

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

Answer any **four** out of the remaining five questions.

Question 1

Answer the following:

- (a) *Audit planning is necessary to conduct an effective audit in an efficient and timely manner for which purpose formulating an audit programme becomes an essential part of audit plan. Study and evaluation of system of Internal control and accounting procedures are important part of it. As an auditor, discuss the features of examination of the system of Internal control.* **(5 Marks)**

- (b) *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? **(5 Marks)**

- (c) *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.* **(4 Marks)**

Answer

- (a) **System of internal control and accounting procedures:** The study and evaluation of internal control helps the auditor to establish the reliance he can place on the internal control in determining the nature, timing and extent of his substantive auditing procedures.

The auditor also obtains an understanding of the accounting system to identify points in processing of transaction and handling of assets where errors or fraud may occur.

When the auditor relies on internal control, it is at these points that he must be satisfied that internal control procedures applied by the entity are effective for his purpose.

The auditor's examination of the system of internal control should have three features - review and preliminary evaluation, testing of compliance and evaluation.

- (i) **Review and preliminary evaluation** - The auditor should review the accounting system and related internal control to gain an understanding of the flow of transactions and the specific control procedures to be able to make a preliminary

evaluation and identification of these aspects of internal control on which it might be efficient and effective to rely in conducting his audit.

- (ii) **Test of compliance** - Compliance tests should be conducted by the auditor to gain evidence that those internal controls on which he intends to rely operate generally as identified by him and that they function effectively throughout the period of intended reliance. Based on the results of his compliance procedure including observed deviations, the auditor should evaluate whether the internal controls are adequate for his purposes.
 - (iii) **Evaluation** - It is essentially an objective process of application of auditor's judgement to determine whether all or any of the internal controls in the client's organisation can be relied upon in carrying out the audit. Based on the degree of reliance which may be full, partial or none, the auditor will programme for the substantive verification of transactions for expression of audit opinion. The results of compliance procedure directly provide the basis for this evaluation and, in turn, basis to determine the nature, timing and extent of the substantive audit procedure. In evaluating the auditor recognises that some deviations from compliance may have occurred.
- (b) 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.

(c) Inquiry: As per SA 500 Audit Evidence:-

- 1 Inquiry consists of seeking information of knowledgeable persons, financial and non-financial, 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.

Question 2

Answer the following:

- (a) *When the computer information systems are significant, the auditor should assess whether it may influence the assessment of inherent and control risks. Discuss the factors, as an auditor, you would consider while evaluating the reliability of the accounting and internal control systems in CIS Environment. (5 Marks)*
- (b) *You are doing audit of unlisted public limited company, Perfect Limited. As per National Financial Reporting Authority Rules, 2018, NFRA has 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. Discuss about the class of companies and bodies corporate, where NFRA is applicable. (5 Marks)*

- (c) *You have been appointed as a statutory auditor of ABC Ltd., a listed company. As an auditor, state the points to be considered by you in verification of approval of remuneration to directors of ABC Ltd. under Regulation 17(6) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.* **(4 Marks)**

Answer

- (a) While evaluating the reliability of the accounting and internal control systems, the auditor would consider whether these systems:
- (i) Ensure that authorized, correct and complete data is made available for processing;
 - (ii) Provide for timely detection and correction of errors;
 - (iii) Ensure that the case of interruption in the work of the CIS environment due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records;
 - (iv) Ensure that accuracy and completeness of output;
 - (v) Provide adequate data security against fire and other calamities, wrong processing, frauds etc.;
 - (vi) Prevent unauthorized amendments to the program;
 - (vii) Provide for safe custody of source code of application software and data files.
- (b) As per NFRA rules, 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**:
- (a) companies whose securities are listed on any stock exchange in India or outside India;
 - (b) 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 of March of immediately preceding financial year;
 - (c) 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 section 1 (4) of the Companies Act, 2013; "Explanation.- For the purpose of this clause, "banking company" includes 'corresponding new bank' as defined in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) and clause (b) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of

1980) and 'subsidiary bank' as defined in clause (k) of section 2 of the State Bank of India (Subsidiary Bank) Act, 1959 (38 of 1959)."

- (d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the NFRA by the Central Government in public interest; and
- (e) 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) above, if the income or net-worth of such subsidiary or associate company exceeds 20% 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) above.

