

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

*Answer any **five** from the rest*

Question 1

Answer the following :

- (a) *During the Audit of Data Solutions Ltd., a listed company, your audit manager observed that several estimates are made by the Company. He seeks your guidance to know areas of accounting estimates that may give rise to lower level of risk of material misstatement. Guide him with examples.* **(5 Marks)**
- (b) *Excellent Bank Ltd. is a Public Limited Company. The said Bank has various branches all over India. The Bank appoints 3 Joint Auditors for the financial year ending 31/03/2019. All the 3 Joint Auditors divide the work with mutual consent. Verification of Consolidation, however, remained undivided. All branches and zones were divided amongst the 3 Joint Auditors. During audit of zones, CA. Z, one of the Joint auditors expressed a concern about internal control in one of the large corporate branches situated in his zone. The irregularity was not reported in the final accounts as the other 2 Joint Auditors were not in favour of reporting and decision of not reporting the same was taken on the basis of majority. Subsequently, fraud was detected in the said branch which was audited by CA. Z. The Bank seeks your advice about the responsibility of the 3 Joint Auditors in the above situation.* **(5 Marks)**
- (c) *A is the proprietor of a firm M/s ABC & Co. The firm has a turnover of ₹ 500 lakhs during the financial year ended 31/03/2019. The firm sold land and building during the year for a consideration of ₹ 15 lakhs, whose value for stamp duty purposes was ₹ 16 lakhs. As the Tax Auditor of the said firm, is the above to be reported? If yes, how will you report the same?* **(4 Marks)**

Answer

- (a) As per **SA 540 “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures”**, some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:
- Accounting estimates arising in entities that engage in business activities that are not complex.
 - Accounting estimates that are frequently made and updated because they relate to routine transactions.
 - Accounting estimates derived from data that is readily available, such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as “observable” in the context of a fair value accounting estimate.

- Fair value accounting estimates where the method of measurement prescribed by the applicable financial reporting framework is simple and applied easily to the asset or liability requiring measurement at fair value.
- Fair value accounting estimates where the model used to measure the accounting estimate is well-known or generally accepted, provided that the assumptions or inputs to the model are observable.

(b) Responsibility and Co-ordination among Joint Auditors: As per SA 299, “Responsibility and coordination of joint Auditors” where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of the work would usually be in terms of audit identifiable units or specified area.

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

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

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

As per SA 299, Before finalizing their audit report, the joint auditors shall discuss and communicate with each other their respective conclusions that would form the content of the audit report. Further, a joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. But in the present scenario, CA. Z brought this matter in the notice of the other 2 joint auditors and the decision for not reporting was taken on majority basis and no separate opinion was expressed through separate audit report pointing out irregularity.

Thus, all the 3 joint auditors will be held responsible for the fraud detected in the branch audited by CA. Z as per SA 299.

(c) Reporting Requirement Under Clause (17) & 29B of Form 3CD: As per Clause 17 of Form 3CD, the tax auditor is required to furnish detailed information in case if any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in

section 43CA or 50C, as under:

Details of property	Consideration received or accrued	Value adopted or assessed or assessable

The auditor should obtain a list of all properties transferred by the assessee during the previous year. He may also verify the same from the statement of profit and loss or balance sheet, as the case may be. Further, the auditor has to furnish the amount of consideration received or accrued, during the relevant previous year of audit, in respect of land/building transferred during the year as disclosed in the books of account of the assessee.

For reporting the value adopted or assessed or assessable, the auditor should obtain from the assessee a copy of the registered sale deed in case, the property is registered. In case the property is not registered, the auditor may verify relevant documents from relevant authorities or obtain third party expert like lawyer, solicitor representation to satisfy the compliance of section 43CA / section 50C of the Act. In exceptional cases where the auditor is not able to obtain relevant documents, he may state the same through an observation in his report 3CA/CB.

In addition, as per clause 29(B) (w.e.f. assessment year 2019-20), in case of an immovable property, where the stamp duty value exceeds the consideration by less than the higher of (i) rupees 50,000 or (ii) 5% of the consideration, the difference is not chargeable to tax. Therefore, for any immovable property, where the stamp duty value is up to 105% of the sale consideration, no addition can be made under section 56(2)(x).

In the given case, M/s. ABC & Co., has sold land and building during the year for a consideration of rupees 15 lakhs which is less than stamp duty value i.e. rupees 16 lakh. Further, it is also more than the higher of 5% of consideration 15 lakh i.e. 75,000 rupees or 50,000 rupees. Hence, tax auditor is required to report on the same under Clause 17 and clause 29(B) of Form 3CD.

