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What Our Students have to Say....

Aman Mahajan (CA AIR 19)

I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test series helped a lot in improving my writing speed and presentation skills.

Sundar Sri Renganathan B (AIR 33)

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

Dwarakesh

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

Yug Manoj Kumar Bhattad

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at IndigoLearn.

Prakash Bhatt

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

Naveen Kumar S

Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

Bhagyasree Chougule

It was only because of IndigoLearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

Mohd Thayyab

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

Lalit Chetan Sanpal

IndigoLearn has been fantastic and brilliant. Helped me a lot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at IndigoLearn. Really grateful. Will go for CA Finals at IndigoLearn For sure. Thank you so much IndigoLearn.

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Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result) because only in Accounting I got exemption. Thank you IndigoLearn.

Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from IndigoLearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well. Special thanks to the FM faculty, I studied only 2 chapters in economics, and still managed to score exemption in the 8th paper.

Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

Rajalaxmi CA Inter

Can't believe I cleared. Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

Priyanka Udeshi

All the faculties have excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

Disclaimer

This book is designed for students pursuing CA Final course, who are appearing for the **Advanced Auditing, Assurance and Professional Ethics** exam in **Nov-24 or afterwards**. The content in the book is not in the order provided by ICAI to ensure logical and comprehensive learning.

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Q1. Exam Nov 2022, 5 marks

AP & Associates, Chartered Accountants, are Statutory Auditors of XP Limited for the last four years. XP Limited is engaged in the manufacture and marketing of FMCG Goods in India. During 2021-22, the Company has diversified and commenced providing software solutions in the area of "e-commerce" in India as well as in certain European countries. AP & Associates, while carrying out the audit for the current financial year, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise and infrastructure to carry out the audit of this diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.

Answer:

Acceptance and Continuance of Client Relationships and Specific Engagements: As per SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

In the given case, AP & Associates, Chartered Accountants, statutory auditors of XP Limited for the last four years, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise for the same, therefore, AP & Associates wish to withdraw from the engagement and client relationship. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

- Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
- Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- Documenting significant issues, consultations, conclusions and the basis for the conclusions.

AP & Associates should address the above issues before deciding to withdraw.

Q2. Exam May 2022, 5 marks

PQR & Associates, Chartered Accountants, is a partnership firm having 3 partners CA P, CA Q and CA R. PQR & Associates are appointed as Statutory Auditors of ABC Limited, a listed entity for the financial year 2021-22 and CA P is appointed as Engagement Partner for the audit of ABC Limited. Before issuing the Audit Report of ABC Limited, CA P asked CA R to perform Engagement Quality Control Review and is of the view that his responsibility will be reduced after review by CA R. Whether the contention of CA P is correct? What are the aspects that need to be considered by CA R while performing Engagement Quality Control Review for audit of financial statements of ABC Limited?

Answer:

As per SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the review does not reduce

the responsibilities of the engagement partner. Hence, contention of CA. P that after engagement quality control review by CA. R, his responsibility will be reduced, is not correct.

However, CA. R needs to consider the following aspect while performing Engagement Quality Control Review for audit of financial statements of a listed entity ABC Ltd.:

1. The engagement team's evaluation of the firm's independence in relation to the
2. specific engagement.
3. Significant risks identified during the engagement and the responses to those risks.
4. Judgments made, particularly with respect to materiality and significant risks.
5. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
6. The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
7. The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
8. Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
9. The appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.

Q3. Exam May 2022, 5 marks

You are the team leader of 10 members for an audit of a Multinational Company. All the team members are concerned about audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned. In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard on Auditing

Answer:

SA 230, "Audit Documentation", provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.

For example,

- a. the existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- b. the existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
- c. An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.
- d. In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
 - Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".

Q4. Exam July 2021, 5 marks

M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020-2021. The Company implemented internal controls for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement? Also discuss certain subject matters or assertions where it is difficult to detect material misstatements due to potential effects of inherent limitations.

Answer:

Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations -

As per SA 200 - "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" and as per SQC 1 because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence.

Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in the light of the overall objectives of the auditor.

In view of above, it can be concluded that auditors did not give correct statement.

In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- (i) Fraud, particularly fraud involving senior management or collusion.
- (ii) The existence and completeness of related party relationships and transactions.
- (iii) The occurrence of non-compliance with laws and regulations.
- (iv) Future events or conditions that may cause an entity to cease to continue as a going concern.

Q5. Exam July 2021, 5 marks

HK & Co. Chartered Accountants have been auditors of SAT Ltd (a listed entity) for the last 8 financial years. CA. H, partner of the firm, has been handling the audit assignment very well since the appointment. The audit work of CA. H and her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards and regulatory and legal requirements. CA. K was out of India for some personal reasons, so this year CA. G has been asked to review the audit work. In your opinion, what areas CA. G should consider at the time of review. List any four areas and also comment whether firm is complying with Standard on Quality Control or not.

Compliance with Standard on Quality Control on review of audit work -

As per SQC 1, an engagement quality control review for audits of financial statements of listed entities includes considering the following:

- (i) The work has been performed in accordance with professional standards and regulatory and legal requirements;
- (ii) Significant matters have been raised for further consideration;
- (iii) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- (iv) There is a need to revise the nature, timing and extent of work performed;
- (v) The work performed supports the conclusions reached and is appropriately documented;
- (vi) The evidence obtained is sufficient and appropriate to support the report; and

(vii) The objectives of the engagement procedures have been achieved.

The firm should establish policies and procedures:

- (i) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and
- (ii) For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with the Code.

The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre- defined period, normally not more than seven years.

From the facts given in the question and from the above stated paras of SQC 1, it can be concluded that firm is not complying with SQC 1 as Engagement Partner H is continuing for more than 7 years.

Q6. Exam Jan 2021, 5 marks

M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y 2019-2020. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2018-19 were incorrectly brought forward. It was found that M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period.

Accordingly, a complaint was filed against NK & Co. in relation to this matter.

You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC).

Answer:

In the given question, NK & Co. did not apply audit procedures to ensure that opening balances had been correctly brought forward. A complaint was filed against the auditors in this context. As per Standard on Quality Control (SQC) 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements",

- (i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:
 - a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
 - b) Allegations of non-compliance with the firm's system of quality control.
- (ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.
- (iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.
- (iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.
- (v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.

Q7. Exam Jan 2021, 5 marks

Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd., you observed that significant deficiency exists in the internal control system and

you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization.

Answer:

(a) In the given case of ABC Ltd, Auditors, while conducting audit has come across significant deficiency existing in the internal control system and also auditors wanted to ascertain that deficiency.

As per SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", Indicators of significant deficiencies in internal control include, for example:

- (i) Evidence of ineffective aspects of the control environment, such as:
 - a. Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
 - b. Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
 - c. Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- (ii) Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- (iii) Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- (iv) Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- (v) Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- (vi) Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- (vii) Evidence of management's inability to oversee the preparation of the financial statements.

Q8. Exam Nov 2020, 5 marks

CA. N has been appointed as an auditor of TRP Ltd. While conducting the audit he has identified some deficiencies in the Internal control. He needs to determine whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency" and has to communicate them in writing to those charged with Governance and management on a timely basis. Guide CA. N with some examples of matters to be considered while determining 'significant deficiency' in internal control with reference to relevant SA.

Answer:

(b) As per SA 265 "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", significant deficiency in internal control means a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgement, is of sufficient importance to merit the attention of those charged with governance.

Examples of matters that CA N, auditor of TRP Ltd may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

1. The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
2. The susceptibility to loss or fraud of the related asset or liability. (3) The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
3. The financial statement amounts exposed to the deficiencies.
4. The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
5. The importance of the controls to the financial reporting process; for example:
 - a) General monitoring controls (such as oversight of management).
 - b) Controls over the prevention and detection of fraud.
 - c) Controls over the selection and application of significant accounting policies.
 - d) Controls over significant transactions with related parties.
 - e) Controls over significant transactions outside the entity's normal course of business.

- f) Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
6. The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
7. The interaction of the deficiency with other deficiencies in internal control.

Q9. Exam Nov 2020, 5 marks

PQ Limited, a listed entity, is in the business of manufacturing of specialty chemicals. The company has appointed CA Jazz as CFO of the company. CA Jazz is concerned about compliance with the provisions of laws and regulations that determine the reported amounts and disclosure in financial statements of PQ Limited. Accordingly, CA Jazz wants to implement such policies and procedures that can assist him in the prevention and detection of non-compliance with laws and regulations. Help CA Jazz by citing examples of such policies and procedures.

Answer:

In PQ Ltd, listed entity, CA Jazz has been appointed as CFO. PQ Ltd is in the business of manufacturing of specialty chemicals. CA Jazz is concerned about compliance with the provisions of Laws and regulations and wants to implement such policies and procedures that would assist him in prevention and detection of non-compliance with laws and regulations. CA Jazz is specifically wanting examples of types of policies and procedures that PQ Ltd may implement so that relevant laws and regulations are properly complied with. Such examples of policies and procedures are given in SA 250.

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements",

The following are examples of the types of policies and procedures PQ Ltd. may implement to assist in the prevention and detection of non-compliance with laws and regulations:

- i. Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- ii. Instituting and operating appropriate systems of internal control.
- iii. Developing, publicizing and following a code of conduct.
- iv. Ensuring employees are properly trained and understand the code of conduct.
- v. Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
- vi. Engaging legal advisors to assist in monitoring legal requirements.
- vii. Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

Q10. Exam Nov 2019, 5 marks

MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also, been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1.

Answer:

As per SQC 1, the firm should obtain such information as it considers 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. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

With regard to the integrity of a client, matters that the firm considers include, for example:

- i. The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- (ii) The nature of the client's operations, including its business practices.
- (iii) Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

- (iv) Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- (v) Indications of an inappropriate limitation in the scope of work.
- (vi) Indications that the client might be involved in money laundering or other criminal activities.
- (vii) The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

Q11. Exam Nov 2019, 4 marks

MF. Ltd., engaged in the manufacturing of various products in its factory, is concerned with shortage in production and there arose suspicion of inventory fraud. You are appointed by MF Ltd. To evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory?

Answer:

Inventory frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

1. Employees may simply remove goods from the premises.
2. Theft of goods may be concealed by writing them off as damaged goods, etc.
3. Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

Verification Procedure for Defalcation of inventory - Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system. The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (i) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (ii) availability of sufficient data from which such a record can be constructed.

The step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated.

In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent.

The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

Q12. Exam May 2019, 4 marks

Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March, 2019.

In the course of audit, it has been observed that there is a major understatement in the value of inventory. The inventory valuation work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors.

Comment on the above situation with regard to responsibilities among joint auditors.

Answer:

- (b) Responsibility and Co-ordination among Joint Auditors: As per SA 299, "Joint Audit of Financial Statements", 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 some cases due to the nature of the business entity under audit, such a division of the work may not be possible. In such situations, the division of the work may be with reference to items of assets or liabilities or income or expenditure or with reference to period of time. The division of the work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

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 –

- (i) The audit work which is not divided among the joint auditors and is carried out by all joint auditors;
- (ii) Decisions taken by all the joint auditors under audit planning phase concerning the nature, timing and extent of the audit procedure to be performed by each of the auditor;
- (iii) 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;
- (iv) Examining that the financial statements of the entity comply with the requirements of the relevant statute;
- (v) Presentation and disclosure of financial statements as required by the applicable financial reporting framework;
- (vi) Ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI;

The joint auditors shall also discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas of audit to be performed by each of the joint auditors and the same shall be communicated to those charged with governance. After identification and allocation of work among the joint auditors, the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.

Hence, in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures.

In the instant case, Dice Ltd. appointed two CA Firms MN & Associates and PQ & Co. as joint auditor for conducting audit. As observed during the course of audit that there is a major understatement in the value of inventory and the inventory valuation work was looked after by MN & Associates.

In view of SA 299 MN & Associate will be held responsible for the same as inventory valuation work was looked after by MN & Associates only. Further, there is violation of SA 299 as the division of work has not been documented.

Q13. Exam May 2019, 4 marks

A professional accountant in public practice is always subject to various threats in compliance with fundamental principles of his profession and you, as a professional accountant, are worried about engagement specific threat in your audit assignment of M/s Soft Ltd. and want to implement some measures to eliminate and reduce the same. Enumerate some engagement specific safeguards which you may introduce in your work environment to ward off such threats.

Answer:

Engagement-specific safeguards in the work environment may include:

- (i) Involving an additional professional accountant to review the work done or otherwise advise as necessary.
- (ii) Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- (iii) Discussing ethical issues with those charged with governance of the client.
- (iv) Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- (v) Involving another firm to perform or re-perform part of the engagement.
- (vi) Rotating senior assurance team personnel.

Q14. RTP Nov 2023

CA Paras has been appointed as the Chief Financial Officer (CFO) of Prashanth Limited. In this role, CA Paras is tasked with the responsibility of ensuring that the company's entity's operations are conducted in accordance with relevant laws and regulations. As part of his duties, CA Paras is emphasising the importance of adhering to all applicable laws and regulations that could impact the entity's specific disclosures in its financial statements. Additionally, he is focusing on compliance with laws and regulations that dictate the appropriate financial reporting framework for the company. CA Paras is also highlighting the significance of avoiding any non-compliance, as certain laws and regulations may impose penalties in the event of violations. Now CA Paras wants to implement policies and procedures in an entity that can assist in the prevention and detection of non-compliance with the laws and regulations. Help CA Paras by citing examples of such policies and procedures.

Answer:

Management Responsibility for Compliance with Laws and Regulations:

SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", states that it is the responsibility of management, with the oversight of those charged with governance to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations. For this purpose, management may apply the following procedures:

- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- Instituting and operating appropriate systems of internal control.
- Developing, publicising and following a code of conduct.
- Ensuring employees are properly trained and understand the code of conduct.
- Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
- Engaging legal advisors to assist in monitoring legal requirements.
- Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

Q15. RTP May 2023

Krishna Ltd is a small-sized 25 years old company having business of manufacturing of pipes. Company has a plant based out of Haridwar and have their corporate office in Meerut. Recently the company appointed new firm of Chartered Accountants as their statutory auditors.

The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter?

Answer:

As per SA 210 Agreeing the Terms of Audit Engagements The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- (i) The objective and scope of the audit of the financial statements;
- (ii) The responsibilities of the auditor;
- (iii) The responsibilities of management;
- (iv) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- (v) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Q16. RTP May 2023

Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the audit of Acharya Ltd., you observed that significant deficiency exists in the internal control system, and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization.

Answer:

(b) In the given case of Acharya Ltd, Auditors, while conducting audit has come across significant deficiency existing in the internal control system and also auditors wanted to ascertain that deficiency.

As per SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", Indicators of significant deficiencies in internal control include, for example:

- (i) Evidence of ineffective aspects of the control environment, such as:
 - (a) Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
 - (b) Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
 - (c) Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- (ii) Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- (iii) Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- (iv) Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- (v) Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- (vi) Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- (vii) Evidence of management's inability to oversee the preparation of the financial statements.

Q17. RTP Nov 2022

Abhinandan Limited a chemical manufacturing company, having its factory located at Nanded Village, for the year 2021-22 appointed Subahu & Co. as their statutory auditors. During the course of the audit, Subahu & Co. identified that Abhinandan Limited received a show cause notice from National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Abhinandan Limited was dumping toxic solid waste, without treating it, on the nearby grounds, and because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation performed by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 and a lot of damage has been done to the environment by Abhinandan Limited. A show cause notice was already issued to Abhinandan Limited by the National Green Tribunal for levying the penalty of an amount of Rs.500 crore. The unaudited profit for the financial year 2021 -22 of Abhinandan Limited was Rs.35 crore and the unaudited turnover was Rs.100 crore. Upon inquiry it was identified that Abhinandan Limited has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

"The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws and the company's legal department has assessed and found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices."

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter.

Answer:

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor is required to obtain an understanding and need to evaluate the impact of other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:

- (a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
- (b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities

As per Section 143(3)(j) read with Rule 11(a), the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

As per SA 570, "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

- (i) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
- (ii) Disclose clearly that there is material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall (a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705; and (b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

In the current scenario, Abhinandan Limited has received a show cause notice from the National Green Tribunal of an amount which is more than the net profit and the turnover of the company for the year. In the event of an unfavourable order for Abhinandan Limited, there will be an impact on Abhinandan Limited's ability to continue as a going concern.

As a result, appropriate disclosure should be provided by management for such events which cast significant doubt on the entity's ability to continue as a going concern. As no appropriate disclosure has been provided by Abhinandan Limited for such show cause notice, Subahu & Co. should report this matter in their audit report under "Going Concern Para" as per SA 570 and under clause (j) of Section 143(3) of the Companies Act, 2013. Also, the auditor is required to issue an adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

Q18. RTP May 2022

During the audit of Mahaveer Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.

Answer:

As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the Engagement Partner shall:

- Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

- Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, the Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

Q19. RTP May 2022

M/s Manidhari & Associates have been appointed as an auditor of JIN Limited, a multinational company dealing in spare parts. During the course of audit, CA Manidhari is facing many problems including the problem of not getting the desired information from the management. Accordingly, he decided to communicate with those charged with the governance about significant difficulties encountered during the audit. CA Manidhari seeks your guidance on matters which can be considered as significant difficulties as per SA 260.

Answer:

As per SA 260, "Communication with Those Charged with Governance", significant difficulties encountered during the audit may include such matters as:

- (i) Significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary for the auditor to perform the auditor's procedures.
- (ii) An unreasonably brief time within which to complete the audit.
- (iii) Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- (iv) The unavailability of expected information.
- (v) Restrictions imposed on the auditor by management.
- (vi) Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion. as per SA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report.

Q20. RTP May 2022

CA Abhinanadan is an auditor of KM Private Limited. During the course of audit, CA Abhinanadan becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations. Being a senior partner of CA. Abhinanadan, guide him regarding audit procedures to be followed when non-compliance is identified or suspected.

Answer:

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", if the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:

- (i) An understanding of the nature of the act and the circumstances in which it has occurred; and
- (ii) Further information to evaluate the possible effect on the financial statements.

If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.

If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion. The auditor shall evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.

Q21. RTP Nov 2020

MEA Limited is a listed company having its operation across India. MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20. After making sure that all of them are qualified to be appointed as statutory auditor, MEA Limited issued engagement letter to all of them. But Mr. X was not clear on some points, so he requested MEA Limited to slightly change the terms of his engagement. This change will not impact the ultimate opinion on the financial statement. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor and identification of framework applicable. It also contains the reference to expected form and content of report from all three joint auditors. In your opinion what was the discrepancy in the Audit engagement letter issued by MEA Limited?

Answer:

Agreement on Audit Engagement Terms : As per SA 210, "Agreeing the Terms of Audit Engagements", the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

Subject to prescribed details under Law or Regulations, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- (i) The objective and scope of the audit of the financial statements;
- (ii) The responsibilities of the auditor;
- (iii) The responsibilities of management;
- (iv) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- (v) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

In the given scenario, MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20 and issued engagement letter to all of them. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor, identification of framework applicable and reference to expected form and content of report from all three joint auditors. However, engagement letter issued by MEA Ltd. does not specify the responsibilities of management, whereas as per SA 210, it should also specify responsibilities of management.

Q22. RTP May 2020

Mr. PM, a practising Chartered Accountant, has been appointed as an auditor of Truth Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit?

