

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

Answer any **four** from the rest

Question 1

Answer the following:

- (a) Ace Limited (manufacturer of textile goods) got an order of manufacturing of PPE kits in December 2020. But there was shortage of machinery and manpower to accomplish the ordered requirement of PPE kits. Ace Ltd. approached another manufacturing unit Jack Limited for purchase of the unit. Jack Limited was interested in the sale of unit, so the deal went through and Ace Limited acquired ninety five percent shares of Jack Limited. The new management of Jack Limited proposed and appointed NKB Associates, Chartered Accountants, (already auditors of Ace Limited) as new auditors of Jack Limited. NKB Associates accepted the assignment without considering information whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. Comment with respect to appropriate Standard on Auditing what type of information assists the engagements partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate or not? **(5 Marks)**
- (b) You as a statutory auditor had audited the financial statements of A Ltd., a listed company, for F.Y. 2019-20. The company has included the comparative financial information in the financial statements prepared for the current F.Y. 2020-21. You as an auditor want to obtain sufficient appropriate audit evidence that comparative financial information has been presented, in all material aspects, in accordance with the requirements in the applicable financial reporting framework. List out audit procedures, as specified in relevant SA, which you are required to follow for the purpose. **(5 Marks)**
- (c) You are an auditor of KAL Ltd., a multinational company dealing in auto parts. The company is operating in a CIS environment comprising of hardware, software, people and transmission media and has implemented an internal control. Different types of controls are used to enhance the reliability of basic components with respect to each type of error. List down major classes of controls that you must evaluate as an auditor. **(4 Marks)**

Answer

- (a) **Acceptance and Continuance of Client Relationships and Audit Engagements** : As per SA 220, "Quality Control for an Audit of Financial Statements", SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

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

- (i) The integrity of the principal owners, key management and those charged with governance of the entity;
 - (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources.
 - (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
 - (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.
- (b) As per SA 710, "Comparative Information - Corresponding Figures and Comparative Financial Statements", the auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified.
- (1) For this purpose, the auditor shall evaluate whether the comparative information agrees with the amounts and other disclosures presented in the prior period and the accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.
 - (2) If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.
 - (3) If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560, "Subsequent Events".
 - (4) As required by SA 580, "Written Representations", the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.
- (c) **In a computer system many different types of controls are used to enhance component reliability. Major classes of control that the auditor must evaluate are:**
- (i) **Authenticity Controls** - Authenticity control are exercised to verify the identity of the individuals or process involved in a system (e.g. password control, personal identification numbers, digital signatures).

- (ii) **Accuracy Control** - Accuracy control ensure the correctness of data and processes in a system (e.g. program validation cheek that a numeric field contains only numeric, overflow checks, control totals, hash total etc.).
- (iii) **Completeness Control** - Completeness control attempt to ensure that no data is missing and that all processing is carried through to its proper conclusion (e.g. program validation check, sequence check etc.).
- (iv) **Redundancy Control** - Redundancy controls attempt to ensure that a data is processed only once (e.g. batch cancellation stamp, circulating error files etc.).
- (v) **Privacy Controls** - Privacy controls ensure that data is protected from inadvertent or unauthorised disclosure (e.g. cryptograph, data compaction, inference control etc.).
- (vi) **Audit Trail Controls** - Audit trail controls ensure traceability of all events occurred in a system. This record is needed to answer queries, fulfil statutory requirements, minimise irregularities, detect the consequences of error etc. The accounting audit trail shows the source and nature of data and process that update the database. The operations audit trail maintains a record of attempted or actual resource consumption within a system.
- (vii) **Existence Controls** - Existence controls attempt to ensure the ongoing avail ability of all system resources (e.g., database dump and logs for recovery purposes duplicate hardware, preventive maintenance, check point and restart control).
- (viii) **Asset Safeguarding Controls** - Asset safeguarding control attempt to ensure that all resources within a system are protected from destruction or corruption (e.g. physical barriers, libraries etc.).
- (ix) **Effectiveness Controls** - Effectiveness control attempt to ensure that systems achieve their goals (e.g. monitoring of user satisfaction, post audits, periodic cost benefit analysis etc.).
- (x) **Efficiency Controls** - Efficiency controls attempt to ensure that a system uses minimum resources to achieve its goals.

Question 2

Answer the following:

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

the Basis for Adverse Opinion section. Comment whether PQR & Co. needs to report under SA 701 'Communicating Key Audit Matters in the Independent Auditor's Report'?