Question 2

Answer the following:

- A listed entity has to obtain a compliance certificate from either the statutory auditors or practicing company secretaries regarding compliance of conditions of corporate governance and annex it to the Directors' Report. Discuss some situations which may require an adverse or qualified statement in respect of the above certificate. **(5 Marks)**
- Enumerate certain important matters which can be included in 'Emphasis of Matter paragraph' in an auditor's report. **(5 Marks)**
- A, a member of the institute of Chartered Accountants of India, not holding certificate of practice, is employed with a firm of Chartered Accountants. He recommends a particular lawyer to his firm for some client related litigation being handled by the firm. The lawyer,

out of the professional fee received by him from the said client, paid a certain sum as referral fee to A. Is A guilty of misconduct under the Chartered Accountants' Act, 1949 ?

(4 Marks)

Answer

- (a) **Adverse or Qualified Statement:** Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance.

Examples of such circumstances:

- (i) The number of non-executive directors is less than 50% of the strength of Board of directors.
 - (ii) A qualified and independent audit committee is not set up.
 - (iii) The Chairman of the audit committee is not an independent director.
 - (iv) The Audit Committee does not meet four times a year.
 - (v) The necessary powers in terms of Part C of Schedule II have not been vested by the Board in the Audit Committee.
 - (vi) The time gap between two Board meetings is more than one hundred and twenty days.
 - (vii) A director is a member of more than ten committees or acts as Chairman of more than five committees across all companies in which he is a director.
 - (viii) The information of quarterly results is neither put on the listed entity's website nor sent in a form so as to enable the stock exchange on which the entity's securities are listed to enable such stock exchange to put it on its own website.
 - (ix) The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer agents.
- (b) **Emphasis of Matter Paragraph in Audit Reports:** SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", deals with additional communication in the auditor's report when the auditor considers it necessary to draw user's attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to user's understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements.

Specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances. These circumstances include:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special purpose framework.
- When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).

Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

However, a widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor's communication about such matters.

- (c) **Referral Fee from Lawyer:** According to Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949, a member of the Institute (other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

In the present case, Mr. A, a member of the ICAI, not holding a certificate of practice, is employed with a CA firm. Mr. A recommends a particular lawyer to his firm for some client related litigation handled by the firm. Being an employee and by referring a lawyer to the firm in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.

Therefore, Mr. A will be held liable for professional misconduct by virtue of Clause (2) of Part II of First schedule.

Question 3

Answer the following:

- (a) You have been appointed as Concurrent Auditor of a nationalized bank branch. The main business at the branch is dealing in foreign exchange. Suggest the main areas of coverage with regard to foreign exchange transactions of the said branch under concurrent audit.

(5 Marks)

- (b) In a Public Limited Company, it is suspected by the Management that there has been embezzlement in supplier's ledger. As an auditor of the Company, you have been asked to investigate the matter. What are the major areas that you would verify in this regard?

(5 Marks)

- (c) CA. P is a newly qualified Chartered Accountant in practice and in order to increase his professional practice and client base, entered into an agreement with Mr. A, a qualified and experienced registered valuer, to share 20% professional fees for all cases of valuation referred to him by CA. P. Based on this, CA. P received ₹ 1,20,000 during the year 2018-19 from Mr. A. Is CA. P guilty of misconduct under the Chartered Accountants' Act, 1949?

(4 Marks)

Answer**(a) Foreign Exchange transactions**

- (i) Check foreign bills negotiated under letters of credit.
- (ii) Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.
- (iii) Check whether inward/outward remittance have been properly accounted for.
- (iv) Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorised and necessary charges have been recovered.
- (v) Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.
- (vi) Ensure that the overbought/oversold position maintained in different currencies is reasonable taking into account the foreign exchange operations.
- (vii) Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations.
- (viii) Ensure verification/reconciliation of Nostro and Vostro account transactions/balances.

- (b) **Areas to be verified in case of embezzlement in supplier's ledger:** While investigating the matters regarding embezzlement in supplier's ledger, below mentioned areas should be verified.

- (i) The auditor should verify the adjustments in fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.
 - (ii) The auditor should ensure that suppressing the Credit Notes issued by suppliers and withdrawing the corresponding amounts not claimed by them.
 - (iii) The auditor should check that withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid to them.
 - (iv) The auditor should verify whether purchase invoices are accepted at prices considerably higher than their market prices and collecting the excess amount, paid in cash, from the suppliers.
 - (v) The auditor should verify the bought journal with reference to entries in the Goods Inward Book and the suppliers' invoices to confirm that amounts credited to the accounts of suppliers were in respect of goods, which were duly received, and the suppliers' accounts had been credited correctly.
 - (vi) The auditor should request all the suppliers to furnish statements of their accounts to see whether or not any balance is outstanding or due so as to confirm that allowances and rebates given by them have been correctly adjusted.
- (c) **Sharing Professional Fees with Registered Valuer:** As per Clause (3) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant will be guilty of professional misconduct if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute.