(c) Approval of Remuneration of Directors [Regulation 17(6)]:

As an auditor of ABC Ltd., a listed company, following points to be considered regarding verification of approval of remuneration to directors of ABC Ltd., under Regulation 17(6) of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015:

1. The auditor should ascertain from the minutes of the Board of Directors' meetings, shareholders' meetings, relevant agenda papers, notices, explanatory statements etc., whether the remuneration of non-executive directors has been decided by the Board of Directors after receiving prior approval of the shareholders in the general meeting;
2. The approval of shareholders by special resolution shall be obtained every year, in case the annual remuneration payable to a single non-executive director exceeds fifty percent of the total annual remuneration payable to all non-executive directors, giving details of the remuneration thereof.
3. The auditor should refer to the Articles of Association of the company, wherever applicable;
4. The auditor is required to examine the Report of the Board of Directors on corporate governance to be included in the annual report of the company and ascertain whether the same contains the disclosures with respect to remuneration of directors and compensation to non-executive directors. The auditor should correlate this data with that contained in the financial statements.

Where application of this clause requires the value of ESOP to be determined, the services of expert may have to be utilized. In this regard, reference may be made to SA 620 dealing with "Using the Work of an Auditor's Expert".

Question 3

Answer the following :

- (a) *M/s XYZ & Co. is an Audit Firm having partners Mr. X, Mr. Y and Mr. Z, Chartered Accountants. Mr. X, Mr. Y and Mr. Z are holding appointment as Auditors in 5, 5 and 10 companies respectively.*
- (i) *Provide the maximum number of Audits remaining in the name of XYZ & Co.*
 - (ii) *Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. X, Mr. Y and Mr. Z.*
 - (iii) *Can XYZ & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than 100 crore, 2 small companies and 2 dormant companies ?*
 - (iv) *Would your answer be different, if out of those 60 private companies, only 15 companies are having paid-up share capital of less than ₹100 crore each ?*

Discuss with reference to ceiling on number of audits as per Companies Act, 2013.

(5 Marks)

- (b) *Mis PQR and Associates, Chartered Accountants are the auditors of Excellent General Insurance Company Limited. The company has paid various insurance claims during the financial year ending 31st March, 2020. Enumerate the aspects to be examined by an auditor in respect of claims paid during the year.*
- (5 Marks)**
- (c) *A company has appointed a practicing Chartered Accountant as an independent director on its board. The said company publishes description about the Chartered Accountant's expertise, specialization and knowledge in any particular field or add appellations or adjectives to his name in the prospectus or public announcements issued by this company. Whether the said publication will be covered under Code of Ethics? What should be the role of the Chartered Accountant in this regard?*
- (4 Marks)**

Answer

- (a) **Fact of the Case:** In the instant case, Mr. X is holding appointment in 5 companies, whereas Mr. Y is having appointment in 5 Companies and Mr. Z is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

Provisions and Explanations: As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore (private company which has not committed a default

in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Conclusion:

- (i) Therefore, XYZ & Co. can hold appointment as an auditor of 40 more companies:

Total Number of Audits available to the Firm $= 20 \times 3 = 60$

Number of Audits already taken by all the partners

In their individual capacity $= 5 + 5 + 10 = 20$

Remaining number of Audits available to the Firm $= 40$

- (ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g) - already holding appointments as an auditor.

Hence (1) Mr. X can hold: $20 - 5 = 15$ more audits. (2) Mr. Y can hold $20 - 5 = 15$ more audits and (3) Mr. Z can hold $20 - 10 = 10$ more audits.

- (iii) In view of above discussed provisions, XYZ & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than ₹ 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.), 2 small companies and 2 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.

- (iv) As per fact of the case, XYZ & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition, they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹ 100 crores. In the given case, out of the 60 private companies XYZ & Co. is offered, 15 companies having paid-up share capital of less than ₹ 100 crore each.

Therefore, XYZ & Co. can also accept the appointment as an auditor for 2 small companies, 2 dormant company, 15 private companies having paid-up share capital less than ₹ 100 crores (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.) and 40 private companies having paid-up share capital of ₹ 100 crore or more each in addition to above 20 company audits already holding.