Answer:

Factors Influencing the amount of Working Papers: As per SA 230 "Audit Documentation", which refers to the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached, the amount of audit working papers depend on factors such as-

- (i) The size and complexity of the entity.
- (ii) The nature of the audit procedures to be performed.
- (iii) The identified risks of material misstatement.
- (iv) The significance of the audit evidence obtained.
- (v) The nature and extent of exceptions identified.
- (vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- (vii) The audit methodology and tools used.
- (viii) Timely preparation of Audit Documentation.

Q23. RTP Nov 2019

Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram. What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement?

Answer:

As per SA 210 "Agreeing the Terms of Audit Engagements", in order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
 - (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - (iii) To provide the auditor with:
 - a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - b. Additional information that the auditor may request from management for the purpose of the audit; and
 - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Further, if management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

In addition if the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

In the instant case, Mr. Ram should not accept the appointment as statutory auditor of XYZ Private Limited due to limitation imposed on his scope of work.

Q24. RTP May 2019

During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.

Answer:

As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

- Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement,

where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

Q25. RTP May 2018

While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.

Answer:

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

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

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

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement.

Q1. Exam Nov 2022, 5 marks

CA. Raj is the auditor of a multiplex cinema house. He has observed during the course of the audit, that the existing venue has undergone renovation. The auditorium was split into smaller ones and additional auditoriums were constructed. CA. Raj, who finalised the audit plan and audit programme wanted to reconsider the same during the course of the audit. Discuss a few circumstances where the audit programme would have to be suitably altered by the auditor.

Answer:

In the given case of multiplex cinema house, CA Raj observed that existing venue undergone renovation, being split into smaller ones and additional auditoriums were constructed. Since CA Raj developed the audit program keeping in view a multiplex cinema house but during the audit, circumstances have changed significantly and hence CA Raj should suitably alter the audit program.

Given below are a few circumstances where in the audit programme would have to be suitably altered:

1. If the audit procedures were designed for a certain volume of turnover and subsequently the volume have substantially increased. Also, when there have been significant changes in the accounting organisation, procedures and personnel subsequent to the audit procedures.
2. Where during the course of an audit, it has been discovered that internal control procedures were not as effective as assumed at the time the audit programme was framed.
3. Where there has been an extraordinary increase in the amount of book debts or that in the value of stocks as compared to that in the previous year.
4. When a suspicion has aroused during the course of audit or information has been received that assets of the company have been misappropriated.

It may be noted that the audit plan and related programme should be reconsidered as the audit progresses. Such re-consideration is based on the auditor's review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures.

Q2. RTP May 2022

In the course of audit of Ambika Ltd, its auditor wants to rely on the audit evidence obtained in the previous audit in respect of the effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.

As per SA 330 on "The Auditor's Responses to Assessed Risks", changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor's decision on whether to rely on the audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.

Factors that may warrant a re-test of controls are-

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT-controls.

In the course of audit of ZED Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.

Answer:

As per SA 330 on "The Auditor's Responses to Assessed Risks", changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.

Factors that may warrant a re-test of controls are-

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT-controls.

Q1. Exam Dec 2021, 5 marks

In the course of audit of Tech limited you observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Tech Limited used a service organisation to record transactions and process related data. As an auditor, what would be your considerations regarding the nature and extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk.

Discuss with reference to relevant Standard on Auditing.

Answer:

As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", when obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
- (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
- (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and
- (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organization.

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

Q2. RTP Nov 2020

ENN Limited is availing the services of APP Private Limited for its payroll operations. Payroll cost accounts for 65% of total cost for ENN Limited. APP Limited has provided the type 2 report as specified under SA 402 for its description, design and operating effectiveness of control.

APP Private Limited has also outsourced a material part of payroll operation M/s SMP & Associates in such a way that M/s SMP & Associates is sub-service organization to ENN Limited. The Type 2 report which was provided by APP Private Limited was based on carve-out method as specified under SA 402.

CA Raman while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA Raman hence asked his assistant to remove such reference and modify report accordingly.

Comment whether CA Raman is correct in removing the reference of the work done by service auditor?

Answer:

Reporting by the User Auditor: As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation", the user auditor shall modify the opinion in the user auditor's report in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organisation relevant to the audit of the user entity's financial statements. The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion.

Thus, in view of above, contention of CA. Raman in removing reference of the work done by service auditor is in order as in case of unmodified audit report, user auditor cannot refer to the work done by service auditor.

Q3. RTP Nov 2018

JIO Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of JIO Ltd. as to how he can obtain an understanding of how JIO Ltd. uses the services of the outsourced agency in its operations.

Answer:

As per SA 402 on "Audit Considerations Relating to an Entity Using a Service Organisation", when obtaining an understanding of the user entity in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
- (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
- (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and
- (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

Q1. Exam May 2023, 5 marks

Joy Ltd. is an entertainment company which runs a circus and travels around the country to entertain the masses. The circus began losing its popularity over the past few years and attendance has reportedly dropped by as much as 75% in the current financial year. Animal rights activists continuously targeted the circus for its use of animal creatures like elephants in the show. The CEO noted that the audience seemed to be abandoning the circus due to their expanding entertainment options. The high cost of moving the show from city to city eventually made the business model untenable. As a result, many key managerial personnel of the company left the company, there were delays in the payment of wages and salaries, and the bank from whom the company had taken funds also decided not to extend further finance or to fund further working capital requirements of the company.

When discussed with the management, the statutory auditor understood that the company had no action plan to mitigate such circumstances (Use of going concern assumption is inappropriate). Further, all such circumstances were not reflected in the financial statements of Joy Ltd. What course of action should the statutory auditor of the company take in the auditor's report in such situation?

Answer:

SA 570, "Going Concern", deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

When the use of going concern basis of accounting is inappropriate i.e., if the financial statements have been prepared using the going concern basis of accounting but in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

Also, when adequate disclosure of a material uncertainty is not made in the financial statements the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and in the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

In the present case, the following circumstances indicate the inability of Joy Ltd. to continue as a going concern:

- Losing popularity over the past few years.
- Animal Rights activists continuously targeting the circus.
- Audience abandoning the circus due to their expanding entertainment options.
- High Cost of moving the show from city to city making the business model untenable.
- Key Managerial Personnel leaving the Company.
- Banks decided not to extend further finance and not to fund the working capital requirements of the Company.
- Non availability of sound action plan to mitigate such circumstances.

Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the Company. Further, such circumstances are not reflected in the financial statements of the Company.

As such, the statutory auditor of Joy Ltd. should:

1. Express an adverse opinion in accordance with SA 705 (Revised) and
2. In the Basis of Adverse Opinion paragraph of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's

ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

The auditor is also required to report as per clause (xix) of CARO 2020 that on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date.

Q2. Exam May 2023, 5 marks

M/s ABC Limited is engaged in the business of construction of infrastructure and housing projects. While preparing the financial statements for the year ended 31.03.2023, management has made various accounting estimates and confirmed to the auditor that all necessary accounting estimates have been recognised, measured and disclosed in the financial statements are in accordance with the applicable financial reporting framework. The auditor during the course of audit observed some changed circumstances giving rise to the need for an accounting estimate. Inquiries of same were sought from the management. Can you list down some circumstances, change of which will result in inquiries from the management?

Answer:

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", inquiries of management about changes in circumstances may include, for example, inquiries about whether:

- The entity has engaged in new types of transactions that may give rise to accounting estimates.
- Terms of transactions that gave rise to accounting estimates have changed.
- Accounting policies relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework or otherwise.
- Regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- New conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. SA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.

Q3. Exam May 2023, 5 marks

While conducting audit of PC Ltd., CA. T decided to use sampling technique to test the trade receivables at the planning stage. He directed his team members to divide the whole population of trade receivables balances to be tested in a few separate groups called 'strata'. He directed to treat each stratum as if it was a separate population and divided the trade receivables balances of PC Ltd. for the Financial Year 2022 -23 into groups on the basis of personal judgment as follows:

Sl. No.	Particulars
1	(a) Balances in excess of Rs.50,00,000;
2	(b) Balances in the range of Rs.40,00,001 to Rs.50,00,000;
3	(c) Balances in the range of Rs.30,00,001 to Rs.40,00,000;
4	(d) Balances in the range of Rs.20,00,001 to Rs.30,00,000;
5	(e) Balances in the range of Rs.10,00,001 to Rs.20,00,000;
6	(f) Balances Rs.10,00,000 and below

From the above mentioned groups, CA. T directed to pick up different percentage of items for examination from each of the group. One of the team members, Mr. Neel, wants to use some other

technique of sampling for the above purpose as the concept of stratification is not clear to him. You are required to explain the concept of stratification and its uses to Mr. Neel.

Answer:

Concept of Stratification: Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

Uses of Stratification

1. Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
2. When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.
3. The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population. For example, 20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).
4. If a class of transactions or account balance has been divided into strata, the misstatement is projected for each stratum separately. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance.

Q4. Exam May 2023, 5 marks

BETA Ltd is engaged in the Construction business since year 2001. The auditor understands that a thorough construction estimate is vital to the viability of any construction business and requested the information related to financing and operating estimated costs from the management to review the outcome of accounting estimates included in the prior period financial statements and their subsequent re-estimation for the purpose of current period.

The management refused to provide the information to the auditor as it believed that the judgments and estimates made in the prior periods were based on the information available at that time, and the review of the prior period information should not be done by the auditor in the current financial year. With reference to the relevant SA, comment on whether the contention of management is correct or not.

Answer:

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.

- Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.
- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures. However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.

In the given case, the management is not correct in refusing the relevant information to the auditor.

Q5. Exam Nov 2022, 5 marks

During the audit of Star Ltd. a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of Rs.20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation.

Answer:

External Confirmation: As per SA 505, "External Confirmation", negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.

Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of Rs.20 lakh has not sent the confirmation on the credit balance. In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non-response for negative confirmation request does not mean that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

Q6. Exam May 2022, 5 marks

JKL Limited is engaged in the business of Construction and real estate having various projects across states. M/s YT & Co, Chartered Accountants have been appointed as Statutory Auditors. Audit Team from M/s YT & Co for audit of JKL Limited comprises of CA Z-Engagement Partner, CA Q, a paid assistant and 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is a managing partner. The engagement team discussed that SA 315 and SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the JKL Limited's related party relationships and transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant Standard on Auditing.

Answer:

(b) As per SA 550 "Related Parties", the engagement team discussion that SA 315 and SA

240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.

Accordingly matters that are to be addressed in the discussion by CA Z among the engagement team include:

- (i) The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).
- (ii) An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
- (iii) The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special - purpose entities for off-balance sheet transactions, or an inadequate information system).
- (iv) The records or documents that may indicate the existence of related party relationships or transactions.
- (v) The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of relevant controls.
- (vi) In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:
 - a) how special-purpose entities controlled by management might be used to facilitate earnings management.
 - b) how transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

Q7. Exam May 2022, 4 marks

CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s Delist Limited is a listed entity at National Stock Exchange and the financial statements are to be drawn up in compliance with Ind AS. M/s Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active and open market. CA Harry is concerned with identification and assessment of the risks of material misstatement for accounting estimates. Guide him with regard to the estimation making process adopted by management with reference to the relevant Standard on Auditing.

Answer:

As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", CA. Harry shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

The estimation making process adopted by the management including-

1. The method, including where applicable the model, used in making the accounting estimates.
2. Relevant controls.
3. Whether management has used an expert?
4. The assumption underlying the accounting estimates.
5. Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
6. Whether and, if so, how the management has assessed the effect of estimation uncertainty.

Q8. Exam Dec 2021, 5 marks

Mr. Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures.

Answer:

Factors that may assist Mr. Agarwal, the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- (i) The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- (ii) The ability or willingness of the intended confirming party to respond – for example, the confirming party:
 - May not accept responsibility for responding to a confirmation request;
 - May consider responding too costly or time consuming;
 - May have concerns about the potential legal liability resulting from responding;
 - May account for transactions in different currencies; or
 - May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- (iii) The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

Q9. Exam Jan 2021, 5 marks

GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2020 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.

Answer:

The auditors, GHK Associates wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501-“Audit Evidence—Specific Considerations for Selected Items”, example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

- (i) Sales, transfers and charges between segments, and elimination of inter-segment amounts.
- (ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
- (iii) The allocation of assets and costs among segments.
- (iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

Q10. Exam Jan 2021, 5 marks

M/s. HK & Co. was appointed as an auditor of GSB Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, GSB Limited is required to pay certain percentage of its annual revenue as license fee. GSB Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues and not only on core business revenues. Matter was disputed and went to court of law. On prudence basis, GSB Limited made a provision on estimated business in its books of accounts of agreed percentage on non-core business receipts also. The amount of provision was of such huge amount that the GSB Limited's profit and loss account for that quarter reflected loss due to that provision. How you as an auditor can evaluate this accounting estimate which involves significant risk and what if Management has not addressed the effects of estimation uncertainty on provision made?

Answer:

In the given case, HK & Co. was appointed as an auditor of GSB Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that GSB Ltd.'s profit and loss account reflected a loss due to that provision. As an auditor evaluation would be done as under:

For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

- (i) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
- (ii) Whether the significant assumptions used by management are reasonable.
- (iii) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.
- (iv) If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.

Q11. Exam Nov 2020, 5 marks

Moon Ltd. is a dealer in electronic appliances. The Company has a centralised warehouse at the outskirts of Mumbai. The Auditors of the company M/s JK Associates normally attend the physical verification of stocks carried out by the Management at the end of the financial year. However, on account of certain disturbances in the region, the physical inventory counting could not be carried out at the year end. The stock taking is decided to be done by management at some other date subsequently, after a month.

In the light of the above facts:

Enumerate the audit procedures to be considered by M/s JK Associates, if physical inventory counting is conducted at a date other than the date of the financial statements with reference to the relevant Standard on Auditing.

Answer:

As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes.

If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor, JK Associates, shall perform the following procedures:

(A) Attendance at physical inventory counting, unless impracticable, to:

- (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- (ii) Observe the performance of management's count procedures;
- (iii) Inspect the inventory; and
- (iv) Perform test counts; and

(B) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

In addition to above, auditor shall also perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.

Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:

- a. Whether the perpetual inventory records are properly adjusted.
- b. Reliability of the entity's perpetual inventory records.
- c. Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

Q12. Exam Nov 2020, 5 marks

You are the auditor of PQR Ltd. which is in the business of supplying food products to various airline companies operating aircrafts in domestic circle only. As per terms of agreement with airlines, the company needs to stock various non-perishable food items for coming one month (average holding of inventory to the tune of INR 75 Crores). Also the payment terms have been settled and the company receives payment in 45 days after the supply of goods. Everything was going on well till the end of March 2020 when pandemic Covid hit the world and everything came to a standstill. Aviation sector was hit hard and there were no flights from April 2020 onwards. Consequently, the business of PQR Ltd. also got severely affected and the scheduled supplies of goods to airlines also were not made. Also, the liquidity position of airline companies got hit and the scheduled payments were also not received on due dates. As the auditor of PQR Ltd. what audit procedures would you perform to ensure that all subsequent events are considered, so that financial statements for the year ended 31.03.2020 represent true and fair view?

Answer:

As per SA 560 "Subsequent Events", the auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required in above paragraph so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.

Being the auditor of PQR Ltd, to ensure that all subsequent events are considered so that financial statements for the year ending 31.03.2020 represent true and fair view, the auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

- a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- d) Reading the entity's latest subsequent interim financial statements, if any.

When, as a result of the procedures performed as required above, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

Q13. Exam Nov 2020, 5 marks

Mr. X, while conducting audit of PQR Ltd, comes across certain transactions which according to him are significant transactions with related parties and identified to be outside the entity's normal course of business. Guide Mr. X with examples of such transactions and to understand the nature of significant transactions outside the entity's normal course of business.

Answer:

- (a) In the given case of PQR Ltd, Mr. X, while conducting audit has come across certain significant related party transaction which are identified to be outside the entity's normal course

of business. Mr. X wants guidance through examples of such significant transactions which are given in SA 550

As per SA 550 "Related Parties", examples of transactions outside the entity's normal course of business may include:

1. Complex equity transactions, such as corporate restructurings or acquisitions.
2. Transactions with offshore entities in jurisdictions with weak corporate laws.
3. The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.
4. Sales transactions with unusually large discounts or returns.
5. Transactions with circular arrangements, for example, sales with a commitment to repurchase.
6. Transactions under contracts whose terms are changed before expiry.

Q14. Exam Nov 2019, 5 marks

Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing.

Answer:

Written Representations: As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

SA 580, "Written Representations" discusses the use of written representations. Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

- (i) About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.
- (ii) That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
- (iii) That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.
- (iv) That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

Q15. Exam Nov 2019, 5 marks

Mr. X has been appointed as an auditor of M/s ABC Ltd., Mr. X wants to be satisfied about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements. Lay down the audit procedure, Mr. X should follow, in the initial audit engagement of M/s ABC Ltd. Also suggest the approach to be followed regarding mention in the audit report if Mr. X is not satisfied about the correctness of 'Opening Balances'?

Answer:

Audit Procedures to be followed in case of initial audit engagement: As per SA 510, 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

(iv) Performing specific audit procedures to obtain evidence regarding the opening balances.

Approach to be followed regarding mention in the Audit Report: If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

Q16. RTP Nov 2023

Mr. Shreyansh, while performing the audit of Red Rock & Silver Sand Limited which was involved in phosphorus mining, decided to appoint an auditor's expert for the valuation of environmental liabilities and site clean-up costs. Red Rock & Silver Sand Limited re-appointed Mr. Sheetal as an independent expert for this engagement. For the last five years, management has been re-appointing Mr. Sheetal. Mr. Sheetal calculated the environmental liabilities pertaining to completed mining sites and the sites which will be discarded in the near future and a provision for clean-up costs. This provision was accepted by management. Mr. Shreyansh, after performing the inquiries with management, was of the opinion that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. Hence, there is no need to raise a question on the objectivity of Mr. Sheetal or on his work performed for the company. However, the audit partner was of the opinion that the audit team needs to evaluate the objectivity of an expert engaged by the entity, irrespective of the fact that he was appointed as an independent expert. Kindly guide the audit partner and Mr. Shreyansh with respect to requirements pertaining to evaluating the objectivity of the management expert.

Answer:

As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, have regard to the significance of that expert's work for the auditor's purposes evaluate the competence, capabilities and objectivity of that expert.

A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the management's expert's profession, legislation or regulation), or by the management's expert's work environment (for example, quality control policies and procedures). Although safeguards cannot eliminate all threats to a management expert's objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert's objectivity and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:

- Financial interests.
- Business and personal relationships.
- Provision of other services.

In the current case, Red Rock & Silver Sand Limited re-appointed Mr. Sheetal for this engagement as an independent expert. The audit team was of the view that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. However, the audit partner had a contrary view.

Hence, the audit team should evaluate the objectivity of an expert engaged by the entity as the threat to objectivity, created by being an employee of the entity, will always be present. An expert appointed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity. As a result, audit partner is correct in his view.

Q17. RTP Nov 2022

Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2021 - 2022. Chintan & Mani seem to have different opinions on Audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population.