A member cannot share his fees with a non-member similarly he is also not permitted to receive and share the fees of others except for sharing with Member of such professional body or other person having such qualification as may be prescribed (Regulation 53A of the Chartered Accountants Regulations, 1988) by the Council. Under the Regulation 53-A of the Chartered Accountants Regulations, 1988, registered valuer is not included.

In the instant case Mr. P, who is a newly qualified Chartered Accountant in practice entered into an agreement with Mr. A, a qualified and experienced registered valuer, to share 20% professional fees for all case of valuation referred to him by CA. P. CA. P also received rupees 1,20,000 for the same from Mr. A. Thus, CA P will be held guilty for misconduct under clause (3) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

Question 4

Answer the following:

- (a) *You have been appointed as statutory auditor of M/s Moon Ltd. for the financial year 2018-19. As the auditor of the Company you want to ensure that closing balances of previous year have been correctly brought forward as opening balances in the current year. State the audit procedures for the same to ensure that there is no-misstatement. (5 Marks)*

- (b) *The financial statements of Beta Ltd. have been prepared by the Management with due disclosures for related parties and transactions with them. However, as the auditor of the Company, you are not sure of the reliability of the said disclosures. Mention the documents and records that may be helpful in gathering information about related party relationships and transactions.* **(5 Marks)**
- (c) *M/s PQR & Co. is a partnership firm of 3 partners P, Q and R. All partners are exclusively associated with the firm in practice and are not doing practice in individual capacity. For the year ended 31st March, 2019, the partners have undertaken audits and signed audit reports under section 44AB / 44AD of the Income Tax Act 1961 as under :*

Under section →	44AB	44AD
<i>P</i>	10	15
<i>Q</i>	60	5
<i>R</i>	100	5

Discuss whether there is any professional misconduct by the partners of the firm in regard to the aforesaid audits. **(4 Marks)**

Answer

- (a) **Audit Procedure for ensuring correctness of Opening Balances:** As per SA 510 “Initial Audit Engagements-Opening Balances”, the auditor shall read the most recent financial statements, if any, and the predecessor auditor’s report thereon, if any, for information relevant to opening balances, including disclosures. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period’s financial statements by –
- (i) Determining whether the prior period’s closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year’s Statement of Profit and Loss;
 - (ii) Determining whether the opening balances reflect the application of appropriate accounting policies; and
 - (iii) Performing one or more of the following:
 - (1) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
 - (2) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - (3) Performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Alternative Answer

Audit Procedure for ensuring correctness of Opening Balances: As per SA 510 "Initial Audit Engagements—Opening Balances", if the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements.

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

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period. In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- Performing audit procedures on the valuation of the opening inventory items.
- Performing audit procedures on gross profit and cut-off.

For non-current assets and liabilities, such as property plant and equipment, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances. In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties, for example, for long-term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

(b) **Verification of Existence of Related Parties:** As per SA 550 “Related Parties”, during the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. Example-

- (i) Entity Income Tax Returns.
- (ii) Information supplied by the entity to regulatory authorities.
- (iii) Shareholder registers to identify the entity’s principal shareholders.
- (iv) Statements of conflicts of interest from management and those charged with governance.
- (v) Records of the entity’s investments and those of its pension plans.
- (vi) Contracts and agreements with key management or those charged with governance.
- (vii) Significant contracts and agreements not in the entity’s ordinary course of business.
- (viii) Specific invoices and correspondence from the entity’s professional advisors.
- (ix) Life insurance policies acquired by the entity.
- (x) Significant contracts re-negotiated by the entity during the period.
- (xi) Internal auditors’ reports.
- (xii) Documents associated with the entity’s filings with a securities regulator (e.g., prospectuses).

Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions.

In particular, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

- (i) Bank, legal and third party confirmations obtained as part of the auditor’s procedures;
- (ii) Minutes of meetings of shareholders and of those charged with governance; and
- (iii) Such other records or documents as the auditor considers necessary in the circumstances of the entity.

(c) **Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961 :** As per the Council General Guidelines 2008, under Chapter VI, a member of the Institute in practice shall not accept, in a financial year, more than the “specified number of tax audit assignments” under Section 44AB of the Income-tax Act, 1961.

