

Steps involved while conducting investigation on behalf of an incoming partner: The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service.

Broadly, the steps involved are the following:

i) Ascertainment of the **history of the inception and growth** of the firm.
ii) Study of the provisions of the **deed of partnership**, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.
iii) Scrutiny of the record of **profitability of the firm's business** over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits.
iv) Particular attention should, however, be paid to the nature of partners' remuneration, which may be excessive or inadequate in relation to the nature and profitability of the business, qualification and expertise of the partners and such other factors as may be relevant.
v) Examination of the **asset and liability position** to determine the tangible asset backing for the partner's investment, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and those for pending tax assessment. In case of firms rendering services, the question of tangible asset backing usually is not important, provided the firm's profit record, business coverage and standing of the partners are of the acceptable order.
vi) Position of **orders at hand and the range and quality of clientele** should be thoroughly examined, which the firm is presently operating.
vii) **Position and terms of loan finance** would call for careful scrutiny to assess its usefulness and implication for the overall financial position; reason for its absence should be studied.
viii) It would be interesting to **study the composition and quality of key personnel** employed by the firm and any likelihood of their leaving the organisation in the near future.
ix) Various important **contractual and legal obligations** should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. Full import of such standing agreements would be gauged before a final decision is reached.
x) **Reasons for the offer of admission** to a new partner should be ascertained and it should be determined whether the same synchronises with the retirement of any senior partner whose association may have had considerable bearing on the firm's success.
xi) Appraisal of the **record of capital employed and the rate of return**. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organisation structure, if any, envisaged along with the admission of the partner.
xii) It would be useful to have a **first hand knowledge about the specialisation,** if any, attained by the firm in any of its activities.
xiii) Manner of **computation of goodwill on admission as also on retirement**, if any, should be ascertained.
xiv) Whether any **special clause exists in the deed of partnership** to allow admission in future of a new partner, who may be specified, on concessional terms.
xv) Whether the **incomplete contracts** which will be transferred to the reconstituted firm will be a liability or a loss.

[Can learn any 8 of above]

4. 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? (SM)

Audit procedures:

- ✓ Carbon **copies of receipts marked 'duplicate'**, should be scrutinised to confirm that they are in fact copies of receipts issued earlier.
- ✓ The **record of sales of scrap of waste paper, that of collection of rents from labourers temporarily accommodated in the company's quarters**, that of refunds of amounts deposited with the electric supply co., or any other Government authorities should be examined for finding out if any of these amounts have been misappropriated.
- ✓ **Cash sales should be vouched** in detail.
- ✓ **Recoveries from customers and sundry parties** should be checked with the copies of receipts issued to them; deductions made on account of cash discounts should be reviewed.
- ✓ **All withdrawals from the bank** should be checked by reference to corresponding entries in the bank pass book.

5. J Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd., what factors would you consider in assessing the future maintainable turnover? (SM + Nov-22)

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?

6. 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? (Nov-19 Old)

Areas to be verified in case of embezzlement in supplier's ledger: While investigating the matters regarding embezzlement in supplier's ledger, below mentioned areas should be verified.

(i) The auditor should verify the **adjustments in fictitious or duplicate invoices** as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.

(ii) The auditor should ensure that **suppressing the Credit Notes issued by suppliers** and withdrawing the corresponding amounts not claimed by them.

(iii) The auditor should check that **withdrawing amounts unclaimed by suppliers**, for one reason or another by showing that the same have been paid to them.

(iv) The auditor should verify **whether purchase invoices are accepted at prices considerably higher than their market prices** and collecting the excess amount, paid in cash, from the suppliers.

(v) The auditor should **verify the bought journal with reference to entries in the Goods Inward Book and the suppliers' invoices** to confirm that amounts credited to the accounts of suppliers were in respect of goods, which were duly received, and the suppliers' accounts had been credited correctly.

(vi) The auditor should **request all the suppliers to furnish statements of their accounts** to see whether or not any balance is outstanding or due so as to confirm that allowances and rebates given by them have been correctly adjusted.

7. XYZ Ltd. has bought a land in Nagpur for setting up a manufacturing unit in the year 2018 at a price of Rs. 10 crores. In the year 2019, one of the directors of company raised suspicion on the price and transactions related to purchase of land. Therefore, an investigation was ordered by the management and PV Associates were appointed to investigate the matter and submit their report accordingly. PV Associates were of the view that they need to take an expert's opinion on the price of land. Whether PV Associates is authorized to take assistance of expert? If yes, what is the process they need to follow?

If PV Associates feels the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation, they are allowed to do so.

It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation and he should settle the question of costs for obtaining the views and other related implications.

8. 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?

(Nov-19 New)

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

(i) Employees may **simply remove goods** from the premises.

(ii) **Theft of goods** may be **concealed by writing them off** as damaged goods, etc.

(iii) **Inventory records may be manipulated by employees** who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

Verification Procedure for Defalcation of inventory - Such thefts usually are possible through **collusion among a number of persons**. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system.

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

(a) a system of inventory control, and existence of detailed record of the movement of inventory, or

(b) availability of sufficient data from which such a record can be constructed.

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

Defalcations of inventory, sometimes, also are **committed by the management**, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take **assistance of an engineer**. For that he will be more conversant with factors which

are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated.

In this regard, **guidance can also be taken from past records** showing extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent.

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

9. Milk Ltd. is engaged in the business of manufacturing and distribution of various milk products like cheese, curd, paneer, etc. Government made certain changes in rules and regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor, who can fund some part of the proposed expansion. Mr. X is interested in the venture and appoints you to act as an advisor to the proposed investment in the business of Milk Ltd. You have to investigate the audited financial statements and ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking and whether you can put reliance on already audited statement of accounts? (July-21 New)

Process used for checking and reliance on already audited statement of accounts - Following process may be carried out

1. If the statements of account produced before investigator were **not audited by a qualified accountant**, then of course there arises a natural duty to get the **figures in the accounts properly checked and verified**.
2. However, when the accounts produced to the investigator have been **specially prepared by a professional accountant**, who knows or ought to have known that these were prepared for purposes of the investigation, he **could accept them as correct relying on the principle of liability to third parties**.
3. Nevertheless, it would be **prudent to see first that such accounts were prepared with objectivity** and that **no bias** has crept in to give advantage to the person on whose behalf these were prepared.

Whether the investigator can put reliance on the already audited statement of account - If the **investigation has been launched** because of some **doubt in the audited statement of account, no question of reliance** on the audited statement of account arises.

However, if the investigator has been requested to **establish value of a business or a share or the amount of goodwill** payable by an incoming partner, ordinarily the investigator would be entitled to **put reliance on audited materials** made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh.

10.What are the Important issues to be kept in mind by the investigator while preparing his report? (RTP July'21)

The important issues to be kept in mind by the investigator while preparing his report are as follows:

(i) The report should **not contain anything which is not relevant** either to highlight the nature of the investigation or the final outcome thereof.

(ii) Every **word or expression used should be properly** considered so that the possibility of arriving at a different meaning or interpretation other than the one intended by the investigator can be minimized.

(iii) Relevant **facts and conclusions should be properly linked with evidence**.

(iv) **Bases and assumptions made should be explicitly stated**. Reasonableness of the bases and assumptions made should be well examined and care should be taken to see that none of the bases and assumptions can be considered to be in conflict with the objective of the investigation. For example, in an investigation into over-stocking of raw materials, inventories and spares etc. it should not be assumed that the ordering levels indicated

on bin cards provide fair guidance about acquisition of further materials. Also, since investigation is a fact-finding assignment, assumptions should be made only when it is unavoidably necessary.

(v) The report should **clearly spell out the nature and objective of the assignment** accepted its scope and limitations, if any.

(vi) The report should be made in **paragraph form with headings** for the paragraphs. Any detailed data and figures supporting any finding may be given in Annexures.

(vii) The report should **also state restrictions or limitations**, if any, imposed on the instructions given by the client. Preferably the reasons for placing such restrictions and their impact on the final result should also be stated.

(viii) The **opinion of the investigator should appear in the final paragraph** of the report.

11. AB Ltd wants to acquire a unit of CT Ltd. AB Ltd is uncertain about the future viability of the unit under consideration. You are appointed to investigate economic and financial position of the unit. What are the factors that you shall consider while studying the economic and financial position of the business? [May-23]

For studying the economic and financial position of the business, the following should be considered:

(i) The adequacy or otherwise of **fixed and working capital**. Are these sufficient for the growth of the business?

(ii) What will be the trend of the **sales and profits** in the future? Establishing the trend of sales, product-wise and area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in the future.

(iii) Whether the **profit which the business could be expected to maintain in the future** would yield an adequate return on the capital employed?

(iv) Whether the business is **operating at its 100 percent capacity or improvements** can be made to reach at full productivity?

12. CA. Kushal has been appointed as an Investigator by M/s. XYZ and Associates. While undertaking this assignment of investigation, the subordinate staff of CA. Kushal inquired about the following issues:
(i) Whether an investigator is required to undertake the cent per cent verification approach or whether he can adopt selective verification?
(ii) Whether an investigator necessarily requires assistance of expert?
(iii) Whether an investigator can retain working papers or not?
Guide CA. Kushal in solving the queries raised by his sub-ordinate staff. [RTP Nov-23]

Investigations broadly range between two extremes; on the one hand there are those in respect of which complete accounts, documents, records and other information are available, and on the other, those in respect of which little information, besides published accounts and statistical data, is available. Then again, investigation may cover the whole of accounting or may relate to only a part or parts of accounting as may be specified. Some more issues often arise in investigation.