Chintan is concerned that whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530,

Answer:

As per SA 530, "Audit Sampling", the auditor shall evaluate:

- (a) The results of the sample; and
- (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

- (I) Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
- (II) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

Q18. RTP Nov 2021

The audit report of Kolsi (P) Ltd. for F.Y. 2020-21 was issued by Bishnoi & Co. on 25th July, 2021. However, a case was filed against Kolsi (P) Ltd. on 4th August, 2021, with the Civil Court, with respect to an incident caused in its factory on 17th January, 2021, the outcome of which may result in paying heavy penalty by Kolsi (P) Ltd.

Mr. Raj Bishnoi, the partner of Bishnoi & Co., discussed the said matter with the management and it was determined to amend the financial statements for F.Y. 2020 -21. Further, Mr. Raj inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.

The management told Mr. Raj that such disclosure was enough as he would further going a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.

In the context of aforesaid case scenario, please answer the following questions:-

- (a) Whether Mr. Raj on behalf of Bishnoi & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Kolsi (P) Ltd.?
- (b) Whether the contention of management of Kolsi (P) Ltd. is valid with respect to the disclosure of the court case in the financial statements?

Answer:

- (a) As per SA 560, 'Subsequent Events', the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
 - (1) Discuss the matter with management and, where appropriate, those charged with governance.
 - (2) Determine whether the financial statements need amendment and, if so,

(3) Inquire how management intends to address the matter in the financial statements. In the given case, on becoming aware of the court case filed against Kolsi (P) Ltd., Mr. Raj discussed the said matter with the management and it was determined to amend the financial statements. Also, he inquired how the management intended to address the said matter in the financial statements.

However, If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where Mr. Raj (hereinafter referred as 'the auditor') believes they need to be amended, the auditor shall notify management and, those charged with governance (unless all of those charged with governance are involved in managing the entity), that the auditor will seek to prevent future reliance on the auditor's report. If despite such notification the management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report in accordance with SA 560.

- (b) As per SA 706, 'Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report', an Emphasis of Matter paragraph is not a substitute for:
- (a) A modified opinion in accordance with SA 705 (Revised) when required by the circumstances of a specific audit engagement;
 - (b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or
 - (c) Reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

In the given case, the management of Kolsi (P) Ltd. has presumed that as the auditor was going to provide a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report, there was no further need for it to provide additional disclosures about the court case in the financial statements.

The said contention of management of Kolsi (P) Ltd. is not valid as 'Emphasis of Matter' paragraph cannot be used as a substitute for disclosures required to be made in the financial statements as per the applicable financial reporting framework or that is otherwise necessary to achieve fair presentation, which is the responsibility of the management.

Q19. RTP Nov 2021

While formulating the audit plan and responding to the risks of material misstatement identified and assessed in related party transaction and relationships, Ms. K the engagement manager of the audit team of ABC Limited, decided to rely upon the internal controls placed for identification and disclosure of related party relationships and transactions in accordance with the applicable financial reporting framework.

You are requested to guide Ms. K regarding the necessity to test the controls to obtain sufficient and appropriate audit evidence. Also guide, whether Ms. K can use the audit evidence obtained, regarding operative effectiveness of control on identification and disclosure of related party relationships and transactions, in the interim period.

Answer:

As per SA 550, "Related Parties", according to para on "Responses to the risks of material misstatement associated with related party relationships and transactions", the auditor should design and performs further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.

Further, as per SA 330, "The Auditor's Responses to Assessed Risks", the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

- (a) the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or

- (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. Moreover, the auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to when the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, and the timing of test of controls over significant risks, in order to provide an appropriate basis for the auditor's intended reliance. When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:

- (a) Obtain audit evidence about significant changes to those controls subsequent to the interim period; and
(b) Determine the additional audit evidence to be obtained for the remaining period.

In the current case, Ms. K shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls as she intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures.

Further, she is also required to obtain the audit evidence about significant changes to those controls subsequent to the interim period along with the additional audit evidence to be obtained for the remaining period in accordance with the requirements of Standards on Auditing as discussed above.

Q20. RTP May 2020

Your firm has been appointed as the statutory auditors of AGM Private Limited for the financial year 2018-19. While verification of company's trade receivables as on 31 st March 2019, accountant of AGM Ltd. has requested you, not to send balance confirmations to a particular group of trade receivables since the said balances are under dispute and the matter is pending in the Court. As a Statutory Auditor, how would you deal in this situation?

Answer:

SA 505 "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. If the management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (i) Inquire as to Management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness,
- (ii) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and
- (iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those in charge of governance and also determine its implication for the audit and his opinion.

Q21. RTP May 2020

RIM Private Ltd is engaged in the business of manufacturing of water bottles and is experiencing significant increase in turnover year on year. During the financial year ended 31 March 2019, the company carried out a detailed physical verification of its inventory and property, plant and equipment.

You are the auditor of RIM Private Ltd. The inventory as at the end of the year was Rs.2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order?

Answer:

As per SA 501 "Audit Evidence – Additional Considerations for Specific Items", the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his

attendance at physical inventory counting. SA 501 is additional guidance to that contained in SA 500, "Audit Evidence", with respect to certain specific financial statement amounts and other disclosures.

If the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and where necessary, perform alternative audit procedures to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded. The auditor would also verify the procedure adopted, treatment given for the discrepancies noticed during the physical count. The auditor would also ensure that appropriate cut off procedures were followed by the management. He should also get management's written representation on (a) the completeness of information provided regarding the inventory, and (b) assurance with regard to adherence to laid down procedures for physical inventory count. By following the above procedure, it will be ensured that the physical verification conducted by the management was in order.

Q22. RTP Nov 2019

MNO Limited is one of the prominent players in the chemicals industry. The company is a public company domiciled in India and listed on BSE and NSE. The Company was facing extreme liquidity constraints and there were multiple indicators that casted doubt over the company's ability to continue as a going concern.

The Company was led into insolvency proceedings by consortium of banks led by PNB and the NCLT ordered the commencement of corporate insolvency process against the Company on 31 August 2018. The company invited prospective lenders, investors and others to submit their resolution plans to the Resolution Professional (RP) latest by 1 January 2019. The RP reviewed the resolution plans and ensured conformity with Insolvency and Bankruptcy Code 2016. The compliant plans were presented to Committee on Creditors (CoC) on 2 February 2019 and the resolution plan submitted by PQR Ltd. was evaluated as highest evaluated Compliant Resolution Plan. CoC of MNO Ltd. approved the Resolution Plan submitted by PQR Ltd. on 2 March 2019. The approval of NCLT was finally obtained on 4 May 2019.

PQR Ltd. submitted detailed plans and commitments as part of the resolution plan including clearance of all outstanding debts which were leading to negative cash flows. Please suggest how would you deal with this situation as the auditors of MNO Ltd.

Answer:

As per SA 570 Going Concern, if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty") through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

- a. Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
- b. Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- c. Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in -
 1. Evaluating the reliability of the underlying data generated to prepare the forecast; and
 2. Determining whether there is adequate support for the assumptions underlying the forecast.
- d. Considering whether any additional facts or information have become available since the date on which management made its assessment.
- e. Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

In the instant case, the approval of the resolution plan is a significant mitigating factor to counter the going concern issues of MNO Ltd. PQR Ltd. has submitted a detailed plan and commitments that has been given as part of the resolution plan which includes clearance of all outstanding debts which were leading to negative cash flows. Therefore, it can be said that the events and conditions are mitigated effectively and there is no material uncertainty in relation to the ability of the company to continue as a going concern.

Q23. RTP Nov 2019

Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 2018-19. While verification of company's inventories as on 31st March 2019, you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of the inventories maintained by other parties. What is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be held and the stock as disclosed in company's records actually belongs to them?

Answer:

(b) Inventory under the Custody and Control of a Third Party: As per SA 501, "Audit Evidence—Specific Considerations for Selected Items" when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- (i) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- (ii) Perform inspection or other audit procedures appropriate in the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include:
 - Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
 - Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
 - Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
 - Requesting confirmation from other parties when inventory has been pledged as collateral.

Q24. RTP May 2019

PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2000 crores and profits are INR 190 crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You

are required to advise about the date of and period covered by written representation in view of SA 580.

Answer:

As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

Q25. RTP May 2019

A Pvt Ltd is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.

Answer:

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.
- Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.
- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.

However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.

In the given case, the management is not correct in refusing the relevant information to the auditor.

Q26. RTP May 2019

CA. Ashutosh has been appointed as an auditor of Awesome Health Ltd. for the financial year 2017-18 which was audited by CA. Amrawati in 2016-17. As the Auditor of Awesome Health Ltd., state the steps that CA. Ashutosh would take to ensure that the Closing Balances of the financial year 2016-17 have been brought to account in 2017-18 as Opening Balances and the Opening Balances do not contain any misstatements.

Answer:

Obtaining sufficient appropriate audit evidence while conducting Initial Audit Engagement: According to SA 510 on "Initial Audit Engagements- Opening Balances", the objective of the Auditor while conducting an initial audit engagement with respect to opening balances is to obtain sufficient appropriate audit evidence so that the-

- (i) opening balances of the preceding period have been correctly brought forward to the current period;
- (ii) opening balances do not contain any misstatement that materially affect the
- (iii) current period's financial statements; and appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Being a new assignment, audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

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 respect of other assets and liabilities such as property plant and equipment, investments, long term debts, the auditor will examine the records relating to opening balances. The auditor may also be able to get the confirmation from third parties (e.g., balances of long term loan obtained from banks can be confirmed from the Bank Loan statement).

Q27. RTP May 2018

During the course of audit of Moon Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one old outstanding of Rs.25 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.

Answer:

External Confirmation: As per SA 505, "External Confirmation", Negative Confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of Rs.25 lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative

confirmation request does not mean that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

Q28. RTP May 2018

XYZ Ltd. supplies navy uniforms across the country. The company has 4 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. XYZ Ltd. appointed M/s MNO & Co. to conduct its audit for the financial year 2016-17. Mr. O, partner of M/s MNO & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s MNO & Co.,

- (a) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?
- (b) How an auditor is supposed to deal when attendance at physical inventory counting is impracticable?

Answer:

- (a) Special Consideration with Regard to Inventory: As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(a) Attendance at physical inventory counting, unless impracticable, to:

- (1) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- (2) Observe the performance of management's count procedures;
- (3) Inspect the inventory; and
- (4) Perform test counts; and

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

- (b) Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

Q1. Exam May 2023, 5 marks

HAM Ltd. is engaged in the business of manufacturing of medicines. The manufacturing process requires raw materials such as hydrochloric acid, caustic soda and other chemicals for the manufacturing of various drugs. The Company has maintained large stock of raw materials of all types of chemicals being used. The nature of raw material is such that its physical verification requires the involvement of an expert. Management hired their expert for the stock taking and auditors also involved their expert for the same purpose.

The auditor observed that the work of the auditor's expert was not adequate for the auditor's purposes and he could not resolve the matter through additional audit procedures which included further work performed by both the auditor's expert and the auditor.

Answer:

As per SA 620, "Using the work of an Auditor's Expert", if the auditor concludes that the work of the auditor's expert is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit procedures, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, it may be necessary to express a modified opinion in the auditor's report in accordance with SA 705 because the auditor has not obtained sufficient appropriate audit evidence.

In addition, the auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the audit opinion.

If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion. In such circumstances, the auditor may need the permission of the auditor's expert before making such a reference.

In the given case, the auditor cannot reduce his responsibility by referring the name of auditor's expert and thereby issuing a clean report. The auditor should have issued a modified report and could have given reference to the work of an auditor's expert in that report if such reference was relevant to understanding of a modification to the auditor's opinion but even in that case the auditor should have indicated in his report that such reference of an auditor's expert does not reduce his responsibility for that opinion.

Q2. Exam Nov 2022, 5 marks

ABC Ltd. is engaged in the business of trading and manufacturing of readymade garments. The company has large balances of accounts receivables as on March 31, 2022, which has been assessed as the area of high risk in the audit planning stage. For the year ended March 31, 2022, in respect of the valuation of accounts receivables, the Statutory Auditor has assigned the checking of the accuracy of the ageing of the accounts receivables and provision made towards doubtful receivables, to the internal auditor. Please advise the statutory auditor, the areas in which direct assistance from internal auditor cannot be taken. Also, comment in this scenario, whether statutory auditor can take internal auditor's assistance.

Answer:

Direct Assistance from Internal Auditor: As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance 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.

Therefore, the amount of judgment involved, and the risk of material misstatement are also relevant in determining the work that may be assigned to internal auditors providing direct assistance.

In the given situation of ABC Ltd., in circumstances where the valuation of accounts receivable is assessed as an area of higher risk, the external auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance.

However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

Q3. Exam May 2022, 5 marks

CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India. Auditors are duly appointed for the subsidiaries and branches as well. With regard to the determination of materiality during the audit of consolidated financial statements, what should be the considerations of CA H? How he should deal in his report if there are observations (for instance modification and/or emphasis of matter in accordance with SA 705/706) made by component auditors?

Answer:

CA. H should consider the requirement of SA 600, "Using the Work of Another Auditor", if he decides to use the work of another auditor in relation to the audit of consolidated financial statements and he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

- (i) The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.
- (ii) The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.
- (iii) The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 needs to be considered i.e. the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor".

Q4. Exam July 2021, 5 marks

PQ Limited, a listed entity, headquartered in Mumbai and is having 15 branches all over India. The Company is in the business of buying paddy grown by farmers directly and processing to produce final products for selling in domestic as well as international markets. PQ Limited appointed four firms of Chartered Accountants for audit of its head office and branches. Your firm is one of those firms. It was agreed that your firm will act as Principal auditor. 'What factors will be considered by you while accepting the position of Principal auditor ?

Answer:

- (a) Factors to be considered while accepting the position of Principal auditor -

SA 600 – Using the work of Another Auditor -

While accepting the position of Principal Auditor, the auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor.

For this purpose, the auditor would consider:

- a) the materiality of the portion of the financial information which the principal auditor audits;
- b) the principal auditor's degree of knowledge regarding the business of the components;
- c) the risk of material misstatements in the financial information of the components audited by the other auditor; and
- d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

Q5. Exam May 2019, 5 marks

CA Dabu has been appointed as an auditor of M/s MAP Technocraft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take services of Mr. Jay, an engineering consultant. Mr. Jay performed his work and submitted details to CA Dabu. State the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay.

Answer:

(a) Evaluating the Adequacy of the Auditor's Expert's Work: As per SA 620 on "Using the Work of an Auditor's Expert", specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes may include:

- (i) Inquiries of the auditor's expert.
- (ii) Reviewing the auditor's expert's working papers and reports.
- (iii) Corroborative procedures, such as:
 - Observing the auditor's expert's work;
 - Examining published data, such as statistical reports from reputable, authoritative sources;
 - Confirming relevant matters with third parties;
 - Performing detailed analytical procedures; and
 - Re-performing calculations.
- (iv) Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.
- (v) Discussing the auditor's expert's report with management.

Therefore, as per SA 620 on "Using the Work of an Auditor's Expert", the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:

- i. The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;
- ii. If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
- iii. If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall:

- (i) Agree with that expert on the nature and extent of further work to be performed by that expert; or
- (ii) Perform further audit procedures appropriate to the circumstances.

Q6. RTP May 2023

Suvrat Ltd had a net worth of INR 2100 crore and Ind AS are applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e., they were working for the first time together but developed a good bonding during the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise.

Answer:

As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In certain situations, the need for a detailed agreement in writing is required like -

- The auditor's expert will have access to sensitive or confidential entity information.
- The matter to which the auditor's expert's work relates is highly complex.
- The auditor has not previously used work performed by that expert.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.

Q7. RTP May 2019

X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise.

Answer:

As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In certain situations, the need for a detailed agreement in writing is required like -

- The auditor's expert will have access to sensitive or confidential entity information.
- The matter to which the auditor's expert's work relates is highly complex.
- The auditor has not previously used work performed by that expert.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.

Q1. Exam Nov 2022, 5 marks

CA. Uma is the Statutory Auditor of RJ Ltd. for the financial year 2021-22. The company is engaged in the production of electronic products. During the course of audit, CA. Uma obtained certain audit evidence of incorrect disclosure of related party transactions and structured finance deals which was not considered with the affirmation leading to misstatement in the financial statements. Discuss how CA Uma should deal with the situation in the auditor's report and the different options which can be considered?

Answer:

Auditor's duties in case of inconsistency in Audit evidence: SA 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

The decision regarding which type of modified opinion is appropriate depends upon:

- a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Further, the auditor shall modify the opinion in the auditor's report when the auditor concludes that based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement:

In the present case, during the course of the audit, CA Uma obtained certain audit evidence which was not consistent with the affirmation made in financial statements. Therefore CA Uma should modify his report in accordance with SA 705.

Conclusion:

Since CA Uma has obtained audit evidence which is inconsistent with the affirmations made in the financial statements. CA Uma should modify his opinion as per the circumstances of the case.

- CA Uma shall express Qualified opinion when, having obtained sufficient appropriate audit evidence, he concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements.
- CA Uma shall express an Adverse opinion, where the auditor, having obtained sufficient appropriate evidence, concludes that misstatements, individually, or in the aggregate, are both material and pervasive to the financial statements.

Q2. Exam Dec 2021, 5 marks

CA Madhu is the statutory auditor of Lakshmi Ltd. for the Financial year 2020 -21. In respect of loans and advances of ` 75 Lakh given to Srinian Pvt. Ltd., the Company has not furnished any agreement to CA Madhu and in absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms.

Justify the type of opinion which CA Madhu should give in such situation. Also, Draft an appropriate Opinion paragraph and Basis of opinion paragraph.

Answer:

In the present case, with respect to loans and advances of ` 75 Lacs given to Sriman Pvt. Limited, the Company has not furnished any agreement to CA Madhu. In the absence of such an agreement, CA Madhu is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidence is the loan agreement. Therefore, the absence of such document in the present case, tantamount to a material misstatement in the financial statements of the company. However, the inability of CA Madhu to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion.

Thus, in the present case, CA Madhu should give a qualified opinion

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

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Lakshmi Limited give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2021 and profit/ loss for the year ended on that date.

Basis for Qualified Opinion

The Company is unable to furnish the loan agreement with respect to loans and advances of ₹ 75 Lacs given to Sriman Pvt Limited. Consequently, in the absence of such an agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.

Q3. Exam July 2021, 5 marks

ABC Ltd. has been dealing in tyres since 1995. The Company envisaged to expand its business and wanted to manufacture the tyres besides trading. Accordingly, the machinery was imported, installed and manufacturing operations commenced. The Government also gave certain incentives like power subsidy, land acquisition subsidy, etc. After 2 years of operations, Company received a notice from the Income Tax authorities to pay tax on incentive received in the form of power subsidy. The demand notice was served for Rs.150.00 Lakhs.

The Company, however, filed an appeal with higher tax authorities against the demand and the matter is undecided as on 31.03 .2021. Legal team of the Company anticipated that tax liability might mature. The Company has not made a provision of anticipated tax liability. Considering the provisions of Companies Act, 2013, how an auditor of ABC Ltd. should see this matter and report in audit report, if required?

Answer:

Audit report - Legal team anticipated tax liability but the company did not make any provision for that -

The Council of the Institute of Chartered Accountants of India has taken note of the fact that there is a practice prevalent whereby companies do not make provision for tax even when such a liability is anticipated. It has expressed the view that on an overall consideration of the relevant provisions of law, non-provision for tax (where a liability is anticipated) would amount to contravention of the provisions of Sections 128 and 129 of the Companies Act, 2013.