For the above purpose, “the specified number of tax audit assignments” means (a) in the

case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, 60 tax audit assignments, in a financial year, whether in respect of corporate or non-corporate assesses. (b) in the case of firm of Chartered Accountants in practice, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

In computing the “specified number of tax audit assignments”, the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.

Where any partner of the firm is also a partner of any other firm or firms of Chartered Accountants in practice, the number of tax audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the “specified number of tax audit assignments” in the aggregate.

In addition, where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the “specified number of tax audit assignments” in the aggregate.

It may be noted that the audits conducted under Section 44AD, 44AE and 44AF of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the “specified number of tax audit assignments”.

In the instant case, M/s PQR & Co., is a partnership firm of Partner P, Q and R. All the partners are exclusively associated with the firm and are not doing practice in individual capacity. Here, in the instant case, 60 tax audit assignments per partner in the firm, in a financial year will be considered for “specified number of tax audit assignments” i.e. 180 tax audits = 3 Partners x 60 tax audits.

In the given situation, number of tax audit reports signed under section 44AB are 170 (i.e. 10 reports signed by Mr. P, 60 reports signed by Mr. Q and 100 reports were signed by Mr. R). and number of tax audit reports signed under section 44AD are 25 (i.e. 15 reports signed by Mr. P, 5 reports signed by Mr. Q and 5 reports were signed by Mr. R). It may be noted that the 25 audits conducted under Section 44AD, of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the “specified number of tax audit assignments”.

In view of above provisions, partner Mr. P, Mr. Q and Mr. R of PQR & Co. have undertaken 170 audits which is not more than 180 tax audits i.e. “specified number of tax audit assignments” under Section 44AB of the Income-tax Act, 1961. Therefore, there is no professional misconduct in regard to the abovesaid audits.

Question 5

Answer the following :

- (a) How will you verify the income & expenditure of earlier years credited/debited in the current year for reporting under clause 27(b) of Form 3CD while carrying out Tax Audit u/s 44AB of the Income Tax Act, 1961? **(5 Marks)**
- (b) You have been appointed as an auditor of a General Insurance Company. In this context, explain unexpired risks reserve and audit procedures for the same. **(5 Marks)**
- (c) M Ltd. acquired 51 % shares of S Ltd. on 01-04-2018 and sold 25% of these shares during the financial year 2018-19. M Ltd. did not prepare Consolidated Financial Statements for the financial year 2018-19 on the plea that the control was only temporary. Do you agree with the view of M Ltd.? Decide, assuming, that M Ltd. is required to prepare its financial statements under Ind AS. **(4 Marks)**

Answer

- (a) **Clause 27(b) of 3CD- Particulars of income or expenditure of prior period credited or debited to the profit and loss account to be verified as :**

- (i) It may be noted that information under this clause would be relevant only in those cases where the assessee follows mercantile system of accounting.
- (ii) Under cash system of accounting, expenses debited/ income credited to the profit and loss account would be current year's expenses/income even though they may relate to earlier years.
- (iii) The tax auditor should obtain the particulars of expenditure or income of any earlier year debited or credited to the profit and loss account of the relevant previous year when mercantile system of accounting is followed.
- (iv) In the case of a person whose accounts of the business or profession have been audited under any other law, the information may be available from annual accounts.
- (v) In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, however, a close scrutiny of the ledger in regard to the period for which expenditure or income is entered in the account books may be necessary.
- (vi) The tax auditor should maintain the following information in his working papers file for the purpose of reporting in the format provided in the e-filing utility:

Sr. No.	Type	Particulars	Amount	Prior Period to which it relates (Year in yyyy-yy format)
1	2	3	4	5

- (b) **Unexpired Risks Reserve:** The need for Unexpired Risks Reserve arises from the fact that all policies are renewed annually except in specific cases where short period policies are issued. Since the insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies normally extend beyond this date into the following year during which risks continue. In other words, at the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year end.

As per section 64V of the Insurance Act, 1938, for the purpose of compliance with the provisions of maintaining control level of solvency margin, a proper value of every item of liability of the insurer shall be placed in the manner as may be specified by the regulations made in this behalf.

It may be mentioned that the profit and gain of insurance companies are governed by the provisions of section 44 of the Income Tax Act, 1961. In this regard, Rule 5 of the First Schedule to the Income Tax Act-Computation of Profit & Loss of General Insurance Business provides for creation of a reserve for unexpired risks as prescribed under Rule 6E of the Income Tax Rules, 1962. According to this Rule, the insurance companies are allowed a deduction of 50 per cent of net premium income in respect of Fire and Miscellaneous Business and 100 per cent of the net premium income relating to Marine Insurance business.