(5 Marks)

- (b) *While conducting the tax audit of PJP Ltd. you observed that company has timely filed ETDS return for TDS deducted on salary u/s 192 of the Income Tax, 1961 in form 24Q in respect of fourth quarter period from 1st January 2021 to 31st March 2021. The company has not furnished list of details which are not reported in the statement of tax deducted at source under the pretext that TDS statements are furnished within the prescribed time. As a Tax Auditor of PJP Ltd. how you would deal and report?* **(5 Marks)**
- (c) *CA. S has been appointed as peer reviewer of JS & Associates, a Level-I CA Firm. CA S wants to appoint CA K as his assistant, as he has working experience in a Level-I CA Firm. What aspects CA S should take care of before appointing CA K as Assistant, for the peer review of JS & Associates?* **(4 Marks)**

Answer

- (a) SA 700 establishes requirements and provides guidance on forming an opinion on the financial statements. Communicating key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation. SA 705, "Modifications to the Opinion in the Independent Auditor's Report", addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements.

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

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

In the given situation J Ltd., a listed company, has not consolidated one of its subsidiary. Further, Consolidated Financial Statements of J Ltd. Are materially misstated due to such non-consolidation. The material misstatement is also deemed to be material and pervasive

and effect of the failure to consolidate have not been determined. In the given situation it is appropriate to give Adverse Opinion by PQR & Co., a Chartered Accountant Firm.

Since, in the given case, Adverse Opinion is being expressed thus PQR & Co. can communicate Key Audit Matter in given below manner:

Key Audit Matters: Except for the matter described in the *Basis for Adverse Opinion* section, we have determined that there are no other key audit matters to communicate in our report.

- (b) **As per Clause 34 (b) of the Form 3CD, the auditor has to report whether the assessee is required to furnish the statement of tax deducted or tax collected. If yes, please furnish the details:**

Tax deduction and collection Account Number (TAN)	Type of Form	Due date for furnishing	Date of furnishing, if furnished	Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported	If not, please furnish list of details/transactions which are not reported

Accordingly, clause 34 (b) requires, a list of details/transactions which are not reported in the statement of tax deducted at source and statement of tax collected at source are required to be furnished. The reporting requirement is notwithstanding the fact that the assessee has furnished the statements of tax deducted at source and tax collected at source within the prescribed time.

In the given situation, PJP Ltd., has timely filed ETDS return for TDS deducted on Salary under section 192 of the Income Tax Act in Form 24Q in respect of 4th quarter. The company has not furnished list of details which are not reported in the statement of tax deducted at source under the pretext that TDS Statements are furnished within the prescribed time. Therefore, in view of above, PJP Ltd. is required to furnish list of details which are not reported in the statement of tax deducted at source.

- (c) **Qualified Assistant:** In the given situation, CA S has been appointed as Peer Reviewer of JS & Associate, a Level I CA Firm. CA S wants to appoint CA K as his assistance. CA S is required to take care of following aspects before appointing CA. K as Assistant for the Peer Review of JS& Associates:

- (1) The reviewer may take the help of a qualified assistant while carrying out peer review. In this context, the Board decided to clarify that a reviewer is permitted to take the

assistance of only one assistant who shall be a chartered accountant and a person who does not attract any of the dis-qualifications prescribed under Section 8 or Section 21 of the Chartered Accountants Act, 1949.

- (2) The name of the qualified assistant which the reviewer would like to assist him shall be identified and intimated to the Board as well as the practice unit before the commencement of the peer review.
- (3) Such a qualified assistant shall also have to sign the declaration of confidentiality as annexed to the Statement.
- (4) He shall have no direct interface either with the practice unit or the Board. Further the person chosen for assisting the reviewer shall be from the firm of the reviewer as a partner or paid assistant as per the records of ICAI.

Question 3

Answer the following:

- (a) *AB & Associates, a chartered accountant firm, was appointed auditors of KEY Company Ltd. for the financial year ended 31st March 2021. Being the first year of audit, the audit firm AB & Associates, as per its system of quality control, involved senior partner of the firm to review the overall audit strategy prepared by the team members. What additional matters would be considered in initial audit engagement by the senior partner in establishing the overall audit strategy and audit plan of KEY Company Ltd.? (5 Marks)*
- (b) *HG & Co. is the statutory auditor of KFN NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was a difference of opinion between Mr. H and his partner Mr. G. Mr. G is of the opinion that evaluation of internal control system and verification of registration with RBI should not be the part of audit procedure, as it is the part of internal audit only. Is the contention of Mr. G correct? Also state what broad areas should mandatorily become part of the audit procedure of HG & Co. for conducting the audit of KFN NBFC Ltd.? (5 Marks)*
- (c) *Mr. Joe, a practicing chartered accountant, has accepted an appointment as auditor of cooperative society and agreed to charge fees @ 7% of the profits of the society during the financial year 2020-21. Comment on action of Mr. Joe with reference to the Chartered Accountants Act, 1949 and Schedules thereto. (4 Marks)*

