

Division A- Multiple Choice Questions

1. (b)
2. (c)
3. (d)
4. (d)
5. (c)
6. (c)
7. (b)
8. (a)
9. (c)
10. (b)
11. (c)
12. (c)
13. (d)
14. (c)
15. (c)
16. (c)
17. (a)
18. (a)
19. (b)
20. (d)

Division B- Descriptive Questions

Question 1 (a)

Auditor's responses on a material misstatement in the Other Information:

- SA 720 "The Auditor's Responsibilities relating to Other Information" deals with the auditor's responsibilities relating to Other Information, whether financial or non-financial information included in an entity's annual report.
- 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:
 - a. Agrees to make the correction, the auditor shall determine that the correction has been made; or
 - b. Refuses to make the correction, the auditor shall communicate the matter with TCWG and request that the correction be made.
- If the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with TCWG, the auditor shall take appropriate action, including:
 - a. Considering the implications for the auditor's report and communicating with TCWG about how the auditor plans to address the material misstatement in the auditor's report,
 - b. Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.
- If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, the auditor shall:
 - a. If the other information is corrected, perform the procedures necessary in the circumstances; or
 - b. If the other information is not corrected after communicating with TCWG, take appropriate action considering the auditor's legal rights and obligations, to seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared.

Question 1 (b)

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:

- Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
- 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:

- a. 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
- b. 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".

Question 1 (c)

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.

Question 2 (a)

In the given scenario, C&AG appointed Sambhav & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit.

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is not performance audit in all aspects.

Question 2 (b)

Rule 3 (1) of National Financial Reporting Authority Rules, 2018 inter alia, provides that the Authority (NFRA) shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate, namely: -

- companies whose securities are listed on any stock exchange in India or outside India;
- unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year;
- insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of sub-section (4) of section 1 of the Act;
- any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority by the Central Government in public interest; and
- a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d), if the income or net-worth of such subsidiary or associate company exceeds twenty percent of the

consolidated income or consolidated net-worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).

The Ministry of Corporate Affairs has vide their letter dated 30th January, 2019, has clarified to the Quality Review Board that in view of Sec.132 (2) of the Companies Act, 2013 r/w Rule 9(4) of NFRA Rules, 2018, the issue of QRB reviewing audits of the companies/bodies corporate specified under Rule 3 of the NFRA Rules, 2018 will only arise in case a reference is so made to QRB by NFRA, and not otherwise.

Considering the above, in the case of auditors of PQR Ltd., X insurance Ltd. and AB banking Company, NFRA has power to oversee quality of services of these audit firms. However, QRB can undertake review of the quality of services of auditors of AAZ Ltd.

Therefore, inclusion of names of auditors of PQR Ltd., X insurance Ltd. and AB banking Company in the draft panel for consideration by QRB is not proper.

Only the inclusion of the name of the auditor of AAZ Ltd in the draft panel is proper.

Question 2 (c)

Expressing an Opinion on Financial Statements where Director is a Relative:

Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 139 and 140 read with Section 141 of the Companies Act, 2013, in respect of such appointment have been duly complied with.

As per Section 141(3) (f) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a director or is in the employment of the company as director or key managerial personnel. The definition of 'Relative' includes husband and wife.

In this case Mrs. Fair is a Director of XYZ Private Limited and the company has appointed Mr. Lovely, Chartered Accountant, Mrs. Fair's spouse, as its statutory auditor. Mr. Lovely should not accept the appointment as statutory auditor of the company, where his wife Mrs. Fair is director. This is contravention of section 141(3) (f) of the Companies Act, 2013.

Therefore, Mr. Lovely is liable for misconduct as per Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Question 3 (a)

Section 44 AB(a) of the Income Tax Act, 1961 prescribes that a person carrying on business shall get his accounts audited if his total sales, turnover or gross receipts exceed ` 1 crore in any previous year. However, this limit was enhanced to ` 10 crore in the following case where: -

- aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount; and
- aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment.