The auditor should verify the collections lodged by agents after the balance sheet date to see whether any collection pertains to risk commencing for the year under audit.

The auditor should also check that the premium has been recorded originally at the gross figure, i.e., without providing for unexpired risks and reinsurances.

- (c) **Consolidation of Financial Statement:** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operating under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.

Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

In the given case, M Ltd acquired 51% shares of S Ltd on 01.04.2018 and sold 25% shares during the year ended 2018-19. M Ltd did not consolidate the financial statements of S Ltd for the year ended 31.03.2019 on the plea that control was only temporary. The intention of M Ltd. is quite clear that the control in S Ltd. is temporary as the former company disposed off the acquired shares in the same year of its purchase.

However, even though the intention of M Ltd. is for temporary holding of shares in S Ltd. as per Ind AS, M Ltd is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110. However, "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee". Here, due to sale of investment in S Ltd. up to 25%, M Ltd. loses control of S Ltd.

Accordingly, M Ltd., is required to prepare consolidated statement till the date of disposal of the 25% shares to comply with the same.

Question 6

Answer the following :

- (a) *On a complaint and request from a Federal Co-operative to which a Multi State Co-operative Society is affiliated, you have been appointed by the Central Registrar to conduct an inquiry into working and financial condition of the Society. What shall be your powers in this regard?* **(5 Marks)**
- (b) *On the advice of Management of M/s Quick Ltd., the auditor of the Company overlooked and did not report on shifting of certain current year's sales transactions to the next year. The National Company Law Tribunal (NCLT) wants to take action against the auditor. Describe the powers of the NCLT under Section 140(5) of the Companies Act, 2013 for such action and consequences for the auditor.* **(5 Marks)**
- (c) *What are the factors that an auditor has to consider while using Computer Assisted Auditing Techniques (CAATs)?* **(4 Marks)**

OR

Write a short note on reversal of income under bank audit. **(4 Marks)**

Answer

- (a) **Under Sec. 78 of the Multi-State Co-operative societies Act, 2002, Person authorised by the Central Registrar shall have the following powers :**
 - (i) He shall at all reasonable times have free access to the books, accounts, documents, securities, cash and other properties belonging to or in the custody of the Multi-State co-operative society and may summon any person in possession or responsible for the custody of any such books, accounts, documents, securities, cash or other properties to produce the same at any place specified by him.
 - (ii) He may, notwithstanding any bye-law specifying the period of notice for a general meeting of the Multi-State co-operative society, require the officer of the society to call a general meeting of the society by giving notice of not less than seven days at such time and place at the head quarters of the society to consider such matters as may be directed to him, and where the officers of the society refuse or fail to call such a meeting, he shall have power to call it himself.
 - (iii) He may summon any person who is reasonably believed by him to have knowledge of the affairs of the Multi-State co-operative society to appear before him at any place at the headquarters of the society or any branch thereof and may examine such person on oath.
 - (iv) The Central Registrar shall, within a period of 3 months of the date of receipt of the report, communicate the report of enquiry to the Multi-State co-operative society, the

financial institution, if any, to which the society is affiliated and to the person or authority, if any, at whose instance the enquiry is needed.

- (b) **Direction by Tribunal in case auditor acted in a fraudulent manner:** As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

It is hereby clarified that in the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

- (c) **Consideration of Factors in Use of CAATs:** In determining whether to use CAATs, the auditor should consider the following factors:
- (i) **Availability of sufficient IT knowledge and expertise:** It is essential that members of the audit team should possess sufficient knowledge and experience to plan, execute and use the results of CAAT. The audit team should have sufficient knowledge to plan, execute and use the results of the particular CAAT adopted.
 - (ii) **Availability of CAATs and suitable computer facilities and data in suitable format:** The auditor may plan to use other computer facilities when the use of CAATs on an entity's computer is uneconomical or impractical, for example, because of an incompatibility between the auditor's package programme and entity's computer.
 - (iii) **Impracticability of manual tests due to lack of evidence:** Some audit procedures may not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.
 - (iv) **Impact on effectiveness and efficiency in extracting a data:** It includes selection of samples, applying analytical procedures, time involved in application of CAAT, etc.
 - (v) **Time constraints:** Time constraints in certain data, such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make arrangements for the

retention of data required, or may need to alter the timing of the work that requires such data.

Or

- (c) **Reversal of Income:** If any advance, including bills purchased and discounted, becomes Non-Performing Assets as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realized. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).