Answer

- (a) **Additional Considerations in Initial Audit Engagements:** As per SA 300 "Planning an Audit of Financial Statements" the purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For initial audits, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- (1) Unless prohibited by law or regulation, arrangements to be made with the predecessor auditor, for example, to review the predecessor auditor's working papers.
 - (2) Any major issues (including the application of accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.
 - (3) The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances in accordance with SA 510 "Initial Audit Engagements– Opening Balances".
 - (4) Other procedures required by the firm's system of quality control for initial audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).
- (b) **Following are broad areas that should be mandatorily part of the audit procedure for conducting the audit of NBFC:**
- (1) **Ascertaining the Business of the Company** - The first step in carrying out the audit of a NBFC is to scan through the Memorandum and Articles of Association of the company, so as to acquaint oneself with the type of business that the company is engaged into.

The task of ascertaining the principal business activity of any NBFC is of paramount importance since the very classification of a company as a NBFC and its further classification would all depend upon its principal business activity. Based on the classification of a company, it will be required to comply with the provisions relating to limits on acceptance of public deposits as contained in the NBFC Public Deposit Directions.
 - (2) **Evaluation of Internal Control System** - An auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed.

In particular, an auditor should review the effectiveness of the system of recovery prevalent at the NBFC. He should ascertain whether the NBFC has an effective system of periodical review of advances in place which would facilitate effective monitoring and follow up. The absence of a periodical review system could result in non-detection of sticky advances at their very inception which may ultimately result in the NBFC having an alarmingly high level of NPAs.

- (3) **Registration with the RBI** - Section 45-IA of the RBI Act, 1934, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds. An auditor should obtain a copy of the certificate of registration granted by the RBI or in case the certificate of registration has not been granted, a copy of the application form filed with the RBI for registration. It may particularly be noted that NBFCs incorporated after 9th January, 1997 are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. The auditor should ascertain whether investment in prescribed liquid assets have been made and whether quarterly returns as mentioned above have been regularly filed with the RBI by the concerned NBFC.
- (4) The auditors must ascertain whether the company properly classified as per the requirements of various regulations. In case, the NBFC has not been classified by the RBI, the classification of a company will have to be determined after a careful consideration of various factors such as particulars of earlier registration granted, if any, particulars furnished in the application form for registration, company's Memorandum of Association and its financial results.
- (5) **NBFC Prudential Norms Directions** - Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans and investments for failure to repay public deposits and norms for concentration of credit/investments.

In the given situation, HG & Co., is the statutory auditor of KFN NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was difference of opinion between H and his partner G regarding evaluation of internal control and verification of registration with RBI.

As discussed above NBFCs are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. Further, auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed.

Accordingly, contention of Mr. G regarding evaluation of internal control system and verification of registration with RBI should not be part of the audit procedure as it is part of internal audits only, is not correct.

- (c) According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he Charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed regulation 192 which exempts certain professional services from the operation of Clause (10).

CA Regulation allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of an auditor of a co-operative society, the fees may be based on a percentage of the paid-up capital or the working capital or the gross or net income or profits.

In the given case, Mr. Joe, a practicing Chartered Accountant, has acted an appointment as auditor of co-operative society and agreed to charge his professional fees on percentage of the profits of the society. Therefore, Mr. Joe shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the profits of the co-operative society.

Question 4

Answer the following:

- (a) You are an auditor of XYZ Insurance Company Ltd. which offers variety of risk management products to business entities wishing to protect their business activities against losses due to various probable risks. XYZ Insurance Company Ltd. is in the process of offering to ABC Ltd., a multinational group having worldwide market, "Trade Credit Insurance Policy" to cover domestic risk export risk and political risk. You as an auditor of Insurance Company have been requested to ensure that all the requirements have been met by XYZ Insurance Company Ltd. before Trade Credit Insurance Product is offered to ABC Ltd. List down those requirements. **(5 Marks)**
- (b) "What constitutes a 'true and fair view' is the matter of an auditor's judgement in particular circumstances of a case." Do you agree? Enlist the requirements you as an auditor will observe to ensure true and fair view. **(5 Marks)**
- (c) AJ & Associates and PK & Co., chartered accountant firms have joined the Network firm A to Z & Affiliates registered with Institute. AJ & Associates was statutory auditor of B Ltd. for last 10 years. Due to rotation of auditor as per section 139 (2) of Companies Act, 2013, B Ltd. retires AJ & Associates and appoints PK & Co., as auditor for the year 2020-21. Comment as per Chartered Accountant Act, 1949 - Guidelines for Networking. **(4 Marks)**