Accordingly, it is necessary for the auditor to qualify his report and such qualification should bring out the manner in which the accounts do not disclose a "true and fair" view of the state of affairs of the company and the profit or loss of the company.

Applying the above to the facts given in the question, auditor should qualify his report.

An example of the manner in which the report on the balance sheet and the Statement of Profit and Loss may be qualified in this respect is given below: "The company has not provided for taxation in respect of its profits and the estimated aggregate amount of taxation not so provided for is ₹including.....for the Year ended on

.....To the extent of such non-provision for the year, the profits of the Company for the financial year under report have been overstated and to the extent of such aggregate non-provision, the reserves of the company appearing in the said balance sheet have been over-stated and the current liabilities and provisions appearing in the said balance sheet have been understated".

Q4. Exam July 2021, 5 marks

MN & Associates, Chartered Accountants have been appointed as statutory Auditors of Cotton Ltd. for the F.Y 2020-2021. The Company is into the business of yarn manufacturing. For this purpose, cotton ginning is also done within the factory premises. Raw cotton is purchased from local market and processed in-house. The Company received a notice from the State Government to deposit

market development fee for the last 5 years to the tune of ₹ 10.00 crores. The Company and all other organizations in the same business have not deposited the market development fee, taking shelter of an old circular issued by the Government. The trade association met with the government officials to resolve the matter and agreed to deposit the same prospectively. However, the matter relating to payment of development fee for the last 5 years is pending before the Government as at the end of the financial year. The Company, however, disclosed the same in notes to accounts, as contingent liability, without quantifying the effect and proper explanation. If the liability is provided in the books of accounts, entire reserves will be wiped off. Auditor seeks your guidance as to how this disclosure affects them while forming an opinion on financial statements.

Answer:

Forming an opinion and reporting on financial statements –

As per Ind AS 37, "Provisions, Contingent Liabilities and Contingent Assets", an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable .

- a) an estimate of its financial effect, measured in the standard;
- b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- c) the possibility of any reimbursement.

SA – 700 - Forming an opinion and reporting on financial statements:

The auditor shall evaluate whether in view of the requirements of the applicable financial reporting framework –

- (i) The financial statements adequately disclose the significant accounting policies selected and applied;
- (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (iii) The accounting estimates made by the management are reasonable;
- (iv) The information presented in the financial statements is relevant, reliable, comparable and understandable;
- (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705.

In the present case, auditor may consider modifying his opinion considering the financial effect of liability not disclosed properly.

Q5. Exam July 2021, 5 marks

CA S has been appointed as Statutory Auditor of SRT Ltd. for the financial year 2020-2021. The Company while preparing financial statements for the year under audit prepared one additional profit and loss account that disclosed specific items of expenditure and included the same as an appendix to the financial statements. CA. S has not been able to understand this as the additional profit and loss account is not covered under applicable financial reporting framework. Guide him as to how he should deal with this issue while reporting on the financial statements of SRT Ltd.

Answer:

If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.

If supplementary information that is not required by the applicable financial reporting framework is not considered an integral part of the audited financial statements, the auditor shall evaluate whether such supplementary information is presented in a way that sufficiently and clearly

differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented.

If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.

When an additional profit and loss account that discloses specific items of expenditure is disclosed as a separate schedule, included as an appendix to the financial statements, the auditor may consider this to be supplementary information that can be clearly differentiated from the financial statements.

Thus, additional profit and loss account is not considered an integral part of the audited financial statements and the auditor shall evaluate that supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements.

Q6. Exam Nov 2020, 5 marks

GS & Co., Chartered Accountants, have been appointed Statutory Auditors of MAP Ltd. for the F.Y 2019-20. The audit team has completed the audit and is in the process of preparing audit report. Management of the company has also prepared draft annual report.

Audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. Audit Manager discussed this issue with partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Answer:

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists:

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", Descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be Included in the other information.

The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor's duties with regard to reporting in the given case are given hereunder:

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", if the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

- (i) Agrees to make the correction, the auditor shall determine that the correction has been made; or
- (ii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

Q7. Exam Nov 2019, 5 marks

LMP Associates, Chartered Accountants, conducting the audit of PQR Ltd., a listed Company for the year ended 31st March 2019 is concerned with the auditor's responsibilities relating to other information, both financial and non-financial, included in the Company's annual report. While reading other information, LMP Associates considers whether there is a material inconsistency between other information and the financial statements. As a basis for the consideration the auditor shall evaluate their consistency, compare selected amounts or other items in the other information with such amounts or other items in the financial statements. Guide LMP Associates

with examples of "Amounts" or "other items" that may be included in the "other information" with reference to SA 720.

Answer:

(b) Examples of Amounts or Other Items that May Be Included in the Other Information: As per SA 720 "The Auditor's Responsibility in Relation to Other Information", the following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.

Amounts

- (i) Items in a summary of key financial results, such as net income, earnings per share, dividends, sales and other operating revenues, and purchases and operating expenses.
- (ii) Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
- (iii) Special items, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
- (iv) Liquidity and capital resource information, such as cash, cash equivalents and marketable securities; dividends; and debt, capital lease and minority interest obligations.
- (v) Capital expenditures by segment or division.
- (vi) Amounts involved in, and related financial effects of, off-balance sheet arrangements.
- (vii) Amounts involved in guarantees, contractual obligations, legal or environmental claims, and other contingencies.
- (viii) Financial measures or ratios, such as gross margin, return on average capital employed, return on average shareholders' equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilable to the financial statements.

Other Items

- (i) Explanations of critical accounting estimates and related assumptions.
- (ii) Identification of related parties and descriptions of transactions with them.
- (iii) Articulation of the entity's policies or approach to manage commodity, foreign exchange or interest rate risks, such as through the use of forward contracts, interest rate swaps, or other financial instruments.
- (iv) Descriptions of the nature of off-balance sheet arrangements.
- (v) Descriptions of guarantees, indemnifications, contractual obligations, litigation or environmental liability cases, and other contingencies, including management's qualitative assessments of the entity's related exposures.
- (vi) Descriptions of changes in legal or regulatory requirements, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position, or will have a material impact on the entity's future financial prospects.
- (vii) Management's qualitative assessments of the impacts of new financial reporting standards that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.
- (viii) General descriptions of the business environment and outlook.
- (ix) Overview of strategy.
- (x) Descriptions of trends in market prices of key commodities or raw materials.
- (xi) Contrasts of supply, demand and regulatory circumstances between geographic regions.
- (xii) Explanations of specific factors influencing the entity's profitability in specific segments.

Q8. Exam May 2019, 5 marks

After accepting the statutory audit of M/s All in One Ltd., a departmental store, you became aware of the fact that management of the company have imposed certain limitations on the scope of your assurance function which may adversely affect and result in your inability to obtain sufficient appropriate audit evidence to discharge your responsibility required by the statute. Indicate the consequences and your response to the limitations imposed by the management on your scope.

Answer:

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement: As per SA 705, Modification to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the prescribed limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (i) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (ii) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 1. Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 2. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

If the auditor withdraws as discussed above, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

Q9. RTP Nov 2023

XYZ Limited involved in the hospitality business, appointed Charan & Karan Associates as their statutory auditor for FY 2022-23. Management of XYZ Limited, while drawing up the financial statement for the said period, decided to add the following statement after the Statement of Cash Flow as supplementary information to be presented with financial statements. No specific mentions or labels were added to this statement to present that this is supplementary information.

Statement of Average Revenue Per Booking (ARPB) and Comparative**Total Bookings during FY**

-	FY 2021-22	36500
-	FY 2022-23	39000

Average Revenue per Booking

-	FY 2021-22 (Refer Note 28 Revenue from Operations)	3500
-	FY 2022-23 (Refer Note 28 Revenue from Operations)	4200

Bookings Ratio (Organic source by Inorganic source)

-	FY 2021-22	1:2
-	FY 2022-23	1:1.65

Kindly guide the audit team regarding the requirement of SA 700 with respect to the Supplementary Information Presented with the Financial Statements.

Answer:

12. As per SA 700 "Forming an Opinion and Reporting on Financial Statements", if supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.

If supplementary information that is not required by the applicable financial reporting framework is not considered an integral part of the audited financial statements, the auditor shall evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.

The auditor's evaluation of whether unaudited supplementary information is presented in a manner that could be construed as being covered by the auditor's opinion includes, for example, where that information is presented in relation to the financial statements and any audited supplementary information and whether it is clearly labelled as "unaudited."

In the current case, the Statement of Average Revenue Per Booking (ARPB) and Comparative is unaudited supplementary information that could be construed as being covered by the auditor's opinion. Hence, the audit team should evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If not, then audit can suggest management to change the presentation of unaudited supplementary information by:

- Removing any cross-references from the financial statements to unaudited supplementary schedules or unaudited notes so that the demarcation between the audited and unaudited information is sufficiently clear.
- Placing the unaudited supplementary information outside of the financial statements or, if that is not possible in the circumstances, at a minimum placing the unaudited notes together at the end of the required notes to the financial statements and clearly labelling them as unaudited. Unaudited notes that are intermingled with audited notes can be misinterpreted as being audited.

If the management of XYZ Limited refuses to do so, the auditor shall identify the unaudited supplementary information, i.e., Statement of ARPB and Comparative and explain in the auditor's report that such supplementary information has not been audited.

Q10. RTP May 2023

Mangal & Co., Chartered Accountants, have been appointed Statutory Auditors of Mani Ltd. for the financial year 2021-22. The audit team has completed the audit and is in the process of preparing audit report. Management of the company has also prepared draft annual report.

Audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. Audit Manager discussed this issue with partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Do you think that the partner is correct in his approach on this issue. Discuss with reference to relevant Standard on Auditing the Auditor's duties with regard to reporting.

Answer:

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists: As per SA 720, "The Auditor's Responsibility in Relation to Other Information", Descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be Included in the other information.

The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor's duties with regard to reporting in the given case are given hereunder:

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", if the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

- (ii) Agrees to make the correction, the auditor shall determine that the correction has been made; or
- (iii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

Q11. RTP May 2023

CA. K is appointed statutory auditor of SEEK INDIA PVT LTD under the Companies Act 2013 for the first time. The company is preparing its accounts, considering the applicable requirements of Division I of Schedule III of the Companies Act, 2013. On scrutinising, the company's financial statements for an audit, it was noticed that notes to accounts show the ageing of trade payables as per amended requirements of the Schedule III of the Companies Act, 2013.

The ageing schedule forming part of the notes is as under: -

Outstanding for following periods from the due date of payment (In Rs.crore)

Particulars	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	NIL	NIL	NIL	NIL	NIL
Others	2	4	3	1	10
Disputed dues- MSME	NIL	NIL	NIL	NIL	NIL
Disputed dues- others	NIL	NIL	NIL	NIL	NIL

Besides above, current ratio, debt-equity ratio, trade payables turnover ratio and net profit ratio disclosed in notes to accounts have slipped drastically as compared to last year and from standard norms. Most of the key financial ratios are in red.

There is no other relevant information concerning above in notes to accounts.

Further, on reviewing bank statement of cash credit limit (against hypothecation of paid stocks), it was noticed that there is no debit transaction in month of March 2022. On inquiry, he came to know that the company's stock audit was conducted in January, 2022 and stock auditors have commented vide their report dated 25.2.2022 that the company had negative drawing power due to high creditors. Accordingly, the bankers have refused further debits in the cash credit account since March 2022.

Further, upon inquiry with the management, it was identified that management did not have any major future contracts to boost their revenue and financial position.

There is no information in this respect in financial statements and notes to accounts.

Discuss how CA K should deal with above for reporting in his audit report under Companies Act, 2013.

Answer:

It is clear from the ageing schedule that company is not able to pay its creditors on time. Outstanding to creditors for a period of 1 year or more account for 80% of total creditors of the company. Most of key financial ratios are adverse.

Further, bankers have refused further debits in cash credit account due to negative drawing power from March 2022. Cash credit loans are repayable on demand. There is no other information available how the company plans to run its business without bank finance.

Also, Further, upon inquiry with the management, it was identified that management did not have any major future contracts to boost their revenue and financial position.

All the above factors are indicators that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern. There is no express disclosure of this fact in financial statements.

Therefore, it is a situation where material uncertainty exists, which has cast significant doubt on company's ability to continue as going concern in accordance with SA 570 , Going Concern.

Considering above the fact that although a material uncertainty exists casting significant doubt on the ability of the company to continue as going concern, adequate disclosure of material uncertainty is not made in financial statements. Thus, CA K shall give qualified or adverse opinion in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report.

Q12. RTP Nov 2021

Mr. Hemant Ramsey was appointed as the engagement partner for conducting the audit of Kshetra Lap Ltd. for F.Y. 2020-21, on behalf of Ramsey & Associates. Mr. Vishay Tyagi was appointed as the engagement quality control reviewer by the firm for the said audit.

During F.Y. 2020-21, there was an implementation of ERP system in a phased manner, in Kshetra Lap Ltd. due to which some of its business processes got automated. As a result of the implementation of such a system, there was a significant effect on the auditor's overall audit strategy. Mr. Hemant discussed the implementation of such a system with Mr. Vishay and also told him that such a matter may be a key audit matter to be reported in the audit report.

Mr. Vishay considered the significance of such matter but however he was of the opinion that such a matter did not appear to link with the matters disclosed in the financial statements and so there was no need to disclose such matter as a key audit matter.

Whether the contention of Mr. Vishay is proper with respect to the matters to be communicated as a key audit matter?

Answer:

As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report', the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.

- (ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the aforesaid matters considered were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

These aforesaid considerations focus on the nature of matters communicated with those charged with governance. Such matters are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.

The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit.

In addition to matters that relate to the specific required considerations, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

In the given case, there was implementation of ERP system in the company due to which some of its business processes got automated and which had a significant effect on the auditor's overall audit strategy during the period.

Accordingly, such a matter can be considered as a key audit matter if according to Mr. Hemant, such a matter required significant attention that had affected his overall audit strategy.

Thus, the contention of Mr. Vishay is not proper as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter if it required significant attention of the auditor which had an impact on its audit.

Q13. RTP Nov 2020

AKB Associates, a renowned audit firm in the field of CA practice for past two decades. The firm was appointed to conduct statutory audit of Rica Ltd. an unlisted company, which is engaged in the business of paper manufacturing. It decided to commence the audit for the recently concluded financial year. Once after making significant progress in the audit, the auditors made the following observations:

Observation 1: The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2: Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material.

You are required to advise, whether AKB Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported?

Answer:

Observation 1 - The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material: As per SA 706, "Emphasis of Matter Paragraph & Other Matter Paragraph in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to matter appropriately disclosed in the financials, that in the auditor's judgement is of such importance that it is fundamental to users' understanding of the financials. Hence, in this case, the auditor shall report about the consequences of the flood which affected the Company's warehouse under Emphasis of Matter Paragraph.

Observation 2 - Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material: As per SA 705, "Modification to Opinion in the Independent Auditor's Report", where the auditor is unable to obtain sufficient and appropriate audit evidence and where such matter is material but not pervasive, the auditor shall issue a qualified opinion.

Thus, in the given situation, on account of flood few records pertaining to particular transactions was completely destroyed and in the absence of duplicate records, the auditor was unable to obtain sufficient and appropriate audit evidence and those details were material but not pervasive. Therefore, in accordance with SA 705, the auditor is required to issue qualified opinion.

Q14. RTP Nov 2019

Write a short note on the following:

- (a) Scope of the Quality review.

Answer:

- (a) The scope of the quality review includes:
 - (i) Examining whether the Engagement Partner has ensured compliance with the applicable technical standards in India and other applicable professional and ethical standards and requirements.
 - (ii) Examining whether the Engagement Partner has ensured compliance with the relevant laws and regulations.
 - (iii) Examining whether the Audit firm has implemented a system of quality control as envisaged in line with the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

Q15. RTP Nov 2018

Write a short note on the following:

- (a) The purpose of communicating key audit matters.

Answer:

- (a) Purpose of Communicating Key Audit Matters : The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in

understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

Q1. Exam May 2023, 5 marks

SPM Ltd., about to complete fifty years of age since its incorporation in the F.Y 2023-2024, decided during the F.Y year 2022-23 to upgrade its registered office at an important location in Mumbai city. As part of planned package, it decided to acquire a land very adjacent to the site of registered office, which had been owned by Mr. Parry, who is a director of the Company. Since he was reluctant to part with the ownership, he had been persuaded to convey the property in favour of the company in exchange of a site owned by the company located at the next street to the street where the registered office is situated, which is 1.50 times larger in area than that of the site owned by the director adjacent to the Registered office. Happier with what he was offered in negotiation, Mr. Parry agreed for transferring the property in favour of the company in a deed of exchange duly executed by authorized persons of the Board, and Mr. Parry. The registration formalities were completed by 31st December, 2022. Assuming that you are the engagement partner for the audit of the accounts of the company for the financial year ended on 31st March, 2023, give a list of additional audit procedures and reporting requirements, if any, that this transaction might trigger in your audit.

Answer:

(b) CARO Audit Procedures and Reporting:

In the given situation, SPM Ltd has entered into non-cash transactions with one of the directors, Mr. Parry during the year, by transferring the property (by Mr. Parry) in favour of the Company in a deed of exchange of a site owned by the company.

Paragraph 3 Clause (xv) of the CARO 2020 & Reporting Requirements:

The auditor is required to report the transaction as per Paragraph 3(xv) of the CARO, 2020 which states that whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.

For reporting on the first part of this clause, the starting point of the auditor's procedures could be obtaining a management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1) of the Act.

The second part of this clause requires the auditor to report whether the company has complied with the provisions of section 192 in this regard. Section 192(1) and (2) of the Act envisage the following compliances in respect of such transactions:

- (i) The company should have obtained a prior approval for such arrangement by a resolution in the general meeting.
- (ii) Notice for approval of the resolution should contain details of the arrangement along with the value of assets involved.

The auditor should check compliance with section 192(2) of the Act and verify the notice of the general meeting that it includes particulars of arrangement along with the value of the assets involved in such arrangements.

This transaction was duly executed by the authorised persons of the Board. The auditor has to state the fact whether approval has been obtained in the general meeting of the company.

Related Party Transactions

This is a transaction with a related party. The provisions of section 188 of the Companies Act, 2013 as regards Related Party Transactions are to be checked for compliance. Section 189 of the Companies Act, 2013 requires a register to be maintained wherein the contract with related parties are to be entered. The compliance with section 177 and section 188 has to be reported under Clause (xiii) of the CARO, 2020.

Documents to be verified:

A scrutiny of the following books of account, records and documents could provide source of such audit evidence to the auditor as to the existence of such non- cash transactions.

- Register of Loans, Guarantee, Security and Acquisition Made by the Company, Register of Contracts with Related Party and Contracts and Bodies etc. in which Directors are Interested.
- Movements in the Fixed Asset Register.
- Minutes book of the General Meeting and Meetings of Directors.
- Report on Annual General Meeting.