- (b) **Claims Paid** - The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows:
- (i) that in case of co-insurance arrangements, claims paid have been booked only in respect of company's share and the balance has been debited to other insurance companies;
 - (ii) that in case of claims paid on the basis of advices from other insurance companies (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company. Such claims which have been communicated after the year-end for losses which occurred prior to the year-end must be accounted for in the year of audit;
 - (iii) that the claims payments have been duly sanctioned by the authority concerned and the payments of the amounts are duly acknowledged by the claimants;
 - (iv) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure;
 - (v) that the amounts of the nature of pure advances/deposits with Courts, etc., in matters under litigation/arbitration have not been treated as claims paid but are held as assets till final disposal of such claims. In such cases, full provision should be made for outstanding claims;
 - (vi) that payment made against claims partially settled have been duly vouched. In such cases, the sanctioning authority should be the same as the one which has powers in respect of the total claimed amount;
 - (vii) that in case of final settlement of claims, the claimant has given an unqualified discharge note, not involving the company in any further liability in respect of the claim; and
 - (viii) that the figures of claims, wherever communicated for the year by the Division to the Head Office for purposes of reinsurance claims, have been reconciled with the trial balance-figure.
- (c) The Council of the ICAI has in a communication to members stated that if the prospectus or public announcements issued by these Companies often publish descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field or add appellations or adjectives to their names. it shall constitute a misconduct under **Clause (6) and (7) of Part I of the First Schedule** to the Chartered Accountants Act. The Council has further stated that in such cases the member concerned has to take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the members.

It is advisable for a member that as soon as he is appointed as a director on the Board of a Company, he should specifically invite the attention of the management of the Company to the aforesaid provisions and should request that before any such prospectus or public announcements or public communication mentioning the name of the member concerned, is issued, the material pertaining to the member concerned should, as far as practicable be got approved by him.

In the given situation, a company has appointed a practicing chartered accountant as independent director on its board. The said company published description about the Chartered Accountant's expertise, specialisation and knowledge in any particular field or add appellations or adjectives to his names in the prospectus or public announcements issued by this Company.

Thus in the instant case, Chartered Accountant would be held to be **guilty of professional misconduct** under Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 and liable for disciplinary action.

Question 4

Answer the following :

- (a) As an auditor of a partnership firm under section 44 AB of the Income Tax Act, 1961, how would you report on the following :
- (i) M/s. WAR wants to purchase a new machine which is available for ₹ 45,000, if purchased on 45 days' credit and for Rs. 40,000, if purchased by cash. The machine is purchased by paying cash on 01/08/2019 and depreciation on it charged to profit and loss account is ₹ 6000.
 - (ii) Technical support is received from Mr. DND, a non-resident for installation of a new machinery. He has raised invoice dated 01/05/2019 in USD equivalent to ₹ 5,00,000. The entire dues are cleared through appropriate banking channel on 25/06/2019. **(3+ 2 = 5 Marks)**
- (b) Assumptions are integral components of accounting estimates. State the matters that the auditor may consider in obtaining an understanding of the assumptions underlying the accounting estimates with reference to relevant SAs. **(5 Marks)**
- (c) There were certain complaints from the members of ABC Cooperative Society, a multi-state cooperative society that the affairs of the society are not managed in a prudent way. State the power of Central Government to order Special Audit in such cases.

(4 Marks)

Answer

- (a) (i) As per section 43(1) to the Income-tax Act, 1961, the expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or

authority. However, where an assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode, exceeds ₹10,000, such expenditure shall not form part of actual cost of such asset.

In the given case, M/s. WAR purchased a new machine by paying cash amounting rupees 45,000 and charged the depreciation of rupees 6,000 to profit and loss account on the same. According to section 43(1), rupees 45,000 paid in cash will not form part of actual cost of such asset. Therefore, depreciation on the same is also not allowable.

The tax auditor is required to report on the same in accordance with Clause 18.

As per Clause 18 of Form 3CD, tax auditor is required to report the particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form:-

Clause 18 (d)	Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of –
Clause 18 (e)	Depreciation allowable.
Clause 18 (f)	Written down value at the end of the year.

- (ii) In the given case, technical support received from Mr. DND, a non-resident, is for installation of new machinery and therefore, it would have been capitalized as the cost of machinery. It is assumed that amount paid through bank was after complying with TDS requirements.

Therefore, the tax auditor will report the same in accordance with Clause 13 (f) of Form 3CD i.e., Disclosure as per ICDS.

Clause 13 (f): Disclosure as per ICDS:

S. No.	ICDS	Disclosure
ICDS V	Tangible Fixed Assets.	Addition of ₹ 5,00,000 technical support fee to Non-resident being capitalized as the cost of machinery

- (b) **As per SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures**, how management makes the accounting estimates, and an understanding of the data on which they are based, including assumptions underlying the accounting estimates.