However, section 44 AB(b) of the Income Tax Act, 1961 states that in case of profession, every person shall get his accounts audited, if his gross receipts in profession exceed ` 50 lakh. The above said firm is engaged in providing engineering consultancy services to insurance corporates. Hence, the benefit of enhanced threshold limit is not available to persons engaged in professional activities.

The information regarding cash receipt and payment although falling within 5% of total receipts/payments is not relevant in the instant case.

Hence, contention of partner is not correct, and firm is required to get its accounts audited under income tax law.

Question 3 (b)

(i) As per Regulation 16(c) of the SEBI (LODR) Regulations, 2015, "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds ten percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year. [Explanation- The listed entity shall formulate a policy for determining 'material' subsidiary.]

Regulation 24(1) of the SEBI (LODR) Regulations, 2015, provides that at least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

[Explanation- For the purposes of Regulation 24(1), notwithstanding anything to the contrary contained in regulation 16, the term “material subsidiary” shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year]

On the basis of above provisions, following information is tabulated as below:

Particulars	Share in Consolidated Income	Share in Consolidated Net Worth
Component 'A'	11.67%	5%
Component 'B'	3.33%	2.5%
Component 'C'	23.33%	17.5%
Component 'D'	21.67%	22.5%
Component 'E'	6.67%	6.25%

It can be observed that Component 'A', Component 'C' and Component 'D', respectively, can be termed as “material subsidiary” as their shares in either consolidated Income or net worth exceeds 10%. Further, at least one independent director from the board of directors of Triumph Ltd. shall be appointed or would have been appointed on the board of Component 'C' and Component 'D', respectively, as their shares in either consolidated income or net worth exceeds 20%.

(ii) Generally, the financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi - location group audit. Such audits and audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components' auditor.

Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, “Modifications to the Opinion in the Independent Auditor's Report”.

In the given situation, two out of seven components of Triumph Ltd. have remained unaudited where Component 'F' is material and Component 'G' is not material to the consolidated financial statements. Since Component 'F' is material, therefore, it may be assumed that reporting of Key Audit Matter in accordance with SA 701 is being done for Component 'F' and not for Component 'G'.

Thus, in case of Component 'F', the Principal Auditor needs to consider its impact on the auditor's opinion on the consolidated financial statements of the group, in terms of the principles laid down in SA 705, Modifications to the Opinion in the Independent Auditor's Report. Whereas in case of Component 'G', the principal auditor should make appropriate reporting under the “Other Matters” paragraph, pursuant to SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs, in the Independent Auditor's Report.

Question 3 (c)

The auditor, CA M appointed as an auditor of Life Secure Insurance Ltd. should ensure that policy documents have not been issued, in case:

- Premium had not been collected at all;
- Premium had been collected but the relevant cheques have been dishonoured; (refer Cheque Dishonoured Book);
- premium had not immediately been collected due to furnishing of a bank guarantee or cash deposit but either the deposit or guarantee had fallen short or has expired or the premium had been collected beyond the stipulated time limit (i.e., there is a shortfall in bank guarantee account or cash deposit account of the insured);
- premium had not been collected due to risk cover being increased or where stipulated limits have been exhausted in respect of open declaration policies (i.e., where premium has accrued but has not been received); and
- instalments of premium have not been collected in time in respect of certain categories of policies, e.g., marine-cum-erection policies where facility has been granted for premium being paid in instalments (such facility is normally available subject to certain conditions, e.g., that the first equated instalment is more by 5 per cent of the total premium payable by instalments).
- Premium collected but policies not issued for long periods of time.

- (vii) Whether the premium received during the year but pertaining to risk commencing in the following year has been accounted for under the head 'Premium Received in Advance' and has been disclosed separately

Question 4 (a)

(i) Mr. Jayprakash has violated following provisions of the Chartered Accountants Act, 1949:

- (a) As per Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be 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.