Answer

- (a) **Basic Requirements of a Trade Credit Insurance Product:** An insurer shall offer trade credit insurance product only if all requirements mentioned below are met -
- (i) Policyholder's loss is non-receipt of trade receivable arising out of a trade of goods or services.
 - (ii) Policyholder is a supplier of goods or services in consideration for a fair market value.
 - (iii) Policyholder's trade receivable does not arise out of factoring or reverse factoring arrangement or any other similar arrangement.
 - (iv) Policyholder has a customer (*i.e.* Buyer) who is liable to pay a trade receivable to the policyholder in return for the goods and services received by him from the policyholder, in accordance with a policy document filed with the insurer.
 - (v) Policyholder undertakes to pay premium for the entire Policy Period.
 - (vi) Any other requirement that may be specified by the Authority from time to time.
- (b) **Significance of True and Fair:** SA 700 "Forming an Opinion and Reporting on Financial Statements", requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion. The auditor is required to express his opinion on the financial statements that it gives a true and fair view in conformity with the accounting principles generally accepted in India (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX; (b) in the case of the Statement of Profit and Loss, of the profit/ loss for the year ended on that date; and (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

In the context of audit of a company, the accounts of a company shall be deemed as not disclosing a true and fair view, if they do not disclose any matters which are required to be disclosed by virtue of provisions of Schedule III to that Act, or by virtue of a notification or an order of the Central Government modifying the disclosure requirements. Therefore, the auditor will have to see that the accounts are drawn up in conformity with the provisions of Schedule III of the Companies Act, 2013 and whether they contain all the matters required to be disclosed therein. In case of companies which are governed by special Acts, the auditor should see whether the disclosure requirements of the governing Act are complied with.

It must be noted that the disclosure requirements laid down by the law are the minimum requirements. If certain information is vital for presenting a true and fair view, the accounts should disclose it even though there may not be a specific legal provision to do so. Thus, what constitutes a 'true and fair' view is the matter of an auditor's judgment in the particular circumstances of a case. In more specific terms, to ensure true and fair view, an auditor has to see:

- (i) that the assets are neither undervalued or overvalued, according to the applicable accounting principles,
 - (ii) no material asset is omitted;
 - (iii) the charge, if any, on assets are disclosed;
 - (iv) material liabilities should not be omitted;
 - (v) the statement of profit and loss discloses all the matters required to be disclosed by Part II of Schedule III
 - (vi) the balance sheet has been prepared in accordance with Part I of Schedule III;
 - (vii) accounting policies have been followed consistently; and
 - (viii) all unusual, exceptional or non-recurring items have been disclosed separately.
- (c) As per Council General Guidelines, 2008, Chapter XV, Guidelines for Networking, once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular in those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.

In the given situation, AJ & Associates was statutory auditor of B Ltd. For last 10 years and due to rotation of auditor as per section 139(2) of the Companies Act, 2013 B Ltd., retires AJ & Associates and appoints PK & Co. as auditor for the year 2020-21.

It may be considered that AJ & Associates and PK & Co., chartered accountant firms have joined the network firm namely A to Z & Affiliates registered with Institute. In view of above Guidelines for Networking PK & Co., is disqualified for appointment as an auditor of B Ltd.

Question 5

Answer the following:

- (a) TEA Ltd., FMCG Company having its tea gardens in north eastern states of the country is exclusively dealing in blending, processing, packing and selling of various brands of Tea. During the year under audit, the company entered into joint venture for purchasing Tea Gardens in Sri Lanka and Kenya. M/s GN & Associates are the statutory auditors of the company for the financial year 2020-21. During the course of audit, the audit team was unable to obtain sufficient appropriate evidence about a single element of the consolidated financial statement being Joint venture investment in Kali Ltd. representing over 90% of the group's net assets having both material and pervasive possible effect to the consolidated financial statements. The group's investment in Kali Ltd. is carried at ₹ 100 crores in the group's consolidated balance sheet.