They are stated below:

(a) Whether an investigator is required to undertake a cent per cent verification approach or whether he can adopt selective verification - The answer to this question depends on the exact circumstances of the case under investigation. If the investigator has to establish the amount of cash defalcated by the cashier, he has probably no option but to carefully examine all the cash vouchers and related records. On the other hand, if he is to arrive at the profitability of a concern, he may verify constituent transactions on a selective basis taking extreme care to see that no material transaction that affects profit has remained concealed from his eyes. In investigation, it is always safer to go by statistically recognised sampling methods than to depend on the so-called "test checks" where circumstances permit selective verification.

(b) Whether an investigator necessarily requires assistance of expert - Often an investigator may feel the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation. It would be

therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation and he should settle the question of costs for obtaining the views and other related implications.

(c) Whether to retain working papers or not - Another important precaution is that the investigating accountant should retain in his files full notes of the work carried out, copies of schedules and all working papers, annexures, facts, figures, record of conversations and the like. Also, the working papers should link up the figures as shown by the books of business with the final figures produced by the investigating accountant. Wherever required the investigator should take representation letter from the appointing authority. In the absence thereof, he would not be able to explain the figures when he is called upon to give evidence in a court of law to support his figures; for quite often the conclusions of the accountant are challenged by parties whose interest is adversely affected by his findings, for example, when the value of shares of a company taken over by the Government has been determined by him. This will also be of immense help to the investigator in correlating facts and events and later in drafting the report.

Study Material 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.

Yes he can express unmodified opinion in respect of trade receivables.

If auditor concludes necessary to express adverse opinion or disclaim opinion on entity's complete set of F.S. but, in context of a separate audit of specific element included in those F.S, auditor nevertheless considers appropriate to express unmodified opinion, auditor shall only do so if:

a. **Not prohibited** by law or regulation
b. Opinion is expressed in **auditor's report not published together with auditor's report containing adverse opinion or disclaimer of opinion** and
c. Specific element **doesn't constitute major portion** of entity's complete set of F.S.

2. List out few factors affecting auditor's determination of the acceptability of the applied criteria before accepting audit of summary financial statements.

Factors affecting auditor's determination of acceptability of applied criteria:

→ The **nature** of entity
→ The **purpose** of the summary F.S.
→ The **info. needs** of intended users of summary F.S. &
→ Whether applied criteria will result in **summary F.S. that are not misleading in circumstances**.

3. SA 800 deals with special considerations applicable in respect of audit of financial statements prepared in accordance with special purpose framework. Explain, by giving examples, meaning of special purpose framework.

Spl. purpose framework is a FRF designed to meet financial info. needs of specific users. FRF may be a fair presentation framework or a compliance framework.

Examples of Special purpose frameworks are: -

- **Cash receipts & disbursements basis of accounting** for cash flow info. that entity may be requested to prepare for **creditors**.
- Financial reporting provisions established by **regulator** to meet requirements of that regulator.
- Financial reporting provisions of **contract**, eg. bond indenture, loan agreement, or project grant.

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?

When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor's report on the summary financial statements shall, additionally: -

(a) State that the **auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion**;

(b) Describe the **basis for that adverse opinion or disclaimer of opinion**; and

(c) State that, as a result of the adverse opinion or disclaimer of opinion, it is **inappropriate to express an opinion on the summary financial statements**.

5. The financial statements of TC & Co. have been prepared by management of an entity in accordance with the financial reporting provisions of a contract (that is, a special purpose framework) to comply with provisions of the contract. Based on the contract, management does not have a choice of financial reporting frameworks. As an auditor what considerations would be undertaken while planning and performing audit?

Considerations for Planning and Performing Audit in case of Special Purpose Framework: As per **SA 800 "Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks"**, financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

i) To **obtain an understanding of the entity's selection and application of accounting policies**. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.

ii) **Compliance of all SAs relevant to audit**, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.

iii) Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those **judgments are based on a consideration of the financial information needs of the intended users**.

iv) In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to **determine materiality in accordance with SA 320** for purposes of planning and performing the audit of the special purpose financial statements.

v) **Communication with those charged with governance** in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility.

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 (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

Keeping in view above, answer the following questions: -

1. Given the above extract of abridged financial statements and description, which of 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 recalculated 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 Abridged 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.

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

Descriptive Questions

1. List out few intended purposes of a "compilation engagement."

Financial information that is subject of a compilation engagement may be required for various purposes including: -

i) To **comply with mandatory periodic financial reporting requirements** established in law or regulation, if any or

ii) For purposes unrelated to mandatory financial reporting under relevant law or regulation, including for example:

- **For management or those charged with governance**, prepared on a basis appropriate for their particular purposes (such as preparation of financial information for internal use).
- For periodic financial reporting undertaken **for external parties under a contract or other form of agreement** (such as financial information provided to a funding body to support provision or continuation of a grant).
- For **transactional purposes**, for example to support a transaction involving changes to the entity's ownership or financing structure (such as for a merger or acquisition).

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.

The practitioner shall comply with relevant ethical requirements. In complying with the Code of Ethics, threats to the practitioner's compliance with relevant ethical requirements are required to be identified and appropriately addressed.

Being in nature of non-assurance engagement, independence requirements do not apply to compilation engagements. However, laws or regulations may specify requirements or disclosure rules pertaining to independence.

3. How do "related services" differ from assurance engagements?

"Assurance engagement" means an engagement in which a **practitioner expresses a conclusion** designed to **enhance the degree of confidence of the intended users** other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

It means that the practitioner **gives an opinion** about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished. Not all engagements performed by practitioners are assurance engagements.

Other frequently performed engagements that do not meet the definition of assurance engagements include: -

- The **preparation of tax returns** where no conclusion conveying assurance is expressed.
- **Consulting (or advisory) engagements** such as management and tax consulting.
- Engagements covered by Standards for Related Services, such as **agreed-upon procedures engagements and compilations of financial or other information**. The above engagements are in **nature of related services.**

4. Discuss main documentation requirements to be taken care of by a practitioner while performing a compilation engagement under SRS 4410.

The practitioner shall include in the engagement documentation: -

a. **Significant matters** arising during the compilation engagement and how those matters were addressed by the practitioner

b. A record of how the compiled financial information **reconciles with the underlying records**, documents, explanations and other information, provided by management and

c. A copy of the **final version of the compiled financial information** for which management or those charged with governance, as appropriate, has acknowledged their responsibility, and the practitioner's report.

5. While compiling the accounts of Hope Ltd., you observed that a few accounting standards have not been followed and there have been omission of some information which was required to be followed in the current situation. How would you deal with this?

Non-Compliance with the Accounting Standards: As per **SRS 4410, "Compilation Engagements",** The financial information may be prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users (that is, a "general purpose financial reporting framework");

The requirements of the applicable financial reporting framework determine the form and content of the financial information. The financial reporting framework may, in some cases, be referred to as the "basis of accounting." Commonly used general purpose financial reporting frameworks includes Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, Indian Accounting Standards (Ind AS) issued by ICAI and Accounting Standards (AS) issued by ICAI etc.

Thus, for not following and omission of some information which was required to be followed in the current situation for Hope Ltd., we should **bring this matter to the attention of the management for rectification** and, if the same is **not rectified by the management, we should include the same in the Notes to the Accounts and the compilation report of the accountant.**

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

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

Descriptive Questions

1. Discuss why "inquiry" is important as an audit procedure in an engagement to review financial statements.

Evidence obtained through inquiry is often the principal source of evidence about management intent. However, information available to support management's intent may be limited. In that case, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. Application of professional scepticism in evaluating responses provided by management is important to enable the practitioner to evaluate whether there are any matters that would cause the practitioner to believe the financial statements may be materially misstated.

Performing inquiry procedures also assists the practitioner in obtaining or updating the practitioner's understanding of the entity and its environment, to be able to identify areas where material misstatements are likely to arise in the financial statements.

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.

- **Reading the documentation**, to the extent necessary, of the **preceding year's audit and reviews of prior interim period(s) of the current year** and corresponding interim period(s) of the prior year, to enable the auditor to identify matters that may affect the current-period interim financial information.
- Considering any **significant risks**, including the risk of management override of controls, that were identified in the audit of the prior year's financial statements.
- Reading the most recent annual and comparable prior period interim financial information.
- **Considering materiality** with reference to the applicable financial reporting framework as it relates to interim financial information to assist in determining the nature and extent of the procedures to be performed and evaluating the effect of misstatements.
- Considering the nature of any **corrected material misstatements and any identified uncorrected immaterial misstatements** in the prior year's financial statements.
- Considering significant financial accounting and reporting matters that may be of continuing significance such as **material weaknesses in internal control**.

3. 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.

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.

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,
XXXXXXXXXXXXXXXXXXXXXXXXXXXXX

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.

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

Descriptive 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?

Assurance report can be provided under SAE 3402.