In this connection, as per the decision of the Council of the ICAI, a Chartered Accountant should not by himself or in his firm name accept the audit of a college, if he is working as a part-time lecturer in the college.

Thus, by accepting audit of a college in which he is working as a part-time lecturer, Mr. Jayprakash has violated the restriction imposed under Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

- (b) 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.

Members of the Institute in practice may engage in a part-time or full-time tutorship under any educational institution other than the coaching organization of the Institute, after obtaining the specific and prior approval of the Council in each case.

Mr. Jayprakash had not taken permission of the ICAI for working as a part-time lecturer in the college and so has violated the restriction imposed under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

- (c) 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.

In this connection, members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, mentioning a firm's name or CA Logo is not permitted. An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor, JP & Associates' was mentioned. Thus, firm's name was mentioned which is not allowed and thus, Mr. Jayprakash has violated the restriction imposed under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

- (d) As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the ICAI 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.

Mr. Jayprakash in the statement of appeal submitted with the Appellate Authority mentioned some facts knowing them to be false and thus, he has violated the restriction imposed under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

(ii) As Mr. Jayprakash has been alleged of misconduct falling in First as well as Second Schedule, so the matter would be placed before the Disciplinary Committee.

The maximum punishment which could have been imposed on him by the said authority would be:-

- reprimanding the member.
- removing name of the member permanently or for any duration, it thinks fit.
- imposing fine upto INR 5,00,000.

Question 4 (b)

Peer Review Report of Reviewer: After completing the on-site Review, the Peer Reviewer, before making his Report to the Board, shall communicate his findings in the Preliminary Report to the Practice Unit if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification.

The Practice Unit shall within 5 days after the date of receipt of the findings, make any submissions or representations, in writing to the Reviewer. (i.e. Response to the Preliminary Report).

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At the end of an on-site Review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings (i.e. Preliminary Report), response by the Practice Unit (Response to Preliminary Report) and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

In case of a modified report, The Board shall order for a "Follow On" Review after a period of one year from the date of issue of report as mentioned above. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report.

In the instant case, in view of Peer Reviewer systems and procedures in Prabhu & Co. LLP are deficient, therefore, Peer Reviewer should not submit the report directly to the Board. Thus, contention of Prabhu & Co. LLP is correct.

Question 4 (c)

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

Examples of risks include:

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

Question 5 (a)

The 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, 2022 showed inadequate drawing power, there was adequate drawing power available throughout the year. Stock audit report dated 31.12.2021 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, 2022 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, 2021 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.

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Question 5 (b)

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 RBI.

In the given case, applying the Criteria (i) Financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets),

A. Financial Assets of Sudarshan Ltd. are =

Non-Current Assets - Loans & Advances	₹ 75.50 Cr.
Add: Current Assets - Loans and advances	₹ 294.33 Cr.
Total Financial Assets	₹ 369.83 Cr.

B. Total Assets (netted off by intangible assets) of Sudarshan Ltd. are=

Total assets of the company	₹ 618.55 Cr.
Less: Intangible assets	₹ 6.35 Cr.
Total Assets (netted off by intangible assets)	₹ 612.20 Cr.

In view of above, Financial assets of Sudarshan Ltd. constitute more than 50 per cent of the total assets (netted off by intangible assets).

Applying the Criteria (ii) Income from financial assets constitute more than 50 per cent of the gross income.

Income from financial assets = ₹ 62.31 Cr

Gross Income = ₹ 111.23 Cr

From the above, it is clear that Sudarshan 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, Sudarshan Ltd. fulfills both these criteria to qualify as an NBFC.

Thus Sudarshan 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.

Question 5 (c)

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

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year's modification.

Question 6 (a)

Validity of Appointments:

(i) Auditor's disqualifications as to security:

As per section 141 (3)(d) (i) a person is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

However, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of Rs. 1,00,000. It is also provided that in the event of acquiring and security or interest by a relative above the threshold limit, the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 days of such acquisition or interest.