Q2. Exam Nov 2022, 5 marks

You are appointed as the Auditor of XMP Pvt. Ltd. for financial year 2021-22 after the resignation of RS & Co. Chartered Accountants, as statutory auditor of the company. RS & Co., had certain concerns on the accounting matters of the company, leading to change of auditors. All the compliances under Sections 139 and 140 are made by the company with regard to resignation and appointment.

During the course of audit, it came to your notice that a survey has been conducted on December 7, 2021 by the Income Tax Department and department has unearthed unrecorded sales of ₹ 5 lakhs which had been made in cash on different dates during the year 2020-21. XMP Pvt. Ltd. has purchased gold from such collections and these transactions are not recorded. Company surrendered and disclosed these transactions before the assessing officer and paid taxes thereon. However, company has not recorded those transactions in books of account even after surrender before Income Tax authorities.

You want to report the above matters in CARO, but the management requested you not to report them. Comment with respect to auditor's response to the management and his reporting requirements to the shareholders.

Answer:

Clause (xviii) of Paragraph 3 of CARO, 2020:

In the given situation of XMP Pvt Ltd, the auditors RS & Co. resigned due to concerns on the accounting matters of the company. However, all the compliances regarding resignation and appointments discussed in section 139 and 140 of the Companies Act, 2013 are also being complied with. The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020 given hereunder:

Clause (xviii) of Paragraph 3 of CARO, 2020 requires the auditor to report whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

Clause (viii) of Paragraph 3 of CARO, 2020:

Further, the auditors noticed that a survey was conducted by the Income Tax Department and unrecorded sales of Rs 5 Lakhs were unearthed which had been made in cash on different dates during the year. XMP Pvt Ltd. has also purchased gold and the transactions remained unrecorded. Though Company surrendered and disclosed these transactions before the Assessing Officer and paid taxes thereon. The auditor would be required to report in CARO as per Clause (viii) of Paragraph 3 of CARO, 2020.

Clause (viii) of Paragraph 3 of CARO, 2020 requires the auditor to report -whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.

Since it is a statutory obligation on the part of the auditor to report in terms of CARO, 2020 as given above and consequently management's request to the auditor that not to report the above transactions is not tenable.

Q3. Exam Nov 2022, 5 marks

What is a Core Investment Company (CIC) under the Reserve Bank of India regulations? What are the specific reporting requirements to be considered by an auditor in respect of CIC under CARO 2020?

Answer:

(a) Core Investment Companies: As per RBI Master Direction – Core Investment Companies (Reserve Bank) Directions, 2016, (Reference may be made to aforesaid Master Direction), these

directions shall apply to every Core Investment Company (CIC), that is to say, a non- banking financial company carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited balance sheet:-

- (i) it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;
 - (ii) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trust only as sponsor constitute not less than 60% of its net assets as mentioned in clause (i) above; Provided; that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.
 - (iii) it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
 - (iv) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the Reserve Bank of India Act, 1934 except
- a. investment in
 - (i) bank deposits,
 - (ii) money market instruments, including money market mutual funds and liquid mutual funds
 - (iii) government securities, and
 - (iv) bonds or debentures issued by group companies,
 - b. granting of loans to group companies and
 - c. Issuing guarantees on behalf of group companies..

As per CARO 2020, the auditor is required to report that –

- (i) Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria; [Paragraph 3(xvi) (c)]
- (ii) Whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group; [Paragraph 3(xvi) (d)]

Q4. Exam May 2022, 5 marks

Jam Private Limited was engaged in business of manufacture of Cycles. CA Roy was appointed as a Statutory Auditor of the Company for the financial year 2021-22. During the year under audit, Jam Private Limited obtained working capital facilities from ABC Bank Limited for ` 10 crore hypothecating the Stock of goods as primary security. On inquiry CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited and the details of submission of quarterly stock statement are as follows:

Period of Quarter	Stock Value as per Books of Account as at the end of the quarter (Rs. in crores)	Stock Value as per quarterly statement submitted to ABC Bank Limited as at the end of quarter (Rs. in crore)
Q1-2021-22	11.50	14.00
Q2-2021-22	14.75	17.00
Q3-2021-22	11.50	14.00
Q4-2021-22	15.25	15.25

The management of Jam Private Limited did not disclose the above variations in notes to accounts forming part financial Statements of the Company for the year 2021 -22. The management replied that there are no variations as on the Balance sheet date and further they are of the view that stock statement furnished to bank is only a formality and computed arbitrarily only for the purpose of securing higher drawing power and hence statutory auditors need not be bothered.

Is the contention of the management valid? As a Statutory Auditor how CA Roy should deal and discuss the disclosure/reporting requirements if any, as per the Companies Act, 2013 and CARO, 2020.

Answer:

As per clause (vii) of point Y of Schedule III to the Companies Act, 2013 - Division I - Financial Statements for a company whose financial statements are required to comply with the Companies (Accounting Standard) Rules, 2006, "where the company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following :

- a) whether quarterly returns or statements of current assets filed by the company with banks or financial institutions are in agreement with the books of accounts.
- b) if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

Further, as per para 3(ii) (b) of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

The above clause requires CA Roy to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ` 5 crores in aggregate. Jam (P) Ltd. has been sanctioned working capital facilities/limit of ` 10 crores which is apparently in excess of ` 5 crores.

Secondly, whether the quarterly returns filed by the Jam (P) Ltd. company with ABC Bank Ltd. are in agreement with the book of accounts of the company.

According to the data given in the instant situation, it is clear that there are variations in Quarter 1, Quarter 2 & Quarter 3 requiring reporting under this clause because of difference in stock value as per Book of Accounts & Stock Value as per Quarterly returns submitted to ABC Bank Ltd.

Therefore, Contention of the management is not valid.

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

	Stock value as per Book Accounts (Rs. in Crore)	Stock value as per quarterly statement Submitted to ABC Bank Ltd. (Rs.in Crore)	Variation
Q-1	11.5	14.00	Excess reporting of stock to Bank by 2.50 crore
Q-2	14.75	17.00	Excess reporting of stock to Bank by 2.25 Crore
Q-3	11.50	14.00	Excess reporting of stock to bank by 2.50 crore

Q5. Exam Dec 2021, 5 marks

Mr. Khanna has been appointed as statutory auditor of RST Ltd. for the financial year ended 31st March, 2021. The financial statements of RST Ltd. are to be drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. The Chief financial officer is of the view that the disclosure requirements specified under Division II of Schedule III of the Companies Act, 2013 are complete and no other additional disclosures shall be made in the Notes or by way of additional statements. Advise on the General instructions to be considered by RST Ltd. while preparing its financial statements.

Answer:

General Instructions for Preparation of Financial Statement of a Company required to comply with Ind-AS:

1. Every company to which Indian Accounting Standards apply, shall prepare its financial statements in accordance with this Schedule or with such modification as may be required under certain circumstances.
2. Where compliance with the requirements of the Act including Indian Accounting Standards (except the option of presenting assets and liabilities in the order of liquidity

- as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment substitution or deletion in the head or sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements under this Schedule shall stand modified accordingly.
3. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Indian Accounting Standards. Additional disclosures specified in the Indian Accounting Standards shall be made in the Notes or by way of additional statement or statements unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 2013 shall be made in the Notes in addition to the requirements set out in this Schedule.
 4.
 - (i) Notes shall contain information in addition to that presented in the Financial Statements and shall provide where required-
 - (a) narrative description or disaggregation of items recognised in those statements; and
 - (b) information about items that do not qualify for recognition in those statements.
 - (ii) Each item on the face of the Balance Sheet, Statement of Changes in Equity and Statement of Profit and Loss shall be cross-referenced to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between providing excessive detail that may not assist users of Financial Statements and not providing important information as a result of too much aggregation.
 5. Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statement including Notes except in the case of first Financial Statements laid before the company after incorporation.
 6. Financial Statements shall disclose all 'material' items, i.e. the items if they could. Individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.
 7. Where any Act or Regulation requires specific disclosure to be made in the standalone financial statement of a company, the said disclosure shall be made in addition to those required under this Schedule.

Q6. RTP Nov 2023

CA. F has been appointed as the Statutory Auditor of XYZ Limited for the financial year 2022-23. XYZ Limited has one subsidiary, namely AT Private Limited, whose statutory auditor is CA. B for the same financial year i.e., 2022-23.

CA. B issued a qualification in CARO 2020 for AT Private Limited, stating that short-term funds raised were utilised for long-term purposes. When consolidating the financial statements, CA. F decided to include the aforementioned qualification in the audit report of the Consolidated Financial Statements for the financial year 2022-23. The management of XYZ Limited argued that CA. F is not obligated to take into account and report the qualification given by CA. B in the audit report of the subsidiary company in the consolidated financial statements for the financial year 2022-23.

Discuss the reporting requirement as per CARO, 2020.

Answer:

XYZ Limited is the parent company, and it has a subsidiary named AT Private Limited. CA F is the appointed statutory auditor for XYZ Limited for the financial year 2022-23. Another auditor, CA B, has conducted the statutory audit for AT Private Limited and issued a CARO 2020 report, which includes a qualification regarding the short-term funds raised and utilised for long-term purposes.

Provision of Paragraph 2 of CARO 2020: Paragraph 2 of CARO 2020 specifies that the CARO provisions do not apply to the auditor's report on consolidated financial statements except for clause (xxi) of Paragraph 3.

Clause (xxi) of Paragraph 3 of CARO 2020: Clause (xxi) of Paragraph 3 of CARO 2020 mandates the auditor to comment on whether there are any qualifications or adverse remarks in the CARO reports of companies included in the consolidated financial statements. If such qualifications or adverse remarks exist, the auditor is required to provide details of the companies and the paragraph numbers of the CARO report containing those qualifications or adverse remarks.

CA F's Responsibility: Considering the provisions stated above, CA F, as the auditor of XYZ Limited's consolidated financial statements, is required to follow these steps:

- a. Report under Clause (xxi) of Paragraph 3 of CARO 2020: CA F must include a comment in the consolidated financial statement's audit report regarding whether there are any qualifications or adverse remarks in the CARO reports of the companies included in the consolidated financial statements.
- b. Incorporate Qualification by CA B: CA F should incorporate the qualification made by CA B (regarding short-term funds raised and utilized for long-term purposes in AT Private Limited) into the auditor's report for XYZ Limited's consolidated financial statements.
- c. Mention Paragraph Number: CA F must also provide the paragraph number of CA B's CARO report where the qualification is stated.

Management's Contention: The management of XYZ Limited's contention that CA F is not required to consider and report CA B's qualification in the subsidiary's CARO report for the consolidated financial statements is not valid. As per the provisions, CA F is indeed required to report such qualifications as specified in Clause (xxi) of Paragraph 3 of CARO 2020.

In conclusion, based on the information provided and the provisions of CARO 2020, CA F is obligated to incorporate the qualification from CA B's CARO report for AT Private Limited into the auditor's report for XYZ Limited's consolidated financial statements for the financial year 2022-23, as well as provide the necessary details as per the requirements of Clause (xxi) of Paragraph 3 of CARO 2020.

Q7. RTP Nov 2023

LIU Private Limited is a company based out of Mumbai. The company had an authorised capital of Rs.200 lakh and paid-up capital plus reserves of Rs.95 lakh as of 31st March. During the audit for the year ended 31st March 202X, the auditor M/s Y&S Associates noted the following points:

- (i) On 15th December, the company had total bank borrowings of Rs.75 lakh. On the said date, the company received a new loan of Rs.30 lakh for a new project that was to be developed. However, the project was shelved on 17th December due to technical reasons, and the whole loan was paid on the same date.
- (ii) During the financial year, a new proceeding was initiated against the company for holding a benami property worth Rs.2.5 crore. However, the company's legal team had advised that the case would not withstand the law and would be dismissed during the hearing in April of next financial year.
- (iii) The company had incurred a cash loss of Rs.39 lakh during the financial year compared to a cash profit of Rs.15 lakh in the previous financial year. The total turnover of the company for the financial year was Rs.45 Crore.

During the year, the Y&S Associates had offered to resign from acting as the company's auditors. However, they later decided to postpone their resignation to the following year. At the conclusion of the audit, there was a difference of opinion between two articled assistants (Jack & Jill), who were assigned to the engagement, concerning disclosing the points mentioned above in the Companies (Auditor's Report) Order 2020. Jack was of the opinion that the proceeding initiated under Benami Property Act need not be disclosed since the expert legal team had informed them that the case would not withstand the law. However, he insisted that the cash loss shall be disclosed along with the amount. Jill was of the opinion that CARO is not at all applicable to the company, hence nothing needs to be reported. They both approached the firm's partners (Mr. Y & Mr. S) to resolve their argument. Mr Y supported Jack's viewpoint & Mr S supported Jill's viewpoint. Now, both partners approached their Senior Partner to get clarification on the same. As a Senior Partner, kindly clarify the correct disclosure requirement.

Answer:

As per para 1 of Companies (Auditor's Report) Order 2020, CARO 2020 is applicable to every company, including a foreign company, as defined in clause (42) of section 2 of the Companies Act 2013, except,

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- (ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938); (iii). a company licensed to operate under section 8 of the Companies Act;
- (iii) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and
- (iv) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the given case, though LIU is a private company, and its paid-up capital is less than Rs.1 crore as on the balance sheet date, it is to be noted that for the period 15th December to 17th December, the total borrowings of the company had exceeded Rs.1 crore (75 lakh + 30 lakh). The borrowings are less than Rs.1 crore as of the balance sheet date and the authorised capital is Rs.200 lakh, are irrelevant to the current scenario. Also, the turnover of the company was greater than Rs.40 crore. Hence, CARO 2020 is applicable to LIU Private Limited.

- (i) As per clause (i) (e) of para 3 of CARO 2020, the auditor shall include a statement on: whether any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

In the given situation, a new proceeding was initiated against the company for holding a benami property worth Rs.2.5 crores during the financial year. However, the company's legal team had advised that the case would not withstand the law and would be dismissed during the hearing, which would be held in April of the next financial year.

Therefore, the above observation of a new proceeding initiated against the company for holding a benami property worth Rs.2.5 crores need to be disclosed as per clause (e) of para 3 of CARO 2020.

- (ii) As per clause (xvii) of para 3 of CARO 2020, the auditor shall include a statement on whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses.

In the given situation, the company incurred a cash loss of ₹ 39 lakh during the financial year. Hence, a cash loss of Rs.39 lakh during the financial year need to be reported as per clause (xvii) of para 3 of CARO 2020.

- (iii) As per clause (xviii) of para 3 of CARO 2020, the auditor shall include a statement on whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

In the instant case, there has been no resignation made by the statutory auditors during the financial year. The mere fact that Y&S Associates were thinking of resigning does not matter in the current scenario, and hence this clause shall not be applicable in the given situation

Q8. RTP Nov 2022

Gautam Limited had borrowed Rs.1000 crore from XYZ Bank, the principal of which was repayable after 5 years and interest was payable at the end of each year. For 4 years, Gautam Limited paid the interest amount on time. Gautam Limited defaulted the 5th instalment of interest payment and principal which was due on June 30, 2021. On March 31, 2021, Gautam Limited approached XYZ bank and MNO bank to restructure the existing liability. As a result, the existing principal and outstanding and overdue interest was restructured into a new loan amounting to Rs.1,100 crore.

The management did not provide any disclosure for the default on the loan on the belief that the old loan ceased to exist and the new loan has maturity after 5 years.

During the statutory audit for the financial year 2021-22, KP & Co. identified this transaction and obtained the relevant documents and understanding. Based on the underlying documents, it was identified that the said restructuring agreement was approved and signed on April 8, 2022, by both of the banks. As a result, on March 31, 2022, the restructuring was still not approved.

In the light of the above scenario, kindly guide the statutory auditors in the reporting of this transaction.

Answer:

As per Clause 3(ix) of CARO 2020, the auditor is required to report whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below.

Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	lender wise details to be provided in case of defaults to banks, financial institutions and Government.				

In the given case, the company Gautam Limited defaulted in payment of the principal amount of the loan due of Rs.1000 crore on 30 June 2021 and the interest instalment of Rs.100 crore. The said default continued till the end of the year and on 8 April 2022, a restructuring agreement was signed by the banks and company for re-structuring the outstanding loan. Moreover, no disclosure was provided by the company with respect to the said matter.

Hence the auditor is required to report the same matter under Clause (ix) of Para 3 of CARO 2020, i.e., whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, then provide the details of the period and the amount of default. Also, the auditor needs to consider the impact of such non-disclosure and the non-compliance with the financial reporting framework and accordingly the auditor needs to either issue a qualified opinion or an adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

Q9. RTP May 2022

Mr. Arjun was appointed as the engagement partner on behalf of Bhism & Co., a Chartered Accountant Firm, for conducting statutory audit assignment of Sinwar Ltd., unlisted public company.

Mr. Brijesh, one of the senior engagement team members, was given the responsibility to audit the matters as per the requirements of CARO, 2020 and in that connection, he made the following observations, that may be relevant for reporting as per the said Order:-

Sr. No.	Observations
(a)	One of the Plant and Equipment taken on a lease ('right of use' asset) by Sinwar Ltd. was revalued based on the valuation by a registered valuer and the net carrying value of Plant and Equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crore.
(b)	During the year under consideration, cash credit limit of ₹ 5.5 crore was sanctioned to Sinwar Ltd. by DMC Bank based on the security of current assets which was reduced to ₹ 4.5 crore after 6 months. In this connection, quarterly returns have been filed by the company with the DMC bank which are in agreement with Books of Accounts.

You are required to examine the contention of Mr. Brijesh regarding reporting of the above observations in accordance with CARO 2020.

Answer:

Matters to be reported by Mr. Brijesh as per CARO, 2020 are as follows:-

- (a) According to Clause (i) (d) of Para 3 of CARO 2020, the auditor is required to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if the change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

In the given situation, Sinwar Ltd. has revalued one of the Plant and Equipment taken on a lease ('right of use' asset) based on the valuation by a registered valuer. The amount of change in the value of such Plant and Equipment is Rs.45 lakh. As the net carrying value of Plant and Equipment in aggregate was changed from ` 4 crore to

Rs.4.45 crore i.e. change was 10% or more.

Thus, the auditor is required to report the amount of change of ` 45 lakh in accordance with Clause (i) (d) of Para 3 of CARO 2020.

- (b) As per Clause (ii) (b) of Para 3 of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

In the instant case, Sinwar Ltd. has been sanctioned a cash credit limit of Rs.5.5 crore by DMC Bank during the year under consideration, which is exceeding the prescribed limit of Rs.5 crore based on the security of current assets. Further, quarterly returns have also been filed by the company with the DMC bank in this connection which is in agreement with Books of Accounts.

In view of the above, the auditor is required to report the same in accordance with Clause (ii) (b) of Para 3 of CARO 2020

Q10. RTP Nov 2021

Mr. Hemant Ramsey was appointed as the engagement partner for conducting the audit of Kshetra Lap Ltd. for F.Y. 2020-21, on behalf of Ramsey & Associates. Mr. Vishay Tyagi was appointed as the engagement quality control reviewer by the firm for the said audit.

During F.Y. 2020-21, there was an implementation of ERP system in a phased manner, in Kshetra Lap Ltd. due to which some of its business processes got automated. As a result of the implementation of such a system, there was a significant effect on the auditor's overall audit strategy. Mr. Hemant discussed the implementation of such a system with Mr. Vishay and also told him that such a matter may be a key audit matter to be reported in the audit report.