2. Discuss the significance of Pro forma financial information included in prospectus of a company.

Pro forma financial information refers to financial information shown together with adjustments to illustrate the impact of an event or transaction on unadjusted financial information as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration.

The Pro forma financial information is, normally, used in the offer documents to demonstrate the effect of a transaction on the financial statements of a company as if those transactions had occurred at an earlier date.

The Pro forma financial information may take the form of Statement of Profit and Loss and Balance Sheet to illustrate how the transactions might have affected the assets, liabilities and earnings of the Issuer. They also include notes in relation to the significant aspects of the transactions, assumptions used to prepare the Pro forma financial information and the adjustments made.

3. Discuss the term "Pro forma adjustment" under SAE 3420.

In relation to unadjusted financial information, Pro forma adjustments include:

(a) Adjustments to unadjusted financial information that illustrate the impact of a significant event or transaction as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration and

(b) Adjustments to unadjusted financial information that are necessary for the pro forma financial information to be compiled on a basis consistent with the applicable financial reporting framework of the reporting entity and its accounting policies under that framework.

4. Discuss, how, a Chartered Accountant can be associated with prospective financial information without violating relevant provisions of the Chartered Accountants Act, 1949.

Clause 3 of the Second Schedule to the Chartered Accountants Act, 1949 states that that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

The above clause does not preclude a Chartered accountant from associating his name with prospective financial statements. A chartered accountant can participate in the preparation of profit or financial forecasts and can review them, provided he indicates clearly in his report the sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts and so long as he does not vouch for the accuracy of the forecasts.

The same also applies to projections made on the basis of hypothetical assumptions about future events and management actions which are not necessarily expected to take place so long as vouching for the accuracy of the projection is not made.

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 regarding 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 of 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.

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

ICAI SM Questions

1. Briefly describe the advantages and challenges of Auditing digitally.

Advantages of Digital Audit

(i) **Enhanced Effectiveness & Efficiency:** Increased efficiency is one of the key benefits of digital audit. With the use of tools and automation techniques, auditee can standardize the processes and routine tasks can be automated like automating a reconciliation process that previously involved hours increase efficiency and saves time and costs.

(ii) **Better Audit Quality:** Technology can correctly evaluate massive volumes of data quickly. This can assist auditors in determining the areas that require more testing, lowering the chance that serious misstatements or other problems would go unnoticed.

(iii) **Lower Costs:** By automating processes that were previously done manually, technology can assist with the cost of auditing. This may shorten the time needed to complete an audit, which may lower the audit's overall cost.

(iv) **Better Analytics:** Improved analytics capabilities can aid management and auditors in seeing trends and patterns that may be challenging to spot manually. For instance, AI can examine a lot of financial data to spot possible fraud, which is hard for auditors to spot manually.

(v) **Improved Risk Assessment:** Creating a number of automations to assist with the audit process and streamlined testing improves the risk assessment procedure. Management and auditors put their testing efforts on sites with a higher risk of material misstatement and make informed decisions.

Consideration and Challenges of Digital Audit: Some considerations that organization should keep in mind while using digital techniques & automation:

- ✓ Know what business benefits the organization wants to achieve with automation
- ✓ Think people first and do not underestimate change is difficult
- ✓ Target the right processes – this is a key for successful automation.
- ✓ Automation is not a standalone solution and should be part of a broader digitalization strategy.
- ✓ Ensure the process works and it is standardised before automating. Bots do not easily adapt to process change
- ✓ Automation introduces new challenges for organization. Don't forget about governance and data security in the risk framework.

2. What are the stages involved in understanding the IT environment and what key considerations auditor should consider?

The stages involved in understanding of IT environment are:
Understand – Identify – Assess.

Key Areas for an Auditor to Understand IT Environment Key Areas for an Auditor to Understand IT Environment are as follows:

1. Understand the flow of transaction: The auditor's understanding of the IT environment may focus on identifying and understanding the nature and number of the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing or storing those transactions or information.

2. Identification of Significant Systems: The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.

3. Identification of Manual and Automated Controls: An entity's system of internal control contains manual elements and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement.

4. Identification of the technologies used: The need to understand the emerging technologies implemented and the role they play in the entity's information processing or other financial reporting activities and consider whether there are risks arising from their use. Given the potential complexities of these technologies, there is an increased likelihood that the engagement team may decide to engage specialists and/or auditor's experts to help understand whether and how their use impacts the entity's financial reporting processes and may give rise to risks from the use of IT.
Some examples of emerging technologies are:

- Blockchain, including cryptocurrency businesses (e.g., token issuers, custodial services, exchanges, miners, investors)
- Robotics
- Artificial Intelligence
- Internet of Things
- Biometrics
- Drone

5. Assessing the complexity of the IT environment: Not all applications of the IT environment have the same level of complexity. The level of complexity for individual characteristics differs across applications. Complexity is based on the following factors – automation used in the organization, entity's reliance on system generated reports, customization in IT applications, business model of the entity, any significant changes done during the year and implementation of emerging technologies. After considering the above factors for each application the over complexity is assessed of the IT environment.

3. Auditor should scope in ITGCs to tests when there are IT dependencies identified in the system. Briefly describe the types of IT dependencies.

Consider the following five situations: -

1. Automated Controls
Automated controls are designed into the IT environment to enforce business rules. For example, Purchase order approval via workflow or format checks (e.g., only a particular date format is accepted), existence checks (e.g., Duplicate customer number cannot exist), and/or reasonableness checks (e.g., maximum payment amount) when a transaction is entered.

2. Reports
System generated reports are information generated by IT systems. These reports are often used in an entity's execution of a manual control, including business performance reviews, or may be the source of entity information used by us when selecting items for testing, performing substantive tests of details or performing a substantive analytical procedure. E.g. (Vendor master report, customer ageing report)

3. Calculations
Calculations are accounting procedures that are performed by an IT system instead of a person. For example, the system will apply the 'straight-line' depreciation formula to calculate depreciation of an asset (i.e., cost of the asset, less the residual value of the asset at the end of its useful life divided by the useful life of the asset) or the system will calculate the value of the amount invoiced to a customer by multiplying the item price times the quantity shipped.

4. Security

Security including segregation of duties is enabled by the IT environment to restrict access to information and to determine the separation of roles and responsibilities that could allow an employee to perpetrate and conceal errors or fraud, or to process errors that go undetected.

5. Interfaces

Interfaces are programmed logic that transfer data from one IT system to another. For example, an interface may be programmed to transfer data from a payroll subledger to the general ledger.

4. What does cyber risk explain it with some examples.

A cyber-attack is an attempt to gain unauthorized access to a computing system or network with the intent to cause damage, steal, expose, alter, disable, or destroy data.

Regulators across the globe have placed the topic of cyber risk management under increasing scrutiny, requiring financial institutions to assess the maturity of their cybersecurity program, manage cyber risks, and enhance resiliency against cyber-attacks.

Most common types of cyberattacks are:

• **Malware :** Malware or malicious software is any program or code that is created with the intent to do harm to a computer, network or server. Malware is the most common type of cyberattack, its subsets are ransomware, fileless Malware trojans, viruses etc.

Ransomware

In a ransomware attack, an adversary encrypts a victim's data and offers to provide a decryption key in exchange for a payment. Ransomware attacks are usually launched through malicious links delivered via phishing emails, but unpatched vulnerabilities and policy misconfigurations are used as well.

Fileless

Malware Fileless malware is a type of malicious activity that uses native, legitimate tools built into a system to execute a cyber-attack. Unlike traditional malware, fileless malware does not require an attacker to install any code on a target's system, making it hard to detect.

Trojan

A trojan is malware that appears to be legitimate software disguised as native operating system programs or harmless files like free downloads. Trojans are installed through social engineering techniques such as phishing or bait websites.

Mobile Malware

Mobile malware is any type of malware designed to target mobile devices. Mobile malware is delivered through malicious downloads, operating system vulnerabilities, phishing, smishing, and the use of unsecured Wi-Fi.

• **Denial-of-Service (DoS) Attacks :** A Denial-of-Service (DoS) attack is a malicious, targeted attack that floods a network with false requests in order to disrupt business operations. In a DoS attack, users are unable to perform routine and necessary tasks, such as accessing email, websites, online accounts or other resources that are operated by a compromised computer or network. While most DoS attacks do not result in lost data and are typically resolved without paying a ransom, they cost the organization time, money and other resources in order to restore critical business operations.

• **Phishing:** Phishing is a type of cyberattack that uses email, SMS, phone, social media, and social engineering techniques to entice a victim to share sensitive information — such as passwords or account numbers — or to download a malicious file that will install viruses on their computer or phone.

Spear Phishing

Spear-phishing is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. The goal of spear phishing is to steal sensitive information such as login credentials or infect the targets' device with malware.

Whaling

A whaling attack is a type of social engineering attack specifically targeting senior or C-level executive employees with the purpose of stealing money or information or gaining access to the person's computer in order to execute further cyberattacks.

Smishing

Smishing is a type of fraudulent practice of sending text messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords or credit card numbers.

Vishing

Vishing, a voice phishing attack, is the fraudulent use of phone calls and voice messages pretending to be from a reputable organization to convince individuals to reveal private information such as bank details and passwords.

