

**MOCK TEST PAPER 1**  
**FINAL COURSE: GROUP – I**  
**PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS**  
**SUGGESTED ANSWERS/HINTS**

**DIVISION A - MCQs (30 Marks)**

Questions no. (1-10) carry 1 Mark each and Questions no. 11-20 carry 2 Marks each.

1. (c)
2. (d)
3. (b)
4. (c)
5. (b)
6. (b)
7. (c)
8. (c)
9. (c)
10. (c)

Questions (11-20) carry 2 Marks each

11. (b)
12. (c)
13. (b)
14. (d)
15. (b)
16. (c)
17. (a)
18. (a)
19. (b)
20. (d)

**DIVISION B - DESCRIPTIVE QUESTIONS (70 Marks)**

1. (a) **Guidance to CA. Prakash with respect to risk factors that relate to misstatements arising from misappropriation of assets as per SA 240 is:**

As per SA 240, “The Auditor’s Responsibilities Relating to Fraud in an audit of Financial Statements”, misappropriation of assets involves the theft of 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.

**Misappropriation of assets** can be accomplished in a variety of ways including stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

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

### **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:

- (i) Known or anticipated future employee layoffs.
- (ii) Recent or anticipated changes to employee compensation or benefit plans.
- (iii) 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:

- (i) Large amounts of cash on hand or processed.
- (ii) Inventory items that are small in size, of high value, or in high demand.
- (iii) Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- (iv) 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. For example, misappropriation of assets may occur because there is the following:

- (i) Inadequate segregation of duties or independent checks.
- (ii) Inadequate oversight of senior management expenditures, such as travel and other reimbursements.
- (iii) Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- (iv) Inadequate job applicant screening of employees with access to assets.
- (v) Inadequate record keeping with respect to assets.
- (vi) inadequate system of authorization and approval of transactions (for example, in purchasing).
- (vii) Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- (viii) Lack of complete and timely reconciliations of assets.
- (ix) Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- (x) Lack of mandatory vacations for employees performing key control functions.
- (xi) Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- (xii) Inadequate access controls over automated records, including controls over and review of computer systems event logs.

### **Attitudes/Rationalizations**

- (i) Disregard for the need for monitoring or reducing risks related to misappropriations of assets.

- (ii) 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.
  - (iii) Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
  - (iv) Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
  - (v) Tolerance of petty theft.
- (b) 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:**
- (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 organization.

"Based on above, the auditor will assess the effect on the audit risk and take necessary steps while conducting the audit".

- (c)** In the present case, with respect to loans and advances of ₹ 95 Lacs given to Shripal Pvt. Limited, the Company has not furnished any agreement to CA Subhadra. In the absence of such an agreement, CA Subhadra 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 Subhadra 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 Subhadra 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 SATI 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 31.03.2022 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 ₹ 95 Lacs given to Shripal 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.

- 2. (a) 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; or

In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant case, if Shrivasti Ltd. does not correct the treatment of depreciation to the extent of rupees 3.95 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.

- (b) Role of Auditor in case of Parent Company and Subsidiary Company: 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 (Ram & 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 (Hanuman & 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.
- (b)** 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 Chandra 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. Stone (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 Stone (P) Ltd. company with Royal 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 Royal Bank Ltd.

Therefore, Contention of the management is not valid.

CA. Chandra should report the differences as per the Companies Act, 2013 and CARO 2020 as follows:

	Stock value as per Book Accounts (₹ in Crore)	Stock value as per quarterly statement Submitted to Royal Bank Ltd. (₹ in Crore)	Variation
Q - 1	21.50	24.00	Excess reporting of stock to Bank by 2.50 crore
Q - 2	24.75	27.00	Excess reporting of stock to Bank by 2.25 Crore
Q - 3	21.50	24.00	Excess reporting of stock to bank by 2.50 crore

3. (a) (i) **Government Guaranteed Advance:** If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not invoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

(ii) **In case of Sale of NPA by Bank, the auditor should examine**

- (1) the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers.
- (2) only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.