Draft the opinion paragraph and basis of opinion paragraph to be included in the Independent Auditor's report. **(5 Marks)**

- (b) What will be liability of Mr. X, an auditor in the following situations? Support your views
- (i) Mr. X has appeared before the Income Tax Authorities as an authorized representative of his Auditee and submitted to the Income Tax Authorities a false declaration. **(2 Marks)**
 - (ii) As an auditor, not appropriately dealing with a misstatement appearing in financial statements amounting to ₹9.84 lakhs. Misstatement does not involve public interest. **(3 Marks)**
- (c) "In reviewing any System or Procedure, the management auditor must concern himself with its purpose as well as its design." Elucidate how you as a management auditor will study system and procedural functions. **(4 Marks)**

Answer

- (a) M/s GN & Associates are unable to obtain sufficient appropriate audit evidence about the financial information of a joint venture investment that represents over 90% of the group's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are both material and pervasive to the consolidated financial statements. Therefore, the statutory auditor should issue a disclaimer of opinion.

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We were engaged to audit the accompanying consolidated financial statements of Tea Ltd., FMCG Company (hereinafter referred to as the "Holding Company") and its subsidiaries (the Holding Company and its subsidiaries together referred to as "the Group"), which comprise the consolidated balance sheet as at March 31, 20XX, the consolidated statement of Profit and Loss, (*consolidated statement of changes in equity*) and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the "Consolidated Financial Statements").

We do not express an opinion on the accompanying consolidated financial statements of the Group. Because of the significance of the matter described in the *Basis for Disclaimer of Opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

Basis for Disclaimer of Opinion

The Group's investment in its joint venture Kali Ltd. Company is carried at ₹ 100 crores on the Group's consolidated balance sheet, which represents over 90% of the Group's net assets as at March 31, 2021. We were not allowed access to the management and the auditors of XYZ Company, including XYZ Company's auditors' audit documentation. As a

result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of Kali Ltd.'s assets that it controls jointly, its proportional share of Kali Ltd.'s liabilities for which it is jointly responsible, its proportional share of Kali Ltd.'s income and expenses for the year, (and the elements making up the consolidated statement of changes in equity) and the consolidated cash flow statement.

- (b) (i) **False Declaration as Authorized Representative:** In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income Tax Act 1961.

Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

In the instant case, Mr. X, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration, thus, he would be liable under section 278 of the Income Tax Act, 1961.

- (ii) **Nature of Liability as per the Companies Act, 2013:** Under section 448 of the Companies Act, 2013, an auditor is liable for criminal prosecution, if he, in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material.

If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act. It may also be noted that where the fraud involves an amount less than ten lakh rupees or one percent of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.]

Thus, in view of above, Mr. X will be held liable for criminal prosecution for not appropriately dealing with a misstatement of rupees 9.84 lakh appearing in audited financial statements though misstatement does not involve public interest and assuming that it was known to auditor.

- (c) The review of systems and procedures is to improve the methods, to get away from the old ways and traditional routines and to reduce the cost in completing and processing the paperwork - eliminating waste, duplication and inefficiencies. In reviewing any system or

procedure, the management auditor must concern himself with its purpose as well as its design and then he must decide on its merits as the best serving the interests of the enterprise. In the study of the systems and procedural functions, the auditor should ask himself:

1. Is the function properly located in the organisation?
2. Do the staff personnel have the necessary training and experience to perform the work?
3. Has a definite programme been established and has been taken for its attentive accomplishment?
4. Is productivity satisfactory?

Question 6

Answer the following:

- (a) C & AG appointed a chartered accountant firm to conduct Performance audit of COP Ltd., a PSU of Govt. of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG. **(5 Marks)**
- (b) Your firm has been appointed as a statutory auditor of a nationalised bank which has multiple banking accounts and consortium accounts of corporate borrowers and of which many accounts are falling within the purview of CDR (Corporate Debt Restructuring) mechanism. Enumerate the audit procedure to be carried out for assessing such borrowers' accounts. **(5 Marks)**
- (c) You are appointed as an auditor of BHK Ltd., a company engaged in export of agricultural equipment. During the course of audit, your audit team informed you regarding non-deduction of TDS on huge payments made to legal counsel of BHK Ltd. You want to alert your team on the possibility of non-compliance with Laws and Regulations by BHK Ltd. Help your audit team in identifying any other indications of non-compliance with Laws and Regulations particularly related to payments made by the company. **(4 Marks)**

OR

- (c) As a tax auditor of RM & Co. for the assessment year 2021-22, how would you deal and report the following:
- (i) RM & Co. has borrowed ₹ 75 lakhs from a bank @ 10% p.a. for purchase of machinery. The machinery was purchased on 30.09.2020, but was put to use on 10.04.2021. The interest paid to bank for the year 2020-21 was charged to Profit and Loss Account.