• **Spoofing:** Spoofing is a technique through which a cybercriminal disguises themselves as a known or trusted source. In so doing, the adversary is able to engage with the target and access their systems or devices with the ultimate goal of stealing information, extorting money or installing malware or other harmful software on the device.

Domain Spoofing

Domain spoofing is a form of phishing where an attacker impersonates a known business or person with fake website or email domain to fool people into the trusting them. Typically, the domain appears to be legitimate at first glance, but a closer look will reveal subtle differences.

Email Spoofing

Email spoofing is a type of cyberattack that targets the businesses by using emails with forged sender addresses. Because the recipient trusts the alleged sender, they are more likely to open the email and interact with its contents, such as a malicious link or attachment.

• **Identity-Based Attacks :** When a valid user's credentials have been compromised and an adversary is pretend to be that user. For e.g., people often use the same user ID and password across multiple accounts. Therefore, possessing the credentials for one account may be able to grant access to other, unrelated account.

• **Insider Threats :** When current or former employees that pose danger to an organization because they have direct access to the company network, sensitive data, and intellectual property (IP), as well as knowledge of business processes, company policies or other information that would help carry out such an attack.

• **DNS Tunneling :** DNS Tunneling is a type of cyberattack that leverages domain name system (DNS) queries and responses to bypass traditional security measures and transmit data and code within the network. This tunnel gives the hacker a route to unleash malware and/or to extract data, IP or other sensitive information by encoding it bit by bit in a series of DNS responses.

• **IoT-Based Attacks:** An IoT attack is any cyberattack that targets an Internet of Things (IoT) device or network. Once compromised, the hacker can assume control of the device, steal data, or join a group of infected devices

Cyber Security Framework includes how management is identifying the risk, protecting and safeguarding its assets (including electronic assets) from the risk. Management preparedness to detect the attacks, anomalies and responsiveness to the adverse event.

1 Identify the risk

Auditor has to determine whether the entity's risk assessment process considers cybersecurity risks.

Entity should conduct a **periodic risk assessment & develop a management strategy** which identifies cybersecurity risks around IT system failure affecting the entity's primary business or potential loss of data or inability to access data as required, Risk of unauthorized access to the IT network.

The entity should maintain and periodically reviews an inventory of their information assets- i.e., **Asset Management** (e.g., intellectual property, patents, copyrighted material, trade secrets and other intangibles).

The entity should classify and prioritize protection of their information assets based on sensitivity and business value and periodically reviews the systems connected to the network on which digital assets reside.

From the **governance** perspective management should review how cybersecurity risks affect internal controls over financial reporting. In case of adverse attack how management is going to assess the impact on the recoverability of financial data and impact on revenue recognition.

Management needs to identify if any established a risk-based cybersecurity program can be leveraged e.g. (NIST, ISO etc.)

To determine overall responsibility for cybersecurity in the **business environment** entity should establish roles and responsibilities over cybersecurity (CISO, CIO). Further the risk assessment should be discussed with those charged with governance (e.g., the Audit Committee or Board of Directors).

2 Protect the risk

Obtained an understanding of the entity's processes for safeguarding of assets subject to cybersecurity. Entity monitors whether there has been **unauthorized access** to electronic assets and any related impact on financial reporting.

Formal training should be conducted to make the teams aware of the risk associated with cyberattacks. Entity should implement effective controls for **data security**. Entity should have a process & procedures in place for identifying material digital/electronic assets on the balance sheet subject to cybersecurity risk (e.g., intellectual property, patents, copyrighted material, trade secrets) and prioritizing their protection based on criticality.

3 Detect The risk

Entity should have controls and procedures that enable it to identify cybersecurity risks and incidents and to assess and analyse their impact on the entity's business, evaluate the significance associated with such risks and incidents, and consider timely disclosures.

Review entity's processes to monitor and detect security breaches or incidents. If management has implemented anti-virus in the system to secure it from anomalies or if firewall logs are being continuously monitored to detect any repetitive attacks. A monitoring process should be established to review how many such events have been denied by the firewall. Monitoring process should also include if any upgrades or updates are required to safeguard the systems from vulnerabilities.

4 Respond to the risk

In case of material cybersecurity or data breach has been identified management should capture the details of nature of incident and how the incident or data breach was identified. Entity should have a response planning in place to

capture the details of nature of incident and the same needs to be communicated with those who are ultimately responsible for this framework and with those charge with governance.

The security incident response plan helps in analysing the impact and severity of the attack and helps the organisation in taking the appropriate actions. Management should assess Litigation costs, Regulatory investigation costs and Remediation costs as a part of mitigation process and improvement management should assess the future action plans that needs to be taken to safeguard the organisation from such attacks.

5 Recover from risk

Entity should undertake appropriate actions to recover from the attack and make sure the business is up and running.

Once the impact evaluated and communicated with the regulators the recovery plan needs to be implemented to overcome the impact. Necessary improvements – like patch upgrades, better controls, improved technology in terms of firewall, anti-virus, tools etc needs to be implemented to safeguard the entity.

5. What are the advantages and disadvantages of remote audit?

Advantages	Disadvantages
Cost and time effective: No travel time and travel costs involved.	Due to **network issues**, interviews and meetings can be interrupted.
Comfort and flexibility to audit team as they would be working from home environment	**Limited or no ability to visualize culture** of org, **& body language** of auditees. Time zone issues could also affect efficiency of remote audit session
Time required to gather evidence can **spread over several weeks**, instead of concentrated into a small period that takes personnel from their daily activities.	Opportunity to present **doctored documents & omit relevant info** is increased. This may call for additional planning, some additional/ different audit procedures, Security & confidentiality violation.
Auditor can get **first-hand evidence** directly from IT system as direct access may be provided.	**Remote access to sensitive IT systems may not be allowed**. Security aspects related to remote access and privacy needs to be assessed
Widens selection of auditors from global network of experts.	**Cultural challenges** for auditor. Lack of knowledge for local Law or Regulation could impact audit. Audit procedures like physical verification of assets and stock taking can't be performed.

6. 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 highlevel 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.

Data Analytic Techniques

Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics. Audit analytics or audit data analytics involves analyzing large sets of data to find actionable insights, trends, draw conclusions and for informed decision making. The use of audit analytics enables greater efficiencies and more accurate findings from the review process.

The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs.

Some of the popular tools used across the industry as part of CAATs are listed below:

1. ACL - Audit Command Language (ACL)

Analytics is a data extraction and analysis software used for fraud detection and prevention, and risk management. It samples large data sets to find irregularities or patterns in transactions that could indicate control weaknesses or fraud.

2. Alteryx - Alteryx is used to consolidate financial or operational data to assess controls. A fully transparent audit trail of every action is performed in Alteryx in form of a workflow which makes it easier for the user to learn as no prior knowledge of coding or scripting is required.

3. Power BI – Power Bi is a business intelligence (BI) platform that provides nontechnical business users with tools for aggregating, analyzing, visualizing and sharing data. From audit perspective, such visualization tools can be used to find the outliers in the population, it can also be used for reporting purpose (audit reports) in an interactive dashboard to the higher management.

4. CaseWare – CaseWare is a data analysis software & provide tools that helps in conducting audit and assurance engagements quickly, accurately and consistently. It shares analytical insights which help in taking better informed decisions. It helps in streamlining processes and eliminating the routine tasks. Used by accounting firms, governments and corporations worldwide, this trusted platform integrates everything you need to conduct assurance and reporting engagements.

7. 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.

1. **Internet of Things**
   - IoT is concept of connecting any device (cell phones, coffee makers, etc) to internet.
   - Key components of IoT are data collection, analytics, connectivity, and people and process.
   - IoT not only changes business model, but also affects strategic objectives of org.
   - Risk profile of entity changes with exposure to new L/R

Audit Implications

- Shift to connected devices & systems may result in auditors unable to rely only on manual controls.
- Instead, auditors may need to scope new systems into their audit.
- Audit firms need to train & upskill auditors to evaluate design and operating effectiveness of automated controls.
- Consumer facing tools that connect to business environments in new ways can impact flow of transactions & introduce new risks for mgt and auditors to consider.
- Eg. payment processing tools allowing users to pay via credit card through mobile device at retail location. Creating a new path for incoming payments that may rely, in part, on new service provider supplying & routing information correctly.
- Auditors need to consider volume of those transactions, processes and controls related to it.

Common risks

Device hijacking, data siphoning, denial of service attacks, data breaches and device theft.

2. **Artificial Intelligence (AI)**
   - Refers to system or machine that can think and learn.
   - AI systems utilize data analysis & algorithms to make decisions based on predictive methods.

- Complex algos are developed to propose decisions based on a pattern or behavior learned over time.

Examples:

- ✓ Self-driving cars, manufacturing robots, smart assistants, virtual travel booking agent etc.
- ✓ AI predicting when to book lowest prices for flights, hotels, car & vacation home rentals. Using historical flight and hotel data, AI will also recommend to user whether booking has reached its lowest price point or if user should hold out a bit longer for price to drop.

Auditor Implications

- **Focus:** Given invisible nature of algos, audits must focus on logical flow of processes.
- **Algo Check:** A review of AI should ascertain whether unintended bias added to algos. Assess effectiveness of algos and whether their output is appropriately reviewed and approved.
- **Bugs & Vulnerability:** Because AI is built on software modules, consider cybersecurity and search for possible bugs and vulnerabilities that can impact AI functionality.
- **AI Affect:** Confirm their understanding of how use of AI affects entity's flows of transactions, including generation of reports or analytics used by mgt.
- **Decision Making:** Also consider whether AI is making decisions or utilized by mgt as part of decision making process.