Mr. Vishay considered the significance of such matter but however he was of the opinion that such a matter did not appear to link with the matters disclosed in the financial statements and so there was no need to disclose such matter as a key audit matter.

Whether the contention of Mr. Vishay is proper with respect to the matters to be communicated as a key audit matter?

Answer:

14. As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report', the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- (ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the aforesaid matters considered were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

These aforesaid considerations focus on the nature of matters communicated with those charged with governance. Such matters are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.

The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit.

In addition to matters that relate to the specific required considerations, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

In the given case, there was implementation of ERP system in the company due to which some of its business processes got automated and which had a significant effect on the auditor's overall audit strategy during the period.

Accordingly, such a matter can be considered as a key audit matter if according to Mr. Hemant, such a matter required significant attention that had affected his overall audit strategy.

Thus, the contention of Mr. Vishay is not proper as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter if it required significant attention of the auditor which had an impact on its audit.

Q11. RTP Nov 2020

AKB Associates, a renowned audit firm in the field of CA practice for past two decades. The firm was appointed to conduct statutory audit of Rica Ltd. an unlisted company, which is engaged in the business of paper manufacturing. It decided to commence the audit for the recently concluded financial year. Once after making significant progress in the audit, the auditors made the following observations:

Observation 1: The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2: Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material.

You are required to advise, whether AKB Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported?

Answer:

Observation 1 - The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material: As per SA 706, "Emphasis of Matter Paragraph & Other Matter Paragraph in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to matter appropriately disclosed in the financials, that in the auditor's judgement is of such importance that it is fundamental to users' understanding of the financials. Hence, in this case, the auditor shall report about the consequences of the flood which affected the Company's warehouse under Emphasis of Matter Paragraph.

Observation 2 - Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material: As per SA 705, "Modification to Opinion in the Independent Auditor's Report", where the auditor is unable to obtain sufficient and appropriate audit evidence and where such matter is material but not pervasive, the auditor shall issue a qualified opinion.

Thus, in the given situation, on account of flood few records pertaining to particular transactions was completely destroyed and in the absence of duplicate records, the auditor was unable to

obtain sufficient and appropriate audit evidence and those details were material but not pervasive. Therefore, in accordance with SA 705, the auditor is required to issue qualified opinion.

Q12. RTP May 2018

- (a) Compare and explain the following:
- Reporting to Shareholders vs. Reporting to those Charged with Governance
 - Audit Qualification vs. Emphasis of Matter.

Answer:

- (a)
- (i) Reporting to Shareholders vs. Reporting to those Charged with Governance:

REPORT	
Reporting to Shareholders	Reporting to those Charged with Governance
Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.	Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.
Statutory Audit Report is on true and fair view and as per prescribed Format.	It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
Statutory Audit Reports are in public domain.	Reporting to those Charged with Governance is an internal document i.e. private report.

- (ii) Audit Qualification vs. Emphasis of Matter:

REPORT	
Audit Qualification	Emphasis of Matter
Standard on Auditing 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with the provisions relating to Audit Qualification.	Standard on Auditing 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with the provisions relating to Emphasis of Matter.
Audit Qualifications are also known as "subject to report" or "except that report".	Emphasis of Matter is a paragraph which is included in auditor's report to draw users' attention to important matter(s) which are already disclosed in Financial Statements and are fundamental to users' for understanding of Financial Statements.
Audit Qualifications are given when auditor is having reservations on some of the items out of the financial statements as a whole i.e. Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements relating to if the impact of material misstatements is not pervasive on the financial statements but is present at some levels of the financial statements, qualified report is issued.	Emphasis of Matter is a paragraph which is issued when there is a uncertainty relating to future outcome of exceptional litigation, regulatory action, etc.; or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.

Q1. Exam May 2019, 5 marks

(a) You are engaged by M/s Active Ltd. to examine and report on prospective financial information which the management of the company has prepared for presentation at an Investor meet program organized by a State Government to attract investment in their state.

The company in its vision document described various plans and proposals of the company with projected financial goals and means to achieve the same and various benefits accruing to the economic development of the State. What important matters will be considered by you while determining the nature, timing and extent of examination procedure to be applied in the review of the same?

Answer:

Examination Procedures: As per SAE 3400, "The Examination of Prospective Financial Information", when determining the nature, timing and extent of examination procedures, the auditor should consider matters such as:

- (i) the knowledge obtained during any previous engagements;
- (ii) management's competence regarding the preparation of prospective financial information;
- (iii) the likelihood of material misstatement;
- (iv) the extent to which the prospective financial information is affected by the management's judgment;
- (v) the sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;
- (vi) the stability of entity's business; and
- (vii) the engagement team's experience with the business and the industry in which the entity operates and with reporting on prospective financial information.

Q2. RTP May 2018

B & Co. is in process to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by B & Co. to examine the projected financial statements and give report thereon. Briefly explain the things you will consider before accepting the audit engagement and what audit evidence will be obtained for reporting on projected financial statements?

Answer:

Projected Financial Statements: As per SAE 3400, "The Examination of Prospective Financial Information", the answer is divided into two parts i.e. (i) the things to be considered before accepting the engagement and (ii) audit evidence to be obtained for reporting on projected financial statements.

- (i) Acceptance of Engagement: As per SAE 3400, "The Examination of Prospective Financial Information", before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:

- 1. the intended use of the information;
- 2. whether the information will be for general or limited distribution;
- 3. the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
- 4. the elements to be included in the information; and
- 5. the period covered by the information.

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement.

- (ii) Audit evidence to be obtained for Reporting on Projected Financial Statements: The auditor should document matters, which are important in providing evidence to

support his report on examination of prospective financial information, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

1. the sources of information,
2. basis of forecasts,
3. the assumptions made in arriving the forecasts,
4. hypothetical assumptions, evidence supporting the assumptions,
5. management representations regarding the intended use and distribution of the information, completeness of material assumptions,
6. management's acceptance of its responsibility for the information,
7. audit plan,
8. the nature, timing and extent of examination procedures performed, and,
9. in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.

Q1. Exam May 2023, 5 marks

SAM Yarns Limited - a listed Company, having its registered office at Meerut is engaged in manufacturing of various types of yarns to be supplied to the textile mills. The Company has installed pollution control equipment for processing the pollutants so that before discharge of effluents outside factory, the level of pollution is kept at a level below the prescribed standard. The Company managed to get pollution clearance certificate by unfair means, while still there continues to be breach of pollution control laws in matters of discharge of polluting effluents. Amount of ₹ 10.25 Lacs had been incurred for arranging clearance certificate and the amount incurred unlawfully had been booked as pollution recycling expenditure. The matter had not reached to those in governance, and the Director-Finance who is a Chartered Accountant came to know of these matters on review of major expenditure incurred during the period. Comment the action/responses expected of Director - Finance (CA Rahul) referring to any applicable requirements of Responses for NOCLAR under Code of Ethics.

Answer:

In the given situation, SAM Yarns Limited, a listed company, has installed pollution control equipment for processing the pollutants to keep the level of pollution below the prescribed standard. The company managed to get pollution certificate by unfair means whereas breach of pollution control laws still continues. For arranging clearance certificate amount of 10.25 lakhs had been incurred unlawfully. CA. Rahul, Director Finance, came to know about these matters on review of the same during the period.

NOCLAR, under Code of Ethics, is applicable on professional accountants in service, and in practice. Among those in practice, it applies to Auditors, as well as professional services other than Audit.

It is applicable to Senior Professional Accountants in service, being employees of listed entities. Senior professional accountants in service ("senior professional accountants") includes directors. NOCLAR takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.

As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted.

CA Rahul, Director-Finance is expected of taking the following action/responses:

- Obtaining an Understanding of the Matter.
- Addressing the Matter.
- Determining Whether Further Action Is Needed.
- Seeking Advice.
- Determining Whether to Disclose the Matter to an Appropriate Authority.
- Imminent Breach.
- Documentation.

Q2. Exam May 2023, 4 marks

SR and Associates are the statutory auditor of ABC Ltd. Audit of the company is pending for F.Y 2021-22 and 2022-23 due to a dispute between auditor and company with respect to certain proposed remarks by the auditor in the audit report for F.Y. 2021-22. The company removed the auditor on 02.05.2023 in shareholders meeting complying with all legal formalities. SR and

Associates after coming to know about the removal, intimated the Registrar of Companies (ROC) through letter highlighting the points of dispute including non-existence of fixed assets, bogus creditors etc. ABC Ltd complained to ICAI against SR and Associates for their above letter to ROC. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force.

An accountant, in public practice, has access to a great deal of information of his client which is of a highly confidential character. It is important for the work of an accountant and for maintaining the dignity and status of the profession that he should treat such information as having been provided to him, only to facilitate the performance of his professional duties for which his services have been engaged. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment.

In the given situation, SR & Associates complained to the Registrar of Companies (ROC) through letter highlighting the points of dispute including non-existence of fixed assets, bogus creditors, etc. after coming to know about the removal. SR & Associates made voluntary disclosure of the information acquired during the professional engagement without the consent of the client and without there being any requirement in law to disclose the same.

Q3. Exam Nov 2022, 5 marks

The professional accountants need to observe certain fundamental principles, which are covered in the Code of Ethics of the Institute of Chartered Accountants of India. Briefly explain each of the five principles which needs to be complied by the Chartered Accountants?

Answer:

Fundamental Principles: In order to achieve the objectives of the Accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles. The fundamental principles as discussed in Code of Ethics of ICAI, to be complied, are given below:

- (i) Integrity – A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness.
- (ii) Objectivity – A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.
- (iii) Professional Competence and Due Care – A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:
 - (a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
 - (b) act diligently in accordance with applicable technical and professional standards.
- (iv) Confidentiality – A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships.
- (v) Professional Behaviour – A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws

and regulations and avoid any conduct that accountant knows or should know might discredit the profession.

Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

Q4. Exam Nov 2022, 4 marks

Mr. X is a practising Chartered Accountant. Mr. Y is a practising advocate representing matters in the court of law. X and Y decided to help each other in matters involving their professional expertise. Accordingly, Mr. X recommends Mr. Y in all litigation matters in the court of law and Y consults X in all matters relating to finance and other related matters, which come to him in arguing various cases, consequently, they started sharing profits of their professional work. Is Mr. X liable for professional misconduct?

Answer:

According to Clause (2) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Furthermore, Clause (3) of Part I of the First Schedule to the said Act states that a Chartered Accountant in practice is deemed to 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.

However, a practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as prescribed by the Council under Regulation 53-A of the Chartered Accountants Regulations, 1988. Under the said regulation, the member of "Bar Council of India" (Advocate) is included.

Therefore, Mr. Y, a practicing advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Mr. X. Hence, Mr. X, a practicing Chartered Accountant, will not be held guilty under any of the above-mentioned clauses for paying and accepting part of profits to/from Mr. Y.

Q5. Exam Nov 2022, 4 marks

Mt. P, a Chartered Accountant did not maintain books of account for his professional work on the ground that his income is assessed under Section 44ADA of the Income Tax Act, 1961. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

Maintenance of Books of Account: As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct.

Accordingly, it does not matter whether section 44ADA of the Income Tax Act, 1961 applies or not.

Conclusion: Hence, Mr. P is guilty of professional misconduct.

Q6. Exam May 2022, 4 marks

CA Ravi, a practising Chartered Accountant, was proprietor of M/s Ravi & Associates. CA Ravi died on 15th September, 2020 due to cardiac arrest. Only family member left behind CA Ravi was his wife, Roohi. On 30th September, 2021, Roohi sold the practice of her husband to CA Balwan for RS.25 Lacs along with right to use the firm name i.e., M/s. Ravi & Associates and requested the Institute to consider the effect of such sale. Give your comments on the following issues with reference to the Chartered Accountants Act, 1949 and Schedules thereto:

- (i) Whether Roohi can sell the practice to CA Balwan?
- (ii) Can CA Balwan continue to practice as proprietor in name of M/s Ravi & Associates?

Answer:

Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

It is being resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.

It further lays down that the sale is permitted subject to certain conditions like such a sale is completed/effected in all respects and the Institute's permission to practice in deceased's proprietary firm name is sought within a year of the death of such proprietor concerned. In respect of these cases, the name of the proprietary firm concerned would be kept in abeyance (i.e. not removed on receipt of information about the death of the proprietor as is being done at present) only upto a period of one year from the death of proprietor concerned as aforesaid.

In the given case, Mrs. Roohi, widow of Mr. Ravi, proprietor of M/s. Ravi & Associates, has sold the practice along with right to use the firm name after one year of his death for ` 25 lakhs. This sale is in effect the sale of goodwill.

From the discussion given above it can be concluded that:

- (i) Mrs. Roohi cannot sell the practice of CA. Balwan with right to use the firm name.
- (ii) CA Balwan cannot continue to practice in the name of the firm M/s. Ravi & Associates as a proprietor because the name of the firm M/s. Ravi & Associates would be kept in abeyance only up to a period of one year from the death of the proprietor.

Q7. Exam May 2022, 4 marks

CA K qualified as Chartered Accountant and started practice as proprietor in the name of M/s K & Associates in the year 2015-16. LST Limited, a listed entity, appointed M/s K & Associates as Statutory Auditor for the year ended 31st March, 2022. CA K signed the balance sheet of LST Limited for the year ended 31st March, 2022 on 14th May, 2022. M/s K & Associates never subjected themselves to the Peer Review process of the Institute since its inception of practice. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available

in general terms from the various pronouncements of the Institute is issued by way of Engagement and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers.

Audit of Listed Companies: Pursuant to SEBI Notification, statutory audit of listed companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s. K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, CA K, the proprietor signed the balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. CA K would be held guilty of professional misconduct under clause (9) of Part I of Second Schedule of the Chartered Accountants Act, 1949. Also, CA K did not comply with the SEBI Notification which was required to be complied with.

Alternative Solution

Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of misconduct if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. It requires every member of the institute to act within the framework of the Chartered Accountants Act, 1949 and the regulations and guidelines made by Council thereunder.

The Statement on Peer Review shall be deemed to be a guideline of the Council under Clause (1) of Part II of Second Schedule to the Act and it is obligatory for the Practice Unit to comply with the provisions contained in this Statement.

As per the Statement every Practice Unit including its branches who has conducted Statutory Audit of Enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI(LODR) regulations, 2015, will be subject to Peer Review in accordance with this statement.

Audit of Listed Companies: Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, Mr K, the proprietor signed the Balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. Hence, CA K would be held guilty of professional misconduct under clause (1) of Part II of Second Schedule of the Chartered Accountants Act, 1949.

Q8. Exam May 2022, 4 marks

Mr. Sirish, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Information Technology. While delivering the speech, he told the audience that he is a Cybersecurity Expert and his firm provides services of cloud accounting, IT governance, risk compliance and information security at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of the audience he also distributed his business cards and telephone number of his firm to those in the audience.

Comment in the light of professional Code of Ethics.

Answer:

Using Designation Other Than a CA and Providing Details of Services Offered: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council. In view of above, it is improper to use designation "Cybersecurity Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Cybersecurity Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also misconduct in terms of Clause (6).

Q9. Exam Dec 2021, 4 marks

The Cashier of a company committed a fraud and absconded with the proceeds thereof. The Chief Accountant of the company also did not know when the fraud had occurred. In the course of the audit, the auditor failed to discover the fraud. After the audit was completed, however, the fraud was discovered by the Chief Accountant. Investigation made at that time indicates that the auditor did not exercise proper skill and care and performed his work in a desultory and haphazard manner. With this background, the Directors of the company intend to file disciplinary proceedings against the auditor. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

In the given case, in the course of audit, auditor failed to discover the fraud. It is clearly given that investigation indicated that the auditor did not exercise reasonable skill and care and performed his work in a casual and unmethodical manner.

According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties".

As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements", it can be concluded that the auditor did not plan and perform the audit with an attitude of professional skepticism. Thus, having regard to this and a fraud has actually taken place during the year, committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.

From the facts given in the case and by applying Clause (7) and SA 240, it is clear that the auditor is guilty of professional misconduct and the directors can file disciplinary proceedings against the auditor.

Q10. Exam Dec 2021, 4 marks

CA Mehta was appointed as the Auditor of CS Ltd. for the year 2020 -21 in the place of retiring auditor CA Gupta. CA Mehta accepted the appointment after obtaining a certificate from the management that the provisions of the Sections 139 and 140 of the Companies Act, 2013 have been complied with.

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

In the given case, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management that the provisions of the Sections 139 and 140 of the Companies Act, 2013 have been complied with.

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.

Under Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, the incoming auditor has to ascertain whether the Company has complied with the provisions of the above sections. The word "ascertain" means "to find out for certain". This would mean that the incoming auditor should find out for certain as to whether the Company has complied with the provisions of Sections 139 and, 140 of the Companies Act, 2013. In this respect, it would not be sufficient for the incoming auditor to accept a certificate from the management of the Company that the provisions of the above sections have been complied with. It is necessary for the incoming auditor to verify the relevant records of the Company and ascertain as to whether the Company has, in fact, complied with the provisions of the above sections. If the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor should not accept the audit assignment.

Applying the above clause to the given case, the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor, CA Mehta should not have accepted the audit assignment. But on the other hand, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management which is not enough and hence CA Mehta is deemed to be guilty of professional misconduct.

Q11. Exam Dec 2021, 4 marks

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto:

CA D, a practicing Chartered Accountant, was appointed as a simplicitor Director in a Pvt. Ltd. company on 01-01-2020. After serving 18 months, Mr. D resigned as the Director. He accepted the appointment as the Statutory Auditor of the company with effect from 01-10-2021.

Is CA D right in accepting the audit?

Answer:

As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicitor in Pvt. Ltd. Company. Mr. D resigned as the Director and after 18 months of resignation accepted the

Statutory Auditor position of the Company. In view of above provisions Mr. D cannot accept the Directorship of the company as tenure of two years after his resignation is yet to be completed. Thus, CA, D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.

Q12. Exam July 2021, 4 marks

CA R, a Chartered Accountant in practice is specializing in the field of Information Systems Audit. He is considered to be one of the experts of this field because of his command over the subject. HKC Limited, a Company engaged in rendering management consultancy offered him to appoint as its managing director. CA R accepted the position of managing director without obtaining prior permission from the Institute. One of his friends, CA S informed him that now he cannot retain full time certificate of practice, thus cannot do attest function and train articled assistants. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

Provisions of the Chartered Accountants Act, 1949 and Schedules thereto -

As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

The Council decided to allow members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate within the meaning of the Companies Act, 2013 provided that the body corporate is engaged exclusively in rendering Management Consultancy and Other Services permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard. The name of the Management Consultancy Company is required to be approved by the Institute and such Company has to be registered with the Institute.

The members can retain full time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company. There will be no restriction on the quantum of the equity holding of the members, either individually and/ or along with the relatives, in such Company. Such members shall be regarded as being in full- time practice and therefore can continue to do attest function either in individual capacity or in Proprietorship/Partnership firm in which capacity they practice and wherein they are also entitled to train articled/audit assistants.

Thus, the action of CA R is valid.