(2 Marks)

- (ii) *RM & Co. is a trading concern and maintains the quantitative details of items traded. The said details have been provided to you by the company for meeting reporting requirements, if any.*

(2 Marks)

Answer

- (a) In the given scenario, C&AG appointed a chartered accountant firm to conduct Performance Audit of COP 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.

(b) Audit Procedure for Accounts falling under CDR (Corporate Debt Restructuring)

Programme: Following audit procedures are to be carried out to assess / gain an understanding about the borrower account-

- (i) Review the present classification of the account under IRAC norms adopted by the bank and corresponding provision made in the books of accounts, if any. If the account is already treated as NPA in the books of the bank, the same cannot be upgraded only because of the CDR package.
- (ii) Review the Debtor - Creditor Agreement (DCA) and Inter Creditor Agreement (ICA) with respect to availability of such agreements and necessary provisions in the agreement for reference to CDR cell in case of necessity, penal clauses, stand-still clause, to abide by the various elements of CDR system etc., (DCA may be entered into at the time of original sanction of loan or at the time of reference to CDR).
- (iii) Auditor has to ascertain the terms of rehabilitation along with the sacrifices, if any, assumed in the rehabilitation program to verify whether such sacrifices have been accounted in the books of accounts of the lender. Ascertain whether any additional financing / conversion of loan into equity have been envisaged in the rehabilitation / restructuring program.
- (iv) Auditor should also ascertain whether account has been referred to BIFR, as such cases are not eligible for restructuring under CDR system. Large value BIFR cases may be eligible for restructuring under CDR if specifically recommended by CDR core group. Auditor has to verify the necessary approvals / recommendations by CDR core group if auditor comes across any BIFR cases.
- (v) Auditor has to ensure that accounts wherein recovery suits have been filed, the initiative to resolve under CDR system is taken by at least by 75% of the creditors by value and 60% in number provided the account meets the basic criteria for becoming eligible under CDR mechanism.

(c) Indications of Non-Compliance with Laws and Regulations: As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", when the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations:

- (1) Payment of fines or penalties.
- (2) Payments for unspecified services or loans to consultants, related parties, employees or government employees.

- (3) Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- (4) Purchasing at prices significantly above or below market price.
- (5) Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- (6) Unusual payments towards legal and retainership fees.
- (7) Unusual transactions with companies registered in tax havens.
- (8) Payments for goods or services made other than to the country from which the goods or services originated.
- (9) Payments without proper exchange control documentation.

OR

- (c) (i) As per Clause 21(a), the tax auditor is required to furnish the details of amounts debited to the profit and loss account, being in the nature of Capital, personal, advertisement expenditure etc.:

Nature	Serial number	Particulars	Amount in ₹
Capital Expenditure			

Further as per Clause 21(i): Amount inadmissible under the proviso to section 36(1)(iii).

The provisions of section 36(1)(iii) provide that the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession would be allowed as a deduction in computing the income referred to in section 28 of the Act. The proviso thereunder provides that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalized in the books or account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was put to use, shall not be allowed as a deduction.

In the given situation, RM & Co. has borrowed rupees 75 lakh from a bank @10% p.a. for purchase of machinery. The machinery was purchased on 30.09.20 but was put to use on 10.04.21. The interest paid to bank for the year 2020-21 was charged to profit and loss account of RM & Co is not in order in accordance with Proviso to

Section 36(1)(iii) therefore, reporting of the same will be done as per Clause 21 (a) and Clause 21(i) of Form 3CD.

(ii) As per Clause 35(a) of Form 3CD, tax auditor is required to report in the case of a trading concern, to give quantitative details of the principal items of goods traded:

- (i) Opening stock;
- (ii) Purchases during the previous year;
- (iii) Sales during the previous year;
- (iv) Closing stock;
- (v) shortage / excess, if any.

The tax auditor should obtain certificates from the assessee in respect of the principal items of goods traded, the balance of the opening stock, purchases, sales and closing stock and the extent of shortage/ excess/damage and the reasons thereof.

In the given situation as a tax auditor of RM & Co., a certificate should be obtained and reporting to be done in accordance with Clause 35(a) of Form 3CD.