Common risks for AI

- **Security** is one of key risks. More data system uses, from more sources, more entry points & connections are formed and greater potential risks.
- **Inappropriate configuration:** AI may be used to diagnose medical conditions. If it is badly configured or malfunctions, it could harm people before problem is spotted.
- **Data privacy:** Data used & shared should have necessary explicit consent from data providers.

3. Blockchain

- Based on a decentralized & distributed ledger secured through encryption.
- Each transaction is validated by blockchain participants, creating a block of info. that's replicated & distributed to all participants.
- All blocks are sequenced so that any modification or deletion of block disqualifies the info.

Example

Bitcoin, cryptocurrency transfer application - Blockchain in money transfer, blockchain smart contracts.

Audit Implications

Governance & Security: Consider appropriate governance and security measures around transactions.

- ✓ Blockchain's core security premise rests on cryptography, there are risks associated with it.
- ✓ As blockchain interacts with legacy systems and business partners, concerns related to insecure application programming interfaces (APIs), data confidentiality & privacy can't be ignored.
- ✓ Weak blockchain application development protocols are something auditors cannot overlook.

Data Privacy Laws: Data privacy L/R may be area of concern as data communicated across geographic boundaries. Determine whether data put on blockchain will expose entity to liability for NOCLAR.

Common risks for blockchain technology (Strengths of blockchain can also be its weaknesses)

- ✓ Inability to reverse transactions & access data without required keys make system secure, but also mean that org need specific protocols & processes to ensure that they aren't locked out & have contingency plans.
- ✓ Operating through network nodes also expose org. to cyber-attacks and data hacks, so security issues are important.

- ✓ Also ensure that org has necessary processes and complies with regulations. Regulatory landscape is still evolving for blockchain, so audit teams should check that compliance managers are following developments constantly and adapting processes accordingly.

8. 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.

CONTROL CONSIDERATIONS OR OBJECTIVES OF AUDITING DIGITALLY

Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks. The strength of the auditing profession is the assessment of risks and controls.

Some examples of technology risks where auditors should test the appropriate controls for relying on digital systems

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both
- Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database)
- The possibility of information technology personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby leading to insufficient segregation of duties
- Unauthorized or erroneous changes to data in master files
- Unauthorized changes to systems or programs
- Failure to make necessary or appropriate changes to systems or programs
- Inappropriate manual intervention
- Potential loss of data or inability to access data as required
- Risks introduced when using third-party service providers
- Cybersecurity risks

As they address the challenge of assessing technology risk, auditors can and should focus on the following control considerations:

1. Auditors should gain a holistic understanding of changes in the industry and the information technology environment to effectively evaluate management's process for initiating, processing, and recording transactions and then design appropriate auditing procedures.
2. Auditors, as appropriate, should consider risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional, legacy systems.
3. Auditors should consider whether digital upskilling or specialists are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.

Integrated Case Scenario

[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 course of audit of company, its noticed that a cyber attack took place on the data in which files were encrypted and computers got locked. Hacker then demanded a booty for decryption of files 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 emails 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 and 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.

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

Descriptive 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?

Top 1000 listed companies by market capitalization required to file BRSR.

Reporting questionnaire is divided into three sections:

(i) Section A – General Disclosures

This section contains the details of the listed companies, its products, services, operations, employee related details, its holding, subsidiary, associate companies etc.

(ii) Section B – Management Process and disclosures

It contains questions related to policy and management processes, governance, leadership, and oversight.

(iii) Section C – Principle-wise performance disclosures

Companies are required to report upon Key performance indicators (KPIs) in alignment with the nine principles of the NGRBC.

The section classifies KPIs into two categories that companies are required to report upon:

- **Essential indicators (Mandatory disclosures)** This would include data on training programs conducted, environmental data on energy, emissions, water, waste management etc.
- **Leadership indicators (Optional disclosures)** It would include life cycle assessments, details of conflict management policy, additional data, on biodiversity, energy consumptions, supply chain managements etc.

2. What are the global trends in sustainable reporting?

The mandatory reporting requirements are mostly associated with the public sector or government run companies, large corporations, multi-national business conglomerates, and listed companies in the stock exchanges. Furthermore, sector-specific, and thematic reporting provisions are also becoming more common.

The most widely used framework in the world is the Global Reporting Initiative (GRI) Sustainability Reporting Standards having 93% of the world's largest 250 corporations report on their sustainability performance through GRI. It is used in over 100 countries to report sustainability. This independent international organization is based in Amsterdam, the Netherlands, and has operational hubs in Brazil, China, Colombia, India, South Africa, and the United States. The GRI Sustainability Reporting Standards are developed with true multi-stakeholder contributions and rooted in the public interest.

1. Global Reporting Initiative (GRI) – helps the organizations to report on economic, environmental, and social impacts. The general disclosures which are required to be reported under this standard are Economic, Environment and Social. This report is addressed to all the stakeholders of the entity.

2. Carbon Disclosure Project (CDP) – captures the environmental performance data which is related to GHG emissions, water, forests, and supply chain. Major details required to be reported are climate change, Forest, and Water security. This report is addressed to all the investors, buyers, and other stakeholders of the entity.

3. International Integrated Reporting Framework (IIRC) – has established guiding principles and content elements in order to allow the companies to produce integrated reports. This report consists of Organisational overview, Governance structure, Business model, risks and opportunities, strategy, performance, outlook etc.

3. What are the 6 C's of Integrated reporting?

There are 6 Cs of Integrated Reporting – also known as 6 capitals:

(i) Financial Capital:

- Pool of funds that is available to the organization for use in the production of goods or provision of services.
- Obtained through financing, such as debt, equity, or grants, or generated through operations or investments.

(ii) Manufactured Capital:

- Seen as human-created, production-oriented equipment and tools.
- Available to the organization for use in the production of goods or the provision of services, including buildings, equipment, infrastructure (such as roads, ports, bridges & waste, and water treatment plants).

(iii) Natural Capital:

- Is an input to the production of goods or the provision of services.
- An organization's activities also impact, positively or negatively, on natural capital.
- Includes water, land, minerals and forests, biodiversity, and ecosystem health.

(iv) Human Capital:

People's skills and experience, their capacity, and motivations to innovate, including their:

- Alignment with and support of the organization's governance framework & ethical values such as its recognition of human rights.
- Ability to understand and implement an organization's strategy.
- Loyalties and motivations for improving processes, goods, and services, including their ability to lead and to collaborate.

(v) Social Capital:

- Institutions and relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being.
- Includes:
  - Common values and behaviour.
  - key relationships, the trust and loyalty that an organization has developed and strives to build and protect with customers, suppliers, and business partners.
  - an organization's social license to operate.

(vi) Intellectual Capital:

Key element in an organization's future earning potential, with a tight link and contingency between investment in R&D, innovation, human resources, and external relationships, which can determine the organization's competitive advantage. Asia Pacific region continues to dominate in presenting sustainability data in annual reports. Approximately with 60% of Companies reporting in 2022. Integrated reporting is strong in the Middle East.

4. What is the methodology of providing assurance in BRSR?

1. Preliminary Review of ESG report, parameters
2. On-site Assessment / Verification of ESG Report
3. Issuance of Assessment Report and Assessment Statement
4. Review of the responses and clarifications on the findings Submission of findings of the onsite assessment and document review
5. Preparation of Assessment / Verification report including final results of Assessment/ Recommendation

5. What is the auditor's role on ESG aspects in an audit of financial statements of the Company?

The role of the auditor is to **obtain reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, to enable auditor to report whether the financial statements are prepared and presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

In developing the **understanding of an entity**, the auditor should include the consideration of climate related risks and how these risks may be relevant to the audits. The climate-related risks could be more relevant in certain sectors or industries, e.g., banks and insurance, energy, transportation, materials and buildings, agriculture, food, and forestry products.

Many investors and stakeholders are seeking information from auditor's reports about how climate related risks were addressed in the audit. With this increased user focus on climate change, auditor need to be aware of, and may face, increasing pressure for transparency about climate matters in our auditor's reports. However, the auditor's reports must follow the requirements of applicable auditing standards.

The **auditor's report is a key mechanism of communication** to users about the audit that was performed. In addition to the audit opinion, it provides information about **auditor's responsibilities** and, when required, an understanding of the **matters of most significance in our audit and how they were addressed**.

In some circumstances, it may warrant inclusion of an **Emphasis of matter paragraph** to draw attention to disclosures that are of fundamental importance to users' understanding of the financial statements. The auditor should also determine whether the entity has appropriately disclosed relevant climate-related information in the financial statements in accordance with the applicable financial reporting framework e.g., Indian Accounting Standards or Accounting Standards, when relevant before considering climate-related matters in the auditor's report.

The auditor should also **read the other information** for consistency with information disclosed in the financial statements and information that may be publicly communicated to stakeholders outside the financial statements, such as management report narratives in the annual report, press releases, or investor updates. This is a requirement under ISA 720 and SA 720, The Auditor's Responsibilities Relating to Other Information.

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 enduse 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?