Q13. Exam July 2021, 5 marks

Vineet & Associates have been offered Statutory Audit of TLP Ltd. As a part of ethical requirements of the Institute of Chartered Accountants, CA V, partner of the firm, communicated with the previous auditor enquiring as to whether any professional reason exists for which he should not accept the audit assignment. Previous auditor informed that he issued a qualified report, so management is changing the auditor. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto as to whether Vineet & Associates can accept the audit.

Answer:

Provisions of the Chartered Accountants Act, 1949 and Schedules thereto -

As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be 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.

The professional reasons for not accepting an audit would be:

- (a) Non-compliance of the provisions of Sections 139 and 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The Chartered Accountants Act, 1949; and
- (b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; and
- (c) Issuance of a qualified report.

There is no rule, written or unwritten, which would prevent an auditor from accepting the appointment offered to him under the circumstance of Issuance of qualified report. However, before accepting the audit, he should ascertain the full facts of the case. For nothing will bring the profession to disrepute so much as the knowledge amongst the public that if an auditor is found to be "inconvenient" by the client, he could readily be replaced by another who would not displease the client and this point cannot be too over-emphasised.

From the above it can be concluded that Vineet & Associates may accept the audit of TLP Ltd if CA V is satisfied that the attitude of the retiring auditor was not proper and justified. If, on the other hand, CA V feels that the retiring auditor had qualified the report for good and valid reasons, he should refuse to accept the audit of TLP Ltd.

Q14. Exam July 2021, 4 marks

M/s. SR & Associates is one of the three firms shortlisted by ARG Cooperative Bank for assignment of Statutory Audit for the F.Y 2020-2021. Bank mailed the list of branches to the audit firms along with the maximum fee per branch and asked them to submit the quotations. SR & Associates responded to the bank and submitted their quotation. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

Provisions of the Chartered Accountants Act, 1949 and Schedules thereto -

As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he Solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Provided that nothing herein contained shall be construed as preventing or prohibiting -

- (i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or
- (ii) A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.

However, as per the guideline issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services.

However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the given case of ARG Cooperative Bank, Bank mailed the list of branches to the audit firms along with maximum fees per branch, in response to which SR & Associates responded and submitted their quotation.

Keeping in view the facts, clause 6 and guideline issued by the council, it can be concluded that SR & Associates is guilty of Professional misconduct.

Q15. Exam Jan 2021, 4 marks

Nam & Co., conducted Stock Audit of DEF Ltd. as per instructions issued by HEG Bank. However instead of visiting the site where the stock was lying, the firm relied on the Management Information Systems report along with inspections reports and photographs of Stock taken by the employees of DEF Ltd. The photographs were also carrying the date and time printed on them. Comment with reference to the Chartered Accountants Act, 1949 and its schedules thereto.

Answer:

According to Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties".

It is a vital clause which usually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

In the instant case, CA. Nam & Co. did not exercise due diligence and is grossly negligent in the conduct of his professional duties since it did not visit the site where the stock was lying and instead the firm relied on the MIS report along with inspection reports and photographs of stock taken by the employees of DEF Ltd, which is incorrect.

To conduct stock audit, ascertainment of existence and physical condition of stocks, cross tallying the stock with Stock statement submitted by bank borrower, correct classification of stocks for valuation purpose etc. is essential. Further submitting stock audit report without physically verifying the stock amounts to gross negligence.

From the above, it can be concluded that Nam & Co. is guilty of professional misconduct under Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Q16. Exam Jan 2021, 4 marks

CA N was appointed as an auditor of JAL Ltd. The company has branches all over the state of Haryana. CA N, in consultation with management, decided to Visit 6 out of 10 branches. Management decided to pay him advance of Rs.2.00 Lacs against the estimated expenses of Rs.2.50 Lacs on visits to be conducted as a part of services rendered. As agreed, Rs. 2.00 Lacs was transferred in his bank account from which he met all the expenses. Comment with reference to Chartered Accountants Act, 1949 whether the action of CA N of receiving the advance money in his saving accounts and not keeping it in separate bank account is valid.

Answer:

As per Clause (10) of Part I of Second Schedule to the Chartered Accountant Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he fails to keep moneys of his client other than the fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilize such funds only in accordance with the instructions of the client or for the purposes intended by the client.

In this connection the Council has considered some practical difficulties of the members and the following suggestion, among other suggestions, has been made to remove these difficulties:

"An advance received by a Chartered Accountant against services to be rendered does not fall under Clause (10) of Part I of the Second Schedule"

In the given case, CA N was given an advance of Rs.2 Lakhs against the estimated expenses of Rs.2.50 Lakhs on visits to be conducted as a part of services rendered.

Applying the above, it can be concluded that CA N is not guilty of professional misconduct under Chartered Accountants Act, 1949.

Q17. Exam Jan 2021, 4 marks

CA AB, a practicing chartered accountant, is a promoter director of ABG Pvt. Ltd. and moreover he is also a sleeping partner in his family business of garments manufacturing firm. Is CA. AB liable for professional misconduct as per Chartered Accountant Act 1949?

Answer:

Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. Promoter/Promoter Director - There is no bar for a member to be a promoter / signatory to the Memorandum and Articles of Association of any company. There is also no bar for such a promoter / signatory to be a Director Simplicitor of that company irrespective of whether the object of the company include areas which fall within the scope of the profession of chartered accounts. Therefore, members are not required to obtain specific permission of the Council in such cases.

Sleeping partner in the family business-

Prior Approval - Members of the Institute in practice may engage in the following category, among other points, of business or occupations, after obtaining the specific and prior approval of the Council in case of:

Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken. In the given case, CA AB is a promoter director of ABG Pvt Ltd and also he is a sleeping partner in his family business of garments manufacturing firm. Applying the above to the given case, it can be concluded that-CA AB:

- As Promoter Director- Not guilty of professional misconduct under Chartered Accountants Act, 1949
- As Sleeping Partner- guilty of professional misconduct under Chartered Accountants Act, 1949 as he did not obtain prior approval of the Council.

Q18. Exam Nov 2020, 4 marks

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto:

CA Dice had signed the Balance sheet of QR Ltd. for the year ended 31st March, 2019 which failed to give disclosure of the charge created for Rs.4.35 crores against the Corporate Guarantee given in favour of a Group Company. The Balance Sheet size of the company filed with the Registrar of Companies was Rs. 26.12 crores.

Answer:

Failure to Disclose Material Facts: As per Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement not misleading where he is concerned with that financial statement in a professional capacity.

It may be observed that this clause refers to failure to disclose a material fact, which is known to him, in a financial statement reported on by the auditor. It is obvious, that before a member could be held guilty of misconduct, materiality has to be established. The determination of materiality has been provided in SA 320, "Materiality in Planning and Performing an Audit".

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain, among other points, that

Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both.

In this case, CA Dice has signed a Balance Sheet which failed to give disclosure of ₹ 4.35 crores (considered material fact applying above SA 320 principle) against the corporate guarantee given in favour of a Group Company. Size of Balance Sheet of QR Ltd is ₹ 26.12 crore.

This material fact has to be disclosed in the financial statements. Keeping in view the above, he is attracted by the provisions of professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Q19. Exam Nov 2020, 4 marks

Mr. Kushal, a practicing Chartered Accountant has signed the GST Audit Reports, Tax Audit Reports u/s 44AB of the Income tax Act, 1961 for the financial year 2019 -20 that are filed online using Digital Signature and without generating UDIN on the ground that there is no field for mentioning UDIN on digitally signed online reports. Is the contention of Mr. Kushal valid? Give your comments with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

Non Generation of UDIN: Whereas, to curb the malpractice of false/certification/attestation by the unauthorized persons and to eradicate the practice of bogus certificates and to save various regulators, banks, stakeholders etc. from being misled, the Council of the Institute decided to implement an innovative concept to generate Unique Document Identification Number (UDIN) mandatorily for all kinds of the certificates/GST and tax audit reports and other attest function in phased manner, for which members of the ICAI were notified through the various announcements published on the website of ICAI at the relevant times.

In exercise of the powers conferred on it under clause 1 of Part II of the Second Schedule to the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India issued the following guidelines for information of public and necessary compliance by members of the Institute-

A member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him which are made mandatory from the following dates through announcements published on the website of the ICAI-

- For all Certificates w.e.f. 1st February, 2019.
- For all GST and Tax Audit Reports w.e.f. 1st April, 2019.
- For all other Audit, Assurance and Attestation functions, w.e.f. 1st July, 2019.

Conclusion: UDIN will be applicable to GST & Tax Audit Reports signed by Mr. Kushal for the financial year 2019-20 that are filed online using Digital Signature. In case where there is no field for mentioning UDION on digitally signed online reports, UDION has to be generated and communicated to "Management" or "Those Charged with Governance" for disseminating it to the stakeholders from their end.

Hence he will be held guilty under Clause 1 of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

Alternative Answer

According to Clause (9) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available

in general terms from the various pronouncements of the Institute is issued by way of statements and Guidance Notes and SAs to members.

A member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him.

In the given case, Mr. Kushal has signed the GST Audit Reports, Tax Audit Reports under section 44AB of the Income Tax Act, 1961 for the F.Y.2019 -20 and also has filed online using Digital Signature without generating UDIN on the ground that there is no field for mentioning UDIN on digitally signed online reports. Applying the above clause, UDIN provision etc. to the given case, Mr. Kushal would be held guilty of professional misconduct.

Q20. Exam Nov 2020, 4 marks

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: Mr. Vineet, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in purple colour. The website also displayed the nature of assignments handled along with the names of clients without such requirement from any of the regulator. He also circulated the information contained in the website through e-mail to acknowledge public at large about his expertise. However, he did not intimate his website address to the Institute.

Answer:

circulating Information Contained in Own Website: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

1. However, the guidelines approved by the Council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. Hence there is no misconduct as per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
2. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request. Mr. Vineet has circulated the information contained in the website through e-mail to public at large. Therefore, he is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the said Act.
3. Nature of assignments handled (to be displayable only on specific "pull" request). Names of clients and fee charged cannot be given without such requirement from any of the regulator. Mr. Vineet has displayed the nature of assignments handled along with the name of clients without such requirement from the regulator. Therefore, he is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the said Act.
4. "The website address of the member be obtained on annual basis in the annual form required to be filed by the member while paying fee and the same be taken as entry on record." Thus guilty of professional misconduct

Q21. Exam Nov 2019, 4 marks

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: A special notice has been issued for a resolution at 3rd annual general meeting of LED Ltd., providing expressly that CA. Anoop shall not be re-appointed as an auditor of the company. Consequently, CA. Anoop submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Anoop included the contributions made by him in

strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company.

Answer:

Soliciting Clients: As per Clause (6) 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 solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re-appointed by the shareholders.

The proposition of the auditor to highlight contributions made by him in strengthening the control procedures in the representation should not be included in such representations because the representation letter should not be prepared in a manner so as to seek publicity.

Thus, highlighting contributions made by him in strengthening the control procedures, while submitting representation U/S 140(4)(iii) of the Companies Act 2013, would amount to canvassing or soliciting for his continuance as auditor.

Therefore, CA. Anoop will be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Q22. Exam Nov 2019, 5 marks

Mr. 'K', a practicing Chartered Accountant is the proprietor of M/s K & Co. since 1995. He went abroad in the month of December 2018. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee for taking care of the important matters of his office. During his absence Mr. 'Y' has conducted the undermentioned jobs in the name of M/s K & Co.

- (i) He issued Net worth certificate to a client for furnishing to a Bank.
- (ii) He attended the GST proceedings for a client as authorized representative before GST Authorities.

Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s K & Co. and liability of Mr. 'K' under the Chartered Accountants Act, 1949.

Answer:

Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA. 'K' proprietor of M/s K & Co., went abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of the important matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit,

asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- (i) In the given case, Mr. 'Y', a chartered accountant being employee of M/s K & Co. has issued net worth certificate for furnishing to a bank. Since the issuance of net worth certificate to a client by Mr. "Y" being an employee of M/s K& Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA. 'K' is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.
- (ii) Further, Mr. "Y", CA employee of the audit firm M/s K& Co. has attended the GST proceedings for a client as authorized representative before GST Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

Q23. Exam Nov 2019, 5 marks

Mr. 'C', a Chartered Accountant employed as Senior executive in charge of Tax in a company, and not holding certificate of practice recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from the employer of Mr. 'C' paid a particular sum as referral fee to Mr. 'C'. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

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. C who beside holding a certificate of practice, is also an employee and by referring a lawyer to the company in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.

Conclusion: Therefore, Mr. C is guilty of professional misconduct by virtue of Clause (2) of Part II of First schedule

Q24. Exam May 2019, 4 marks

CA Natraj, in practice, accepted an assignment as advisor and consultant to the public issue of shares by his client M/s Super Ltd.

Besides helping the company as an advisor, he also underwrote the public issue of the company to the extent of 25% at a commission of 1%. Remaining shares were underwritten by banks and other financial institutions at the same rate of commission. He contends that above assignments are part of management consultancy work permitted by the council of the Institute. Do you agree with the view of CA Natraj? Decide in the light of applicable code of conduct.

Answer:

Assignment as Advisor and Consultant: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a

resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

In the instant case, CA Natraj accepted an assignment as advisor and consultant to the public issue of shares by his client M/s Super Ltd. In addition, he also underwrote the public issue of the company to the extent of 25% at a commission of 1%. Contention of CA. Natraj that advisor, consultant and underwriting work is part of management consultancy work and permitted by the council is not correct as Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

Conclusion: In view of this, CA. Natraj would be guilty of misconduct under the Chartered Accountants Act, 1949.

Q25. Exam May 2019, 4 marks

CA Sant, a newly qualified professional with certificate of practice, approached CA Pant, the auditor of his father's company M/s Max Ltd., to allow him to have some practical and professional knowledge and experience in his firm before he can set up his own professional practice. CA Pant allowed him to sit in his office for 6 month and allotted a small chamber with other office infrastructure facility. In the course of his association with CA Pant's office, he used to provide tax consultancy independently to the client of the firm and also filed few IT and GST return and represented himself before various tax authorities on behalf of the firm although no documents were signed by him. During his association in CA Pant's office, he did not get any salary or share of profit or commission but only re-imbursement of usual expenses like conveyance, telephone etc. was made to him. After the end of the agreed period, he was given a lump sum amount of ₹ 3,00,000 by CA Pant for his association out of gratitude.

Examine the case in the light of code of professional misconduct.

Answer:

Clause (1) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner, or his employee and would work under his control and supervision.

In the instant case, CA Pant allowed CA Sant (who is a newly qualified CA professional with COP) to sit in his office for 6 months, and allowed him to provide tax consultancy independently to his firm's clients, filing of some IT and GST Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA Sant was only reimbursed with his usual expenses and was not paid any salary or share of profit for the same. However, after the end of agreed period he was given a lump-sums of rupees 3,00,000 for his association out of gratitude.

Thus, in the present case CA. Pant will be held guilty of professional misconduct as per Clause (1) of Part I of First Schedule to the Chartered Accountants Act, 1949 as he allowed CA Sant to practice in his name as Chartered accountant and CA Sant is neither in partnership nor in employment with CA. Pant.

Q26. RTP May 2023

Mr. S is a practising chartered accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper - setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members).

Answer:

Given situation can be visualised in following parts:

(A) Mr S used to involve himself in equity research and used to advise his friends, relatives and other known people: As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation. In the given case, though Mr S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr S shall not make him guilty of professional misconduct.

(B) Mr S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities: As per Clause 11 of Part I of First Schedule of Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include:

- Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination.
- Owning agricultural land and carrying out agricultural activities.

Therefore, in the given case, the activities of Mr S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct.

(C) Mr. S was discharged insolvent: Disabilities for the Purpose of Membership : Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period.

In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council.

In the given case, it is clearly stated that Mr S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr S has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.

Q27. RTP Nov 2023

Comment on the following scenario with reference to the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto.

Statutory Audit of Arihant Limited for the year 2021-22 was done by CA Acharya. Arihant Limited was in existence since 2010. The relevant extract from books of account of Arihant Limited are as below:

Particulars	As at 31.03.2023 (Rs. in lakh) (Unaudited)	As at 31.03.2022 (Rs.in lakh) (Audited)
Equity Share Capital	5.00	5.00
Reserve and Surplus	(10.00)	(8.00)
Provision for Audit Fees	For FY 2021-22- 1.00 For FY 2022-23- 1.00	1

CA. Nemi accepted the Statutory Audit of Arihant Limited for the year 2022-23 in spite of the fact that as on date of acceptance by CA Nemi, the audit fees of CA Acharya was unpaid.

Answer:

As per Chapter VII of Central Council Guidelines 2008, a member of the Institute in practice shall not accept the appointment as auditor of an entity in case the undisputed audit fee of another Chartered Accountant for carrying out the statutory audit under the Companies Act, 2013 or various other statutes has not been paid:

Provided that in the case of sick unit, the above prohibition of acceptance shall not apply where a sick unit is defined to mean "where the net worth is negative as at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

As Explanation 1 of the Chapter VII of Central Council Guidelines 2008, for the purpose, the provision for audit fee in accounts signed by both — the auditee and the auditor along with other expenses, if any, incurred by the auditor in connection with the audit, shall be considered as "undisputed audit fees".

In the instant case, though the undisputed fees are unpaid, CA Nemi would still not be guilty of professional misconduct since the Arihant Limited is a sick unit having negative net worth for the year 2022-23.

Q28. RTP Nov 2023

CA Sumati is a practicing chartered accountant having office in Mumbai. CA Sumati is owner of domain cap.net. In order to generate additional revenue CA Sumati sold this domain name to XYZ Limited for earning royalty of Rs.2,25,000. One of the directors of XYZ Limited contended that CA Sumati has violated the Code of Conduct. CA Sumati responded that there is no violation of Code of Conduct as selling of domain name is not related to any professional assignment which requires approval of the Institute.

Answer:

As per Clause (11) of Part I of Schedule I to the Chartered Accountants Act, 1949, a member in practice is deemed to be guilty if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being a managing director or a whole-time director) unless he or any of his partners is interested in such company as an auditor.

As per Regulation 190A, a chartered accountant in practice not to engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council.

In the given case, CA Sumati is a practicing chartered accountant having office in Mumbai. CA Sumati is owner of domain cap.net. In order to generate additional revenue, CA Sumati sold this

domain name for earning royalty of ₹ 2,50,000 to XYZ Limited. One of the directors of XYZ Limited contended that CA Sumati has violated the Code of Conduct. CA Sumati responded that there is no violation of Code of Conduct as selling of domain name is not related to any professional assignment which requires approval of the Institute. As per Regulation 190A, the activity of selling domain name for earning Royalty would amount to "other business/occupation" without approval is prohibited.

Hence, CA Sumati is guilty of professional misconduct under Clause 11 of Part I of Schedule I to the Chartered Accountants Act, 1949 for selling domain name for a royalty.

Q29. RTP Nov 2022

Comment on the following with reference to the with reference to the Chartered Accountants Act, 1949 and Schedules thereto:

- (a) CA Dev started practice in Punjab in the year 2019. CA Dev issued 'Turnover Certificate' for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of availing cash credit facility and machinery term loan. Brother of CA Dev was proprietor of M/s. ASAUS Traders.
- (b) Aagam Private Limited requested CA Sheetal, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied and pasted by another Director of Aagam Private Limited. CA Sheetal, without verifying the genuineness of the resignation letter, digitally signed the form and the said form was uploaded on the website of Registrar of Companies.