In the present case, Mr. B, a partner of Mr. A held shares of face value of Rs. 1,00,000 in DEF Ltd., the holding company of ABC Ltd. Mr. B has sold the securities after a period of 45 days from the date of appointment of Mr. A as an auditor of ABC Ltd.

Conclusion: Appointment of Mr. A as auditor in ABC Ltd. is not valid as he is disqualified by virtue of provisions as stated in Sec. 141(3)(d)(i). Subsequent sale of securities by the partner is of no relevance in this case.

(ii) Auditor's disqualifications as to security:

As per section 141 (3)(d) (iii) a person is disqualified to be appointed as an auditor if he, or his relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees 1 Lac.

These disqualifications need to be examined as at the time of appointment.

In the present case, Mrs. A, wife of Mr. A had given a financial guarantee for the principal amount of a debt owed by Mr. X to ABC Ltd. for Rs. 6 lakhs. Mr. X has repaid Rs. 5 lakhs to ABC Ltd. 2 days before the date of appointment of Mr. A as an auditor of the company.

Conclusion: Appointment of Mr. A as auditor in ABC Ltd. is valid as the amount of guarantee given by the Mrs. A for indebtedness of Mr. X in the company does not exceed Rs. 1 lac as on date of appointment.

Question 6 (b)

Evaluating the professional judgment exercised by the auditor: It is also important for the Technical Reviewer (hereinafter referred as TR) to understand that "professional judgment", as defined in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" is an integral concept in the context of an audit and application of SAs in real life audit scenarios. SA 200 defines professional judgment as "the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the course of action that is appropriate in the circumstances of the audit engagement."

The concept of "professional judgment" underscores the fact that Standards, particularly, Standards on Auditing are written to lay down the fundamental principles that would apply to an audit situation. Hence, no Standard can have straight jacketed application/solutions for all audit scenarios. Above all, the Standards on Auditing issued by the Institute of Chartered Accountants of India are principle based rather than rule based. Hence, almost all the SAs envisage exercise of professional judgment by the auditor in their application in real life audit scenarios.

The TR would need to appreciate that the exercise of professional judgment in any particular case is based on the facts and circumstances that are known to the auditor as at the time of exercising that professional judgment. Normally, exercise of professional judgement by an auditor is preceded by consultation on the relevant matters both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm.

In evaluating the professional judgment exercised by the auditor, the TR should consider the following factors:

- whether the judgment reached reflects a due consideration and application of the relevant auditing and accounting principles; and

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- whether the judgment is appropriate in the light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report. Hence, the TR and the QR Team should not, under any circumstance, use "hindsight" (i.e. perception or retrospection) in their evaluation of exercise of professional judgment by the auditor.

Since the auditor needs to exercise professional judgment throughout the audit, the latter also needs to be appropriately documented. Hence, the TR can expect to find such audit documentation as a part of the audit engagement file. It is important to note that professional judgment cannot be used by an auditor as a justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

Question 6 (c)

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.

Question 6 (d)

Auditor's liabilities in case of short provisions:

- ♦ SA 500 on "Audit Evidence" requires that auditor to perform appropriate procedures while using the work of management expert as audit evidence. Before relying on expert's opinion, the auditor should have seen that opinion given by the expert is *prima facie* appropriate and acceptable.
- ♦ In the present case, opinion of the management expert was inconsistent with legal position with regard to certain items. It is, perhaps, quite possible that auditor did not seek reasonable assurance as to the appropriateness of the source data, assumptions and methods used by the expert properly.
- ♦ SA 500 requires that auditor to resolve the inconsistency by discussion with the management and the expert. In case, the experts' work does not support the related representation in the financial information, the inconsistency in legal opinions could have been detected by the auditor if he had gone through the same. This seems apparent having regard to wide difference in the liability worked out by the assessing authority.

Conclusion: Auditor should reject the opinion and insisted upon making proper provision.