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. 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?

Company A has absorbed impact of regulatory changes. It has decided to eliminate redlabelled 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.

3. What would be the consideration by the auditors of Company A and B in the audit of financial statements?

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.

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.

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

CARO 2020

1. Jam Private Limited was engaged in business of manufacture of Cycles. CA Roy was appointed as a Statutory Auditor of the Company for the financial year 2021-22. During the year under audit, Jam Private Limited obtained working capital facilities from ABC Bank Limited for ₹ 10 crore hypothecating the Stock of goods as primary security. On inquiry CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited and the details of submission of quarterly stock statement are as follows:

Period of Qtr	Stock value as per Books of a/c at end of Qtr (₹ in Cr)	Stock Value as per quarterly statement submitted to ABC Bank Ltd as at end of qtr (₹ in Cr)
Q1	11.50	14.00
Q2	14.75	17.00
Q3	11.50	14.00
Q4	15.25	15.25

The management of Jam Private Limited did not disclose the above variations in notes to accounts forming part financial Statements of the Company for the year 2021-22. The management replied that there are no variations as on the Balance sheet date and further they are of the view that stock statement furnished to bank is only a formality and computed arbitrarily only for the purpose of securing higher drawing power and hence statutory auditors need not be bothered.

Is the contention of the management valid? As a Statutory Auditor how CA Roy should deal and discuss the disclosure/reporting requirements if any, as per the Companies Act, 2013 and CARO, 2020. [May-22]

As per **clause (vii) of point Y of Schedule III to the Companies Act, 2013 - Division I - Financial Statements** for a company whose financial statements are required to comply with the Companies (Accounting Standard) Rules, 2006, "where the company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following :

(a) whether **quarterly returns or statements of current assets** filed by the company with banks or financial institutions are in agreement with the books of accounts.

(b) if not, **summary of reconciliation and reasons of material discrepancies,** if any to be adequately disclosed.

Further, as per **para 3(ii) (b) of CARO 2020**, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

The above clause requires CA Roy to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ₹ 5 crores in aggregate. Jam (P) Ltd. has been sanctioned working capital facilities/limit of ₹ 10 crores which is apparently in excess of ₹ 5 crores. Secondly, whether the quarterly returns filed by the Jam (P) Ltd. company with ABC Bank Ltd. are in agreement with the book of accounts of the company.

According to the data given in the instant situation, it is clear that there are variations in Quarter 1, Quarter 2 & Quarter 3 requiring reporting under this clause because of difference in stock value as per Book of Accounts & Stock Value as per Quarterly returns submitted to ABC Bank Ltd.

Therefore, Contention of the management is not valid. CA. Roy should report the differences as per the Companies Act, 2013 and CARO 2020 as follows:

Qtr	Stock value as per Book Accounts (₹ in Crore)	Stock value as per quarterly statement Submitted to ABC Bank Ltd. (₹ in Crore)	Variation
Q1	11.50	14.00	Excess reporting by 2.50 Cr
Q2	14.75	17.00	Excess reporting by 2.25 Cr
Q3	11.50	14.00	Excess reporting by 2.50 Cr

2. Gautam Limited had borrowed ₹ 1000 crore from XYZ Bank, the principal of which was repayable after 5 years and interest was payable at the end of each year. For 4 years, Gautam Limited paid the interest amount on time. Gautam Limited defaulted the 5 th instalment of interest payment and principal which was due on June 30, 2021. On March 31, 2021, Gautam Limited approached XYZ bank and MNO bank to restructure the existing liability. As a result, the existing principal and outstanding and overdue interest was restructured into a new loan amounting to ₹ 1,100 crore. The management did not provide any disclosure for the default on the loan on the belief that the old loan ceased to exist and the new loan has maturity after 5 years.

During the statutory audit for the financial year 2021-22, KP & Co. identified this transaction and obtained the relevant documents and understanding. Based on the underlying documents, it was identified that the said restructuring agreement was approved and signed on April 8, 2022, by both of the banks. As a result, on March 31, 2022, the restructuring was still not approved. In the light of the above scenario, kindly guide the statutory auditors in the reporting of this transaction. [RTP Nov-22]

As per **Clause 3(ix) of CARO 2020**, the auditor is required to report whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below.

Nature of borrowing, including debt securities	Name of lender	Amt not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, any if
	*lender wise details for Banks, financial institutions & Govt				

In the given case, the company Gautam Limited defaulted in payment of the principal amount of the loan due of ₹ 1000 crore on 30 June 2021 and the interest instalment of ₹ 100 crore. The said default continued till the end of the year and on 8 April 2022, a restructuring agreement was signed by the banks and company for re-structuring the outstanding loan. Moreover, no disclosure was provided by the company with respect to the said matter.

Hence the auditor is required to report the same matter under **Clause (ix) of Para 3 of CARO 2020**, i.e., whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, then provide the details of the period and the amount of default. Also, the auditor needs to consider the impact of such non-disclosure and the non-compliance with the financial reporting framework and accordingly the auditor needs to either issue a qualified opinion or an adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

3. Mr. Arjun was appointed as the engagement partner on behalf of Bhism & Co., a Chartered Accountant Firm, for conducting statutory audit assignment of Sinwar Ltd., unlisted public company. Mr. Brijesh, one of the senior engagement team members, was given the responsibility to audit the matters as per the requirements of CARO, 2020 and in that connection, he made the following observations, that may be relevant for reporting as per the said Order:

S No	Observations
(a)	**One of the Plant and Equipment taken on a lease ('right of use' asset) by Sinwar Ltd. was revalued based on the valuation by a registered valuer and the net carrying value of Plant and Equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crore.**
(b)	**During the year under consideration, cash credit limit of ₹ 5.5 crore was sanctioned to Sinwar Ltd. by DMC Bank based on the security of current assets which was reduced to ₹ 4.5 crore after 6 months. In this connection, quarterly returns have been filed by the company with the DMC bank which are in agreement with Books of Accounts.**

You are required to examine the contention of Mr. Brijesh regarding reporting of the above observations in accordance with CARO 2020. [RTP May-22]

Matters to be reported by Mr. Brijesh as per CARO, 2020 are as follows:-

(a) According to **Clause (i) (d) of Para 3 of CARO 2020**, the auditor is required to report whether the company has **revalued** its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a **Registered Valuer**; specify the **amount of change**, if the **change is 10% or more in the aggregate of the net carrying value** of each class of Property, Plant and Equipment or intangible assets;

In the given situation, Sinwar Ltd. has revalued one of the Plant and Equipment taken on a lease ('right of use' asset) based on the valuation by a registered valuer. The amount of change in the value of such Plant and Equipment is ₹ 45 lakh. As the net carrying value of Plant and Equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crore i.e. change was 10% or more.

Thus, the auditor is required to report the amount of change of ₹ 45 lakh in accordance with Clause (i) (d) of Para 3 of CARO 2020.

(b) As per **Clause (ii) (b) of Para 3 of CARO 2020**, the auditor is required to report whether during any point of time of the year, the company has been **sanctioned working capital limits in excess of five crore rupees**, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

In the instant case, Sinwar Ltd. has been sanctioned a cash credit limit of ₹ 5.5 crore by DMC Bank during the year under consideration, which is exceeding the prescribed limit of ₹ 5 crore based on the security of current assets. Further, quarterly returns have also been filed by the company with the DMC bank in this connection which is in agreement with Books of Accounts.

In view of the above, the auditor is required to report the same in accordance with Clause (ii) (b) of Para 3 of CARO 2020.

4. Astha Pvt. Ltd. has fully paid capital of ₹ 140 lakhs. During the year, the company had borrowed ₹ 15 lakhs each from a bank and a financial institution. It had the turnover (Net of GST ₹ 50 lakhs which is credited to a separate account) of ₹ 475 lakhs. Will Companies (Auditor's Report) Order, 2020 be applicable to Astha Pvt. Ltd.?

In the case of Astha Pvt. Ltd., it has outstanding loan of ₹ 30 lakhs (₹ 15 lakhs + ₹ 15 lakhs) collectively from bank and financial institution which is less than ₹ 1 crore rupees and turnover is ₹ 475 lakhs i.e. also less than ₹ 10 crores and not exceeding the limit. However, it has paid capital of ₹ 140 lakhs i.e. more than ₹ 1 crore.

Thus, considering its paid up capital which is exceeding the prescribed limit for exemption, CARO, 2020 will be applicable to Astha Pvt. Ltd.

5. A term loan was obtained from a bank for ₹ 80 lakhs for acquiring R&D equipment, out of which ₹ 15 lakh was used to buy a car for use of the concerned director who was looking at the R&D activities. As a statutory auditor, how would you report under CARO 2020.

According to **clause (ix) of Para 3 of CARO, 2020,** the auditor is required to report "whether term loans were applied for the purposes for which those were obtained. If not, the amount of loan so diverted and the purpose for which it is used may be reported".

The auditor should examine T&Cs of term loan with actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.
In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car which has no relation with R&D equipment.
Therefore, **car though used for R&D Director cannot be considered as R&D equipment.** The auditor should state the fact in his report as per Paragraph 3 clause (ix) of the CARO 2020, that out of the term loan taken for R&D equipment, ₹ 15 lakhs was not utilised for the intended purpose of acquiring R&D equipment.