Assumptions are integral components of accounting estimates. Matters that the auditor may consider in obtaining an understanding of the assumptions underlying the accounting estimates include, for example:

- The nature of the assumptions, including which of the assumptions are likely to be significant assumptions.
- How management assesses whether the assumptions are relevant and complete (that is, that all relevant variables have been taken into account).
- Where applicable, how management determines that the assumptions used are internally consistent.
- Whether the assumptions relate to matters within the control of management (for example, assumptions about the maintenance programs that may affect the estimation of an asset's useful life), and how they conform to the entity's business plans and the external environment, or to matters that are outside its control (for example, assumptions about interest rates, mortality rates, potential judicial or regulatory actions, or the variability and the timing of future cash flows).
- The nature and extent of documentation, if any, supporting the assumptions.

Assumptions may be made or identified by an expert to assist management in making the accounting estimates. Such assumptions, when used by management, become management's assumptions.

(c) Power of Central Government to direct special audit in certain cases - Under section 77 of the Multi-State Co-operative Societies Act, 2002, where the Central Government is of the opinion:

- (i) that the affairs of any Multi-State co-operative society are not being managed in accordance with self-help and mutual aid and co-operative principles or prudent commercial practices or with sound business principles; or
- (ii) that any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains; or
- (iii) that the financial position of any Multi-State co-operative society is such as to endanger its solvency.

The central Government may at any time by order direct that a special audit of the Multi-State co-operative society's accounts for such period or periods as may be specified in the order, shall be conducted and appoint either a chartered accountant or the Multi-State co-operative society's auditor himself to conduct the special audit.

However, central Government shall order for special audit only if that Government or the State Government either by itself or both hold fifty-one percent or more of the paid-up share capital in such Multi-State co-operative society.

Question 5

Answer the following :

- (a) *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.* **(5 Marks)**
- (b) *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.* **(5 Marks)**
- (c) *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.* **(4 Marks)**

Answer

- (a) 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.

(b) Obligation of auditor to submit an exception report to the RBI

- (I) 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 unfavorable 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 **unfavorable 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.

- (c) 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.

Question 6

Answer the following:

- (a) *Somi-Kraft Paper Ltd. is a Public Limited company. There is a proper system of Operational Audit in the company. You as an advisor to the company have suggested desirability of Management Audit. Management is of the strong opinion that there is no difference between management audit and Operational Audit. Elaborate. (5 Marks)*
- (b) *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. Briefly discuss the usefulness of careful and adequate audit planning. (5 Marks)*
- (c) *In GSTR 9, details of outward and inward supplies declared during the financial year have to be given. Discuss the details required in GSTR 9. (4 Marks)*

OR

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. (4 Marks)

Answer

- (a) **Management and Operational Audit:** Operational audit is an audit for the management; it is undertaken at the instance of the management for providing it with information and appraisal of operations and activities. A parallel development in auditing is getting shaped as a management audit. Management audit is an “audit of the management” also.

The scope and content of management audit should cover everything that we know as operational audit and, in addition, it should also include a review of the adequacy and competence of the objectives, plans, policies and decisions of the top management.

Difference between Management Audit & Operational Audit

- Management audit is concerned with the “**Quality of managing**”, whereas operational audit focuses on the “**Quality of operations**”.
 - Management audit is the “**Audit of management**” while the operational audit is the “**Audit for the management**”. The focus of Management Audit is on “Quality of Decision Making” rather than the effectiveness or efficiency of operations.
 - The basic difference between the two audits, then, is **not in method**, but in the **level of appraisal**. In a management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfillment of plans in conformity with the prescribed policies.
- (b) **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.

(c) **Details required in the FORM GSTR 9**

Sr. No.	Parts of GSTR – 9	Information Required
1.	Part – I	Basic details of the taxpayer which will be auto-populated.
2.	Part – II	Details of outward and inward supplies made during the FY. These details may be picked up by consolidating summary from all GST returns filed in previous FY. It may also be noted that any additional liability not declared in the GST returns may be declared in this return.
3.	Part – III	Details of ITC for the FY. This will be summarised values picked up from all the GST returns filed in previous FY. It may be noted that taxpayers cannot claim ITC through this return but can make reversals or payment of wrongly/ excess claimed ITC.
4.	Part – IV	Details of tax paid as declared in returns filed during the FY.
5.	Part – V	Usually, the summary of amendment or omission entries belonging to current FY but reported in subsequent FY would be segregated and declared here.
6	Part – VI	Other information comprising details of: GST demands and refunds, HSN-wise summary of the quantity of goods supplied and received with its corresponding tax details against each HSN code, late fees payable and paid details, segregation of inwards supplies received from different categories of taxpayers like composition taxpayers, deemed supply under section 143 and goods supplied on approval basis.

OR

- (c) **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.