- (3) the assets have been sold "without recourse" only.
- (4) 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.
- (5) the NPA has been sold at cash basis only.
- (6) on the sale of the NPA, the same has been removed from the books of the account.
- (7) the short fall in the net book value has been charged to the profit and loss account.
- (8) where the sale is for a value higher than the NBV, no profit is recognised and the excess provision has not been reversed but retained to meet the shortfall/ loss because sale of other non-performing financial assets.

- (b) **Alternative Way to Tackle the Hostile Management:** While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore, he gives his suggestions and recommendations.

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

The Participative Approach comes to the help of the auditor. In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes a co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When the participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal.

The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor does not have to force any change on the auditee.

Hence, the Operational Auditor of Amazon Manufacturing Unit should adopt the above-mentioned participative approach to tackle the hostile management of Amazon.

- (c) 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. Nageshwar 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. Nageshwar would be held guilty for other misconduct.

- 4 (a) (i) **One non-executive director has attained the age of 72 years:** The auditor should ensure that no listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy-five years. In the given situation, there

is **no violation** of LODR 2015 for Non-executive director who has attained the age of 72 years.

- (ii) **One of the Directors is a Director in eight other Listed Entities:** As per LODR 2015, a person shall not be a director in more than seven listed entities. In the given situation, there is **non-compliance** as one of the directors is director in eight other listed entities which is exceeding the prescribed limit of seven entities.
- (iii) **The Managing Director is serving as Independent Director in Four listed entities of which one entity's equity shares are not listed on a Stock Exchange:** Any person who is serving as a whole-time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities. For the purpose of above-mentioned provision, the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange. In the given situation, Managing Director has been serving as Independent Director in four listed entities of which one entity's Equity Shares are not listed on a stock exchange. So, it is not exceeding the prescribed limit of three entities, hence there is no violation of LODR 2015.
- (iv) **One Independent Director has been serving as Independent Director in Eight Listed Entities of which Equity Shares are listed on a Stock Exchange:** A person shall not serve as an independent director in more than seven listed entities in case its Equity Shares are listed on a Stock Exchange. It may be noted that the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange.

In the given situation, there is **non-compliance** as one of the Independent Director has been serving as Independent Director in eight listed entities which is exceeding the prescribed limit of seven entities.

- (b) (i) As per Clause 22 of Form 3CD of the Income Tax Act, 1961, the tax auditor is required to state the amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006. Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, in accordance with the provisions of this Act, shall not be allowed as a deduction for the purposes of the computation of income under the Income Tax Act, 1961.  
Accordingly, the CA. Mahaveer is required to report the payment of interest of ₹ 50,000 to Vendor Ghanshyam who was registered under MSME Act, 2006 under clause 22 of Form 3CD of the Income Tax Act, 1961.
- (ii) As per Clause 21(h) of Form 3CD of the Income Tax Act, 1961, the tax auditor is required to report about the amount of deduction inadmissible in terms of section 14A Income Tax Act, 1961, in respect of the expenditure incurred in relation to income which does not form part of the total income.  
Therefore, CA. Mahaveer, the auditor is required to scrutinize expense accounts particularly interest account to check whether there is included any expense which is relatable to exempt income. He is also required to note down the amount and mention against the clause.  
Thus, in the given situation, CA. Mahaveer is required to report the same as per clause 21 (h) of Form 3CD of the Income Tax Act, 1961.
- (iii) As per Clause 29(A) of Form 3CD of the Income Tax Act, 1961 of the Income Tax Act, 1961, the auditor is required to report,
  - (a) whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub section (2) of section 56 the Income Tax Act, 1961.
  - (b) If yes, to provide the nature of income and amount thereof.

The auditor is also required to obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year and examine whether any amount of such advances has been written back during the year and examine the basis of such write back to determine whether such write back was on account of an act of forfeiture. Further, the auditor is also required to verify the terms of contract to check the conditions to forfeit of such advance and such conditions have occurred, then should verify whether the amount has been actually forfeited.

Thus, same is required to be reported under clause 29(A) of Form 3CD of the Income Tax Act, 1961.

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

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

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

5. (a) **Steps involved while conducting investigation on behalf of an incoming partner:** The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service.