6. T Pvt. Ltd.'s paid up capital & reserves are less than ₹ 50 lakhs and it has no outstanding loan exceeding ₹ 25 lakhs from any bank or financial institution. Its sales are ₹ 6 crores before deducting trade discount ₹ 10 lakhs and sales returns ₹ 95 lakhs. The services rendered by the company amounted to ₹ 10 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss.

In the given case, paid up capital and reserves of T Pvt. Ltd. are less than ₹ 1 crore and has no loan outstanding exceeding ₹ one crore from any bank or financial institution.
Further, its total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) is not exceeding rupees ten crore during the financial year as per the financial statements.
Thus, CARO 2020 will not be applicable to T Pvt. Ltd.

7. Physical verification of only 40% of items of inventory has been conducted by the company. The balance 60% will be conducted in next year due to lack of time and resources. As a statutory auditor, how would you report under CARO 2020.

Physical Verification of Inventory: Clause (ii) of Para 3 of CARO, 2020 requires the auditor to report on whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate. Physical verification of inventory is the responsibility of the management which should normally verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals and on coverage and procedures applied should examine the adequacy of evidence and record of verification.

In the given case, the above requirement of CARO, 2020 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact thereof on financial statements and his report accordingly.

8. You are appointed as the Auditor of XMP Pvt. Ltd. for financial year 2021-22 after the resignation of RS & Co. Chartered Accountants, as statutory auditor of the company. RS & Co., had certain concerns on the accounting matters of the company, leading to change of auditors. All the compliances under Sections 139 and 140 are made by the company with regard to resignation and appointment.

During the course of audit, it came to your notice that a survey has been conducted on December 7, 2021 by the Income Tax Department and department has unearthed unrecorded sales of ₹5 lakhs which had been made in cash on different dates during the year 2020-21. XMP Pvt. Ltd. has purchased gold from such collections and these transactions are not recorded. Company surrendered and disclosed these' transactions before the assessing officer and paid taxes thereon. However, company has not recorded those transactions in books of account even after surrender before Income Tax authorities.

You want to report the above matters in CARO, but the management requested you not to report them. Comment with respect to auditor's response to the management and his reporting requirements to the shareholders.

[Nov-22]

As per **clause (xviii) Para 3 CARO 2020**, Auditor needs to report, whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors; So, he should have considered the concerns on the accounting matters of the company raised by previous auditor.

Also, as per **clause (viii) Para 3 of CARO 2020**, Auditor needs to report, whether any **transactions not recorded in the books of account have been surrendered or disclosed as income** during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year;

Since in given case Company surrendered and disclosed these' transactions before the assessing officer and paid taxes thereon. However, company has not recorded those transactions in books of account even after surrender before Income Tax authorities. Auditor needs to report the same.

9. What is a Core Investment Company (CIC) under the Reserve Bank of India regulations ? What are the specific reporting requirements to be considered by an auditor in respect of CIC under CARO 2020 ?

[Nov-22]

Core Investment Company (CIC) is a **non-banking financial company** carrying on the **business of acquisition of shares and securities** and which satisfies the **following conditions** as on the date of the last audited balance sheet:-

(i) it holds **not less than 90% of its net assets** in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

(ii) its **investments in the equity shares** (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) **in group companies** and units of Infrastructure Investment Trust (InvITs) only as sponsor constitute **not less than 60% of its net assets** as mentioned in clause (i) above;

Provided; that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.

(iii) it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

(iv) it does **not carry on any other financial** activity referred to in Section 45I(c) and 45I(f) of the Reserve Bank of India Act, 1934 except

a. investment in

i) bank deposits,
ii) money market instruments, including money market mutual funds that make investments in debt/money market instruments with a maturity of up to 1 year
iii) government securities, and
iv) bonds or debentures issued by group companies,

b. granting of loans to group companies and

c. issuing guarantees on behalf of group companies.

Auditor's reporting requirement under Clause (xvi) Para 3 CARO 2020,

(c) whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;

(d) whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group;

10. LIU Private Limited is a company based out of Mumbai. The company had an authorised capital of ₹ 200 lakh and paid-up capital plus reserves of ₹ 95 lakh as of 31st March. During the audit for the year ended 31st March 202X, the auditor M/s Y&S Associates noted the following points:

(i) On 15th December, the company had total bank borrowings of ₹ 75 lakh. On the said date, the company received a new loan of ₹ 30 lakh for a new project that was to be developed. However, the project was shelved on 17th December due to technical reasons, and the whole loan was paid on the same date.

(ii) During the financial year, a new proceeding was initiated against the company for holding a benami property worth ₹ 2.5 crore. However, the company's legal team had advised that the case would not withstand the law and would be dismissed during the hearing in April of next financial year.

(iii) The company had incurred a cash loss of ₹ 39 lakh during the financial year compared to a cash profit of ₹ 15 lakh in the previous financial year. The total turnover of the company for the financial year was ₹ 45 Crore.

During the year, the Y&S Associates had offered to resign from acting as the company's auditors. However, they later decided to postpone their resignation to the following year.

At the conclusion of the audit, there was a difference of opinion between two articled assistants (Jack & Jill), who were assigned to the engagement, concerning disclosing the points mentioned above in the Companies (Auditor's Report) Order 2020. Jack was of the opinion that the proceeding initiated under Benami Property Act need not be disclosed since the expert legal team had informed them that the case would not withstand the law.

However, he insisted that the cash loss shall be disclosed along with the amount. Jill was of the opinion that CARO is not at all applicable to the company, hence nothing needs to be reported. They both approached the firm's partners (Mr. Y & Mr. S) to resolve their argument. Mr Y supported Jack's viewpoint & Mr S supported Jill's viewpoint. Now, both partners approached their Senior Partner to get clarification on the same. As a Senior Partner, kindly clarify the correct disclosure requirement. [RTP May-23]

As per para 1 of Companies (Auditor's Report) Order 2020, CARO 2020 is applicable to every company, including a foreign company, as defined in clause (42) of section 2 of the Companies Act 2013, except, (i) a **banking company** as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an **insurance company** as defined under the Insurance Act,1938 (4 of 1938);

(iii) a company licensed to operate under **section 8** of the Companies Act;

(iv) a **One Person Company** as defined under clause (62) of section 2 of the Companies Act and a **small company** as defined under clause (85) of section 2 of the Companies Act; and

(v) a **private limited company, not being a subsidiary or holding company of a public company**, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the given case, though LIU is a private company, and its paid-up capital is less than ₹ 1 crore as on the balance sheet date, it is to be noted that for the period 15th December to 17th December, the total **borrowings of the company had exceeded ₹ 1 crore** (75 lakh + 30 lakh). The borrowings are less than ₹ 1 crore as of the balance sheet date and the authorised capital is ₹ 200 lakh, are irrelevant to the current scenario. Also, the turnover of the company was greater than ₹ 40 crore. Hence, **CARO 2020 is applicable** to LIU Private Limited.

i) As per **clause (i) (e) of para 3 of CARO 2020**, the auditor shall include a statement on: whether any **proceedings have been initiated or pending against the company** for holding any benami property under the **Benami Transactions (Prohibition) Act, 1988**(45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.
In the given situation, a new proceeding was initiated against the company for holding a benami property worth ₹ 2.5 crores during the financial year. However, the company's legal team had advised that the case would not withstand the law and would be dismissed during the hearing, which would be held in April of the next financial year.
Therefore, the above observation of a new proceeding initiated against the company for holding a benami property worth ₹ 2.5 crores **need to be disclosed** as per clause (i) (e) of para 3 of CARO 2020.

ii) As per **clause (xvii) of para 3 of CARO 2020**, the auditor shall include a statement on whether the company has **incurred cash losses in the financial year and in the immediately preceding financial year**, if so, state the amount of cash losses. In the given situation, the company incurred a cash loss of ₹ 39 lakh during the financial year. Hence, a cash loss of ₹ 39 lakh during the financial year **need to be reported** as per clause (xvii) of para 3 of CARO 2020.

iii) As per **clause (xviii) of para 3 of CARO 2020**, the auditor shall include a statement on whether there has been any **resignation of the statutory auditors during the year**, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

In the instant case, there has been no resignation made by the statutory auditors during the financial year. The mere fact that Y&S Associates were thinking of resigning does not matter in the current scenario, and hence this **clause shall not be applicable** in the given situation.

11. CA. F has been appointed as the Statutory Auditor of XYZ Limited for the financial year 2022-23. XYZ Limited has one subsidiary, namely AT Private Limited, whose statutory auditor is CA. B for the same financial year i.e., 2022-23. CA. B issued a qualification in CARO 2020 for AT Private Limited, stating that short -term funds raised were utilised for long-term purposes. When consolidating the financial statements, CA. F decided to include the aforementioned qualification in the audit report of the Consolidated Financial Statements for the financial year 2022-23. The management of XYZ Limited argued that CA. F is not obligated to take into account and report the qualification given by CA. B in the audit report of the subsidiary company in the consolidated financial statements for the financial year 2022-23. Discuss the reporting requirement as per CARO, 2020. [RTP Nov-23]

XYZ Limited is the parent company, and it has a subsidiary named AT Private Limited. CA F is the appointed statutory auditor for XYZ Limited for the financial year 2022 -23. Another auditor, CA B, has conducted the statutory audit for AT Private Limited and issued a CARO 2020 report, which includes a qualification regarding the short-term funds raised and utilised for long-term purposes.

Provision of Paragraph 2 of CARO 2020: Paragraph 2 of CARO 2020 specifies that the CARO provisions do not apply to the auditor's report on consolidated financial statements except for clause (xxi) of Paragraph 3.

Clause (xxi) of Paragraph 3 of CARO 2020: Clause (xxi) of Paragraph 3 of CARO 2020 mandates the auditor to comment on whether there are any qualifications or adverse remarks in the CARO reports of companies included in the consolidated financial statements. If such qualifications or adverse remarks exist, the auditor is required to provide details of the companies and the paragraph numbers of the CARO report containing those qualifications or adverse remarks.

CA F's Responsibility: Considering the provisions stated above, CA F, as the auditor of XYZ Limited's consolidated financial statements, is required to follow these steps:

a. **Report under Clause (xxi) of Paragraph 3 of CARO 2020:** CA F must include a comment in the consolidated financial statement's audit report regarding whether there are any qualifications or adverse remarks in the CARO reports of the companies included in the consolidated financial statements.
b. **Incorporate Qualification by CA B:** CA F should incorporate the qualification made by CA B (regarding short-term funds raised and utilized for long-term purposes in AT Private Limited) into the auditor's report for XYZ Limited's consolidated financial statements.
c. **Mention Paragraph Number:** CA F must also provide the paragraph number of CA B's CARO report where the qualification is stated.

Management's Contention: The management of XYZ Limited's contention that CA F is not required to consider and report CA B's qualification in the subsidiary's CARO report for the consolidated financial statements is not valid. As per the provisions, CA F is indeed required to report such qualifications as specified in Clause (xxi) of Paragraph 3 of CARO 2020.

In conclusion, based on the information provided and the provisions of CARO 2020, CA F is obligated to incorporate the qualification from CA B's CARO report for AT Private Limited into the auditor's report for XYZ Limited's consolidated financial statements for the financial year 2022-23, as well as provide the necessary details as per the requirements of Clause (xxi) of Paragraph 3 of CARO 2020.

Company Audit

1. Mr. Raj, the engagement partner of R.O.K. & Co., in connection with statutory audit of Waria Ltd., had assigned the responsibility of enquiring into propriety matters of the Company as required by section 143(1) of the Companies Act, 2013, to Mr. Samay, an engagement team member. Mr. Samay while making such enquiries, was having following queries, as tabulated below, which he ought to get resolved from Mr. Raj, as follows:- (MTP Apr'21)

1. What documents to be seen in case of loan given by the company in lieu of hypothecation of goods from lender as a security for the purpose of reporting as per clause (a) of section 143(1) of the Companies Act, 2013?
Mr. Samay should see **deed of Hypothecation** or other document creating the charge, together with a statement of stocks held at the balance sheet date in order.

2. What shall be the cost of Debentures and Bonus Shares sold by the company for which the cost is not ascertainable for the purpose of reporting as per clause (c) of section 143(1) of the Companies Act, 2013?
For Debentures sold: Where the cost of debentures sold is not ascertainable, the **book value** thereof at the date of sale may be treated as the cost for the purposes of this clause.

For Bonus Shares sold: When bonus shares are received, the number of shares in the portfolio would be increased by the bonus shares while the cost of the total portfolio would remain the same as before. The result would be that the average cost per unit of the total holding would come down proportionately. The usual accounting practice for apportioning the cost of a part of the total holding on the sale thereof is to take it at its **average cost**.

3. Whether the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash for the purpose of reporting as per clause (f) of section 143(1) of the Companies Act, 2013?
The law on the subject has hitherto been that, where the consideration for the issue of shares is an adjustment against a bona fide debt payable in money on demand by the company, the shares are deemed to have been subscribed in cash (vide the decision in Spargo's Case – 1873, 8, Ch. A. 407). According to the legal opinion obtained by the ICAI, the expression "shares allotted for cash" may also include shares allotted against a debt. Therefore, in cases which are covered by the decision in Spargo's case, no comment is required by the auditor, even though the company may have in the Return of Allotment under Section 75, shown such shares as allotted against adjustment of a debt.

Thus, the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be **considered to be allotted for cash**.

2. CA. G, was appointed by DP Ltd., as Statutory Auditor. While doing the audit of DP Ltd., CA. G observed that certain loans and advances were made without proper securities; certain trade receivables and trade payables were adjusted inter se; and personal expenses were charged to revenue. As a company auditor comment on the, reporting responsibilities of CA. G. (Nov-19 New)

Duty of Auditor to Inquire on certain matters: Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry in respect of specified matters during the course of his audit. Since the law requires the auditor to make an enquiry, the Institute opined that the **auditor is not required to report** on the matters specified in sub-section (1) **unless he has any special comments** to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. It is to be noted that the auditor is required to make only enquiries and not investigate into the matters referred to therein.

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) of the Companies Act, 2013 is worth considering and reproduced below:

"The auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor's Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider his duties under section 143(1)."

Clause (a) of Section 143(1) requires the auditor to inquire: "Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members".

If the auditor finds that the **loans and advances have not been properly secured**, he may enter an adverse comment in the report but cannot probably doubt the true view of the accounts by reference to this fact so long the loans and advances are properly described and presented in terms of Part I of Schedule III to the Companies Act. Further the auditor to inquire whether or not the terms on which the loans or advances have been made are prejudicial to the interests of the company or its members. If it is, he should qualify his report.

If **trade receivables and trade payables are adjusted inter se, this amounts to merely book entries**. The auditor, as per clause (b) of section 143(1), should enquire "whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company". This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards".

Regarding **Personal Expenses, Clause (e) of section 143(1)** requires the auditor to inquire: "Whether personal expenses have been charged to revenue account". The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon. It suffices to say that if the auditor finds that personal expenses have been charged to revenue and if the amounts are material, he should qualify his report also.

3. RX Ltd. is a sugar manufacturing company. The company appointed Mr. Suresh, a practicing cost accountant, to conduct cost audit of its cost records under section 148 of the Companies Act, 2013. While conducting audit, Mr. Suresh found some misstatement resulting into fraud committed by the officers of the company amounting rupees 1.5 crore. However, he did not report the matter to the Central Government believing that liability for such reporting lies only with statutory auditor of the company. Advise. (Apr-18 MTP)

Reporting of Fraud by Cost Accountant: As per **section 143(12) of the Companies Act, 2013 read along with Rule 13 of the Companies (Audit and Auditors) Rules, 2014** if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government after following the prescribed procedure. It may be noted that the provisions related to reporting of fraud shall also apply, mutatis mutandis, to a cost accountant in practice conducting cost audit under section 148 of the Companies Act, 2013.

In the given case, Mr. Suresh, being the cost auditor of RX Ltd., found misstatement resulting into fraud amounting 1.5 crore committed by the officers of the company, was required to report the fraud to the Central Government which he failed to do so.

SQC-1 & SA 220

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?

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?

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?

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?

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?

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.

6. 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.

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.

7. 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.

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"

8. 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.

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.

9. 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?

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.

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 abovesaid 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.

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

SA 240

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?

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?

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. 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?

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.

SA 250

1. 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.

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 noncompliance 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 services" for ₹ 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.

2. 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 of 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?

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.

3. 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?

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 auditor.
- Whether an act constitutes non-compliance is **ultimately a matter for legal determination by a court of law**.

Integrated Case Scenario

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 noncompliance 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.

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

SA 260

1. 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?

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.

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?

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. 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.

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.

SA 299

1. 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?

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.

2. 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?

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.

3. 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.

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.

SA 500

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?

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.

1. 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?

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

2. On reviewing legal expenses account of Zed Ltd., CA. Sunitha, auditor of company, finds that legal fees amounting to ₹ 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?

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.

3. 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 on November 22 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.

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.

SA 505

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?

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.

SA 510

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?

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.

CASE STUDY

Honest Speciality 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 and 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.

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?

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-inprogress, 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 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.

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. What additional procedures does the auditor need to carry out in respect of stocks lying with consignees all over the country?

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. What procedures should the auditor need to undertake for litigation matters?

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 inhouse 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.

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

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

SA 530

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.

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.

SA 550

"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 al so 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"?

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.

CASE STUDY

"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 middleclass 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 for eign 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.

1. Please guide the engagement team on the further course of action as per SA 550.

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 throughout 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. What are fraud risk factors in given case?

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 and 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. 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 crores as 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?

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. 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?

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.

MCQs

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

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

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 ₹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?

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?

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.

Integrated Case Scenario

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.

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

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

SA 570

1. 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.

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.

2. 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?

- 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.

Integrated Case Scenario

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 cashflow 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: -

Statement I: - The Management is under a responsibility to make specific assessment of the company's ability to continue as a going concern.

Statement 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.

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

2. 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 moneybudget 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 upkeeping 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" was 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.

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?

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. 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?

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. 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.

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. 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?

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. What kind of written representation does the auditor need to obtain in case of the scenario covered in Q3 above?

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.

MCQs

1. Which of the following is not a financial event/ condition as per SA 570 Going Concern?

(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

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

SA 580

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 noncompliance 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

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.

SA 600

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?

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.