Primarily, an incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of the existing partners, socio-economic setting, etc., and whether he would be capable of deriving continuing benefit in the shape of return on capital to be contributed and remuneration for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully.

**Broadly, the steps involved are the following:**

- (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. 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.
- (iv) 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.

- (v) Position of orders at hand and the range and quality of clientele should be thoroughly examined, which the firm is presently operating.
- (vi) 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.
- (vii) 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.
- (viii) 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.
- (ix) 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.
- (x) 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.
- (xi) It would be useful to have a first hand knowledge about the specialisation, if any, attained by the firm in any of its activities.
- (xii) Manner of computation of goodwill on admission as also on retirement, if any, should be ascertained.
- (xiii) 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.
- (xiv) Whether the incomplete contracts which will be transferred to the reconstituted firm will be a liability or a loss.

It would always be worthwhile to remember that, in a partnership, personal considerations count predominantly over other considerations and assessment of standing of the firm, standing and reliability of other partners, their personal reputation and the goodwill enjoyed by the products/services are important.

On the basis of the broad frame of considerations as given above, the investigating accountant should devise his own considerations in each case which may be quite diverse. Additional considerations may come up in the case of service-rendering firms where profit and business record, goodwill of the firm and of individual partners would assume greater significance.

Again, in the case of industrial firms, the network of customers, their scatter, size, etc., would be relevant for consideration.

- (b) 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. Nemi, 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. Nemi will be held guilty for professional and other misconduct under abovementioned Clauses to the Chartered Accountants Act, 1949.

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

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

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

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

**6 (a) The following steps are involved in the audit of government companies:**

- (i) **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013** - Statutory auditors of Government Companies are appointed or re-appointed by the C&AG. There is thus, a departure from the practice in vogue in the case of private sector companies where appointment or re-appointment of the auditors and their remuneration are decided by the members at the annual general meetings. In the case of government companies, though the appointment of statutory auditors is done by the C&AG, the remuneration is left to the individual companies to decide based on certain guidelines given by the C&AG in this regard.

- (ii) **The C&AG may direct the appointed auditor** on the manner in which the accounts of the Government company are required to be audited and the auditor so appointed has to submit a copy of the audit report to the Comptroller and Auditor-General of India. The report, among other things, includes the directions, if any, issued by the C&AG, the action taken thereon and its impact on the accounts and financial statement of the company.

The report under section 143(5) is in addition to the reports issued by the Statutory Auditors under various other clauses of section 143.

- (iii) **Supplementary audit under section 143(6)(a) of the Companies Act, 2013** -The Comptroller and Auditor-General of India shall **within 60 days** from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statements of the government company by such person or persons as he may authorize in this behalf and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the C&AG may direct.

- (iv) **Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013** - Any comments given by the C&AG upon, or in supplement to, the

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

(v) **Test audit under section 143(7) of the Companies Act, 2013** -Without prejudice to the provisions relating to audit and auditor, the C&AG may, in case of any company covered under **sub-section (5) or sub-section (7) of section 139** of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of **section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.**

(b) **Provision for Claim:** No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

(c) **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 35% 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.

**OR**

(c) The actions that the Board may take, based upon consideration of recommendations of the Quality Review Group, include one or more of the following: -

- (a) Make recommendations to the Council of ICAI u/s 28B(a) of Chartered Accountants Act, 1949 for referring the case to the Director (Discipline) of the Institute for consideration and necessary action under the Chartered Accountants Act, 1949.
- (b) Issue advisory and guidance to the AFUR u/s 28B(c) of Chartered Accountants Act, 1949 for improvement in the quality of services and adherence to various statutory and other regulatory requirements. A copy of such advisory may also be sent to the ICAI for information.
- (c) Inform the details of the non-compliance to the regulatory bod(y)/ies relevant to the entity as may be decided by the Board.

- (d) Intimate the AFUR as to the findings of the Report as well as action initiated as above.
- (e) In case of review arising out of a reference received from a regulatory body, inform the results of review and the details of action taken to the concerned regulatory body.
- (f) Consider the matter complete and inform the AFUR accordingly.