Answer:

- (a) As per Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Further, it is not permissible for a member to undertake the assignment of certification, wherein the client is relative of the member. The "relative" for this purpose would refer to the definition mentioned in Accounting Standard (AS) - 18.

In the given situation, CA Dev started practice in Punjab in the year 2019. CA Dev issued Turnover certificate for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of obtaining Loan. Brother of CA Dev is proprietor of M/s. ASAUS Traders. Brother is very well covered in the definition of relative mentioned in Accounting Standard (AS)-18.

Hence, CA Dev is guilty of professional misconduct.

- (b) As per Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he does not exercise due diligence or is grossly negligent in the conduct of this professional duties.

In the given case, Aagam Private Limited requested CA Sheetal, a practicing chartered accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied and pasted by another Director of Aagam Private Limited.

CA Sheetal, without verifying the genuineness of the Resignation Letter, digitally signed the Form and the said form was uploaded on the website of Registrar of Companies.

Due to forged resignation letter, the resignation of Mr. Rohit from directorship of the Aagam Private Limited had been occurred. It was noted that CA Sheetal had not taken any step to verify forged signature on resignation letter which anyone would have taken in normal circumstances. Consequently, CA. Sheetal would be held liable for professional misconduct as per Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Q30. RTP May 2022

(a) Mr. Avi, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. Ravi gave him an idea to start online services and give stock certifications to traders with Cash Credit Limits in Banks. Mr. Avi started a website with colourful catchy designs and shared the website address on his all social media posts and stories and tagged 40 traders of his local community with the caption "Simple Online Stock Certification Services". Besides, Mr. Avi entered into an agreement with a Digital Marketer to give him 8% commission on each service procured through him. Discuss if the actions of Mr. Avi are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.

(b) CA Sheetal is contesting Central Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period. Comment on the action of CA. Sheetal with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

- (a) As per Clause (6) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Mr. Avi is wrong in seeking clients through family and friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines.

In the given situation, Mr. Avi shared the website address on his all social media posts and stories and tagged 40 traders of his local community with the caption "Simple Online Stock Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on the website issued by the ICAI.

Thus, CA, Avi would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

- (b) Other Misconduct: CA Sheetal has engaged his Articled Assistant for his election campaigning for the Central Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work. This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'.

Hence, CA Sheetal is guilty of 'Other Misconduct'.

Q31. RTP May 2022

Write a short note on the following:

- (a) Reporting in case the parent company's auditor is not the auditor of all its components.
- (b) Relationship between the overall audit strategy and the audit plan.

Answer:

(a) Reporting in case the Parent Company's Auditor is not the Auditor of all its Components: In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of SA 600.

As prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s).

This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidation adjustments.

Reference in the report of the auditor on the consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its subsidiaries.

- b. Relationship between the Overall Audit Strategy and the Audit Plan: The audit strategy is prepared before the audit plan. The audit plan is more detailed than the overall audit strategy. Audit strategy and audit plan are inter-related because a change in one would result into a change in the other. The audit strategy provides the guidelines for developing the audit plan. It establishes the scope and conduct of the audit procedures and thereby, works as a basis for developing a detailed audit plan. Detailed audit plan would include the nature, timing and extent of the audit procedures so as to obtain sufficient appropriate audit evidence.

The overall audit strategy & Audit plan should take into consideration the element of materiality and its relationship with Risks & procedures to be adopted. It is summarized as under:-

High Materiality	Detailed Procedures	High Risks
Low Materiality	Test Checks	Low Risks

Q32. RTP Nov 2021

The Director (Discipline) of the ICAI received information of alleged misconduct against Mr. Jayprakash, the proprietor of JP & Associates, as follows:-

- (i) Audit of a college was accepted by JP & Associates in which Mr. Jayprakash is working as a part-time lecturer and also, he had not taken permission of the ICAI for working as a part-time lecturer in the college.
- (ii) An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor, JP & Associates' was mentioned.

On the basis of above information and along with certain evidence against Mr. Jayprakash, he was found guilty and so he was reprimanded and a fine of ₹ 1 lakh was imposed by an order passed against him dated 12th July, 2020.

Against the said order, Mr. Jayprakash preferred an appeal with the Appellate Authority on 17th August, 2020 by submitting a statement of appeal along with the application form of appeal.

During such appellate proceedings, it was discovered that the said statement of appeal contained some facts which were false to which Mr. Jayprakash admitted it to be false and apologized for it.

(a) Mr. Jayprakash has violated which of the provisions of the Chartered Accountants Act, 1949?

(b) Before which authority, the matter of Mr. Jayprakash would have been placed and what maximum punishment could have been imposed on him by the said authority in accordance with the Chartered Accountant Act, 1949?

Answer:

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

(i) As per Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

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

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

(ii) As per Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.

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

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

(iii) As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

In this connection, members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, mentioning a firm's name or CA Logo is not permitted.

An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor, JP & Associates' was mentioned. Thus, firm's name was mentioned which is not allowed and thus, Mr. Jayprakash has violated the restriction imposed under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

- (iv) As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the ICAI shall be deemed to be guilty of professional misconduct, if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority, any particulars knowing them to be false.

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

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

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

- (i) reprimanding the member.
- (ii) removing name of the member permanently or for any duration, it thinks fit.
- (iii) imposing fine upto ` 5,00,000.

Q33. RTP Nov 2020

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (c) CA. Srishti and CA. Mishti are two partners of the CA firm 'Srishti Mishti & Associates'. Being very pious, CA. Srishti organised a religious ceremony at her home for which she instructed her printing agent to add her designation "Chartered Accountant" with her name in the invitation cards. Later on, the invitations were distributed to all the relatives, close friends and clients of both the partners.
- (d) Ms. Preeto, a CA, had an account with a bank. The normal balance in this account remained at a level below Rs.5,000. The bank inadvertently credited this account with a cheque of Rs.2,70,000 belonging to another account holder. When CA. Preeto came to know about this she withdrew the amount of Rs.2,75,000 and closed the bank account. After 1 year the bank noticed the mistake and claimed Rs.2,75,000 with interest. CA. Preeto contested this claim. Can the bank approach the Institute of Chartered Accountants of India for disciplinary action against CA. Preeto?
- (e) CA. Moni is practicing since 2009 in the field of company audit. Due to her good practical knowledge, she was offered editorship of a 'Company Audit' Journal which she accepted. However, she did not take any permission from the Council regarding such editorship.

Answer:

- (a) Printing of Designation "Chartered Accountant" on Invitations for Religious Ceremony: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.
- However, the Council of the ICAI is of the view that the designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards, invitations for marriages, religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned.

In the given case, CA. Srishti has instructed to write designation "Chartered Accountant" on invitation cards for a religious ceremony and distributed the same to all the relatives, close friends and clients of both the partners.

In this context, it may be noted that the Council has allowed using designation "Chartered Accountant" in invitations for religious ceremony, provided these are sent to clients, relatives and close friends of the members concerned only.

Therefore, CA. Srishti would be held guilty of professional misconduct under the said clause for sending such invitations to the relatives, close friends and clients of CA. Mishti as well.

- (b) Disrepute to the Profession: As per Clause 2 of Part IV of First Schedule of the Chartered Accountant Act, 1949, a Chartered Accountant will be deemed to be guilty of other misconduct if he in the opinion of the Council brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

In the instant case, CA. Preeto, a CA, had an account with a bank from which she withdrew the amount of ₹ 2,75,000 and closed the account. This amount of ₹ 2,75,000 was pertaining to ₹ 5,000 minimum balance and ₹ 2,70,000 belonging to other account holder and inadvertently credited to his account by the bank. The said act of CA. Preeto to withdraw the money which does not belong to her will bring disrepute to the profession. Hence under this clause the bank can file a suitable complaint under Clause 2 of Part IV of First Schedule of the Chartered Accountant Act, 1949 with the Institute of Chartered Accountants of India.

- (c) Permission from the Council: As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In the instant case, CA. Moni accepted editorship of a journal for which she did not take any permission from the Council. In this context, it may be noted that the editorship of professional journals is covered under the general permission and specific permission is not required.

Therefore, CA. Moni shall not be held guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Q34. RTP Nov 2020

Write a short note on the following:

- (a) Classification of frauds by NBFC.
- (b) General steps in the conduct of risk based audit.
- (c) Contents of an audit plan.

Answer:

- (a) Classification of Frauds by NBFC: In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

- (i) Misappropriation and criminal breach of trust.
- (ii) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- (iii) Unauthorised credit facilities extended for reward or for illegal gratification.
- (iv) Negligence and cash shortages.
- (v) Cheating and forgery.
- (vi) Irregularities in foreign exchange transactions.
- (vii) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

- (i) cases of cash shortages more than Rs.10,000/- and
 - (ii) cases of cash shortages more than Rs,5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.
- (a) General Steps in the Conduct of Risk Base Audit: RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable level and the reporting to auditee of audit results. These are achieved through the following:

Step 1 Understand auditee operations to identify and prioritize risks: Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

Step 2 Assess auditee management strategies and controls to determine residual audit risk: Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.

Step 3 Manage residual risk to reduce it to acceptable level: Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.

Step 4 Inform auditee of audit results through appropriate report: The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of internal controls that affect the organization's ability to record, process, summarize and report financial data.



(b) Contents of an Audit Plan: The auditor shall develop an audit plan that shall include a description of-

- (i) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- (ii) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".
- (iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

Q35. RTP May 2020

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) OPAQ & Associates, a firm of Chartered Accountants responded to a tender issued exclusively for Chartered Accountants by an organisation in the area of tax audit. However no minimum fee was prescribed in the tender document.
- (b) Agarwal Pvt Ltd. approached CA. Prem, a Chartered Accountant in practice, for debt recovery services. CA Prem accepted the work and insisted for fees to be based on 2% of the debt recovered.
- (c) ABZ & Co., a firm of Chartered Accountants, develops a website "abz.com". The colour chosen for the website was a very bright green and the web-site was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator.
- (d) Mr. P and Mr. Q are running a firm of Chartered Accountants in the name of PQ & Co. On 23.05.2019, they included the name of Mr. R, a practicing Chartered Accountant, without his knowledge, as a partner while submitting an application for empanelment as auditor for branches of a public sector bank, to the Institute. However, they added Mr. R as a partner to their firm offering a share of 25% of the profits, on 25.05.2019.

Answer:

- (a) Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. It states that a member may respond to

tenders or enquiries issued by various users of professional services or organizations from time to time and secure professional work as a consequence.

However, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for Chartered Accountants, such as audit and attestation services. Though, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the instant case, OPAQ & Associates responded to a tender of tax audit which is exclusively reserved for Chartered Accountants even though no minimum fee was prescribed in the tender document.

Therefore, OPAQ & Associates shall be held guilty of professional conduct for responding to such tender in view of above-mentioned guideline.

- (b) Charging of Fees based on Percentage: Clause (10) of Part I to First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.

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 debt recovery services where fees may be based on a percentage of the debt recovered.

In the given case, CA. Prem has insisted for fees to be based on percentage of the debt recovered (which is exempted under Regulation 192). Hence, CA. Prem will not be held guilty for professional misconduct.

- (c) Posting of Particulars on Website: The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause

(6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by ABZ & Co. are:

- No restriction on the colours used in the website;
- The websites are run on a “pull” technology and not a “push” technology
- Names of clients and fees charged not to be given.

However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that “This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].

In view of the above, ABZ & Co. would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

- (d) Submitting Wrong Information to the Institute: As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

In the instant case, Mr. P and Mr. Q, partners of PQ & Co., included the name of Mr. R, another Chartered Accountant, as partner in their firm, without his knowledge, in their application for empanelment as auditor of branches of Public Sector Banks submitted to the Institute. However, such a member was not a partner of the said firm as on the date of application submitted. Here, Mr. P and Mr. Q have submitted wrong information to the Institute.

Therefore, Mr. P and Mr. Q, both, would be held guilty of professional misconduct under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

Q36. RTP May 2020

Write a short note on the following:

- (a) "Mandatory Review" areas of the audit committee.
- (b) Understanding and documenting automated environment

Answer:

- (a) Mandatory Review Areas of the Audit Committee: The Audit Committee shall mandatorily review the following information as per LODR Regulations-
- (i) Management discussion and analysis of financial condition and results of operations;
 - (ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
 - (iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
 - (iv) Internal audit reports relating to internal control weaknesses; and
 - (v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.
 - (vi) Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.
- (b) Understanding and Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:
- The applications that are being used by the company;
 - Details of the IT infrastructure components for each of the application;
 - The organisation structure and governance;
 - The policies, procedures and processes followed;
 - IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230.

Q37. RTP Nov 2019

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) Mr. 'A' is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee, for taking care of routine matters of his office. During his absence, Mr. 'Y' has conducted the under mentioned jobs in the name of M/s A & Co.:
- (i) He issued the audit queries to client which were raised during the course of audit.
 - (ii) He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.

Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s A & Co. and liability of Mr. 'A' under the Chartered Accountants Act, 1949.

- (b) M/s Amudhan & Co., a firm of Chartered Accountants, received ` 2.8 lakhs in January, 2019 on behalf of one of their clients, who has gone abroad and deposited the amount in their Bank account, so that they can return the money to the client in July, 2019, when he is due to return to India.
- (c) CA Raman who is contesting Regional Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period.
- (d) Mr. Anil, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.

Answer:

- (a) Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA. 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

1. In the given case, Mr. 'Y', a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here "Y" is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
2. In this instance, Mr. "Y", CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of

Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

- (b) Money of Clients to be Deposited in Separate Bank Account: Clause (10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended".

In the given case, M/s Amudhan & Co. received the money in January, 2019 which is to be paid only in July 2019, hence, it should be deposited in a separate bank account. Since in this case M/s Amudhan & Co. has failed to keep the sum of ₹ 2.8 lakhs received on behalf of their client in a separate Bank Account, it amounts to professional misconduct under Clause (10) of Part I of Second Schedule.

- (c) Other Misconduct: CA Raman has engaged his Articled Assistant for his own election campaigning for the Regional Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work. This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'.

Hence, CA Raman is guilty of 'Other Misconduct'.

- (d) Not Exercising Due Diligence: According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard, he was guilty of professional misconduct under Clause (7).

Since, Mr. Anil has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Q38. RTP Nov 2019

Write a short note on the following:

- (a) Auditor's objectives in an audit of consolidated financial statements.
- (b) Areas of propriety audit under Section 143(1) of the Companies Act, 2013.

- (c) Auditor's considerations while reviewing of Investment Department of Life Insurance Company.
- (d) State whether a Tax audit report can be revised and if so state those circumstances.

Answer:

The auditor's objectives in an audit of consolidated financial statements are:

- (i) to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of applicable financial reporting framework;
 - (ii) to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements;
 - (iii) to enquire into the matters as specified in section 143(1) of the Companies Act, 2013; and.
 - (iv) to report on the matters given in the clauses (a) to (i) of section 143(3) of the Companies Act, 2013, for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014, to comment on the matters specified in sub-rule (a),(b) and (c)1 to the extent applicable;
 - (v) The auditor should also validate the requirement of preparation of CFS for the company as per applicable financial reporting framework.
- (a) Areas of propriety audit under Section 143(1): Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to -
- (i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
 - (ii) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made;
 - (iii) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
 - (iv) whether loans and advances made by the company have been shown as deposits;
 - (v) whether personal expenses have been charged to revenue account;
 - (vi) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.
- A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.
- (b) Role of Auditor: The Auditor during his review of Investment Department of Life Insurance Company should mainly consider the following:
- Review the Investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office.
 - Review of insurer's Standard Operating Procedures which are prescribed by the IRDA Regulations and are required to cover the entire gamut of investment related processes and policies.
 - Review of insurer's Investment policy.

- Review of functioning and scope and minutes of Investment Committee.
- Compliance of all Investment regulations, various other circulars specified by IRDA and other regulations specified in the Insurance Act, 1938.
- Review of insurer's Disaster Recovery, Backup and Contingency Plan.
- Review of access Controls, authorization process for Orders and Deal execution, etc.
- Review of insurer's Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer's system should be able to determine the amount of Investible surplus.
- Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments.
- Review of fund wise reconciliation with Investment Accounts, Bank, and Custodian records.
- Ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life (Participating & Non-Participating), Pension & Group (Participating & Non-Participating) and Unit Linked Fund.
- Review the arrangements and reconciliations of holdings with the insurer's custodian.
- Review and check insurer's Investment Accounting and valuation policy and the controls around this process.
- insurer's risk management policies and processes to manage investment risk such as Market risk, Liquidity risk, Settlement risks, etc.
- Determine the extent of activities outsourced and the controls over such activities.
- Controls over NAV computation and declaration.
- Controls over various system interfaces such as Seamless integration of data, between front office and back office, in the Investments accounting system.
- Flow of data from PMS to the Investment Accounting system.
- Controls around personal dealings, insider trading and front running.

(c) Revision of Tax Audit Report:

- (1) Normally, the report of the tax auditor cannot be revised later.
- (2) However, when the accounts are revised in the following circumstances, the tax Auditor may have to revise his Tax audit report also.
 - (i) Revision of accounts of a company after its adoption in the annual general meeting.
 - (ii) Change in law with retrospective effect.
 - (iii) Change in interpretation of law (e.g.) CBDT Circular, Notifications, Judgments, etc.

The Tax Auditor should state it is a revised Report, clearly specifying the reasons for such revision with a reference to the earlier report.

Q39. RTP May 2019

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) Mr Bold, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in blue colour. He also circulated the information contained in the website through E-mail to acknowledge public at large about his expertise. However, due to shortage of time, he could not intimate his website address to the Institute.
- (b) The manager of ZedEx (P) Ltd. approached CA. Vineet in the need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA.

Vineet issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute.

- (c) WCP & Co LLP are the internal auditors of DEF Ltd. WCP & Co LLP also agreed to undertake Goods and Service Tax (GST) Audit of DEF Ltd simultaneously.
- (d) Mr. M, a Chartered Accountant in practice, has printed visiting cards which besides other details also carries a Quick Response (QR) code. The visiting card as well the QR code contains his name, office and residential address, contact details, e-mail id and name of the firm's website.

Answer:

- (a) **Circulating Information Contained in Own Website:** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the guidelines approved by the Council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request.

Further, members are not required to intimate the Website address to the Institute. Members are only required to comply with the Website Guidelines issued by the Institute in this regard.

In the given case, Mr. Bold has circulated the information contained in the website through E-mail to public at large. Therefore, he is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the said Act. However, there is no such misconduct for not intimating website address to the Institute.

- (b) **Issuing Certificate without having Certificate of Practice:** As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, CA. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, CA. Vineet will be held guilty of professional misconduct in terms of Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

- (c) The Council of the Institute, while considering the issue whether an internal auditor of an entity can also undertake GST Audit of the same entity as required under the Central Goods and Service Act, 2017, decided, that internal auditor of an assessee, whether working with the organization or independently practising Chartered Accountant being an individual chartered accountant or a firm

of chartered accountants, cannot be appointed as his Tax auditor (under the Income Tax Act, 1961). Upon consideration, the Council decided that based on the conflict in roles as statutory and internal auditor simultaneously, the bar on internal auditor of an entity to accept tax audit (under Income Tax Act, 1961) will also be applicable to GST Audit (under the Central Goods and Service Act, 2017). Accordingly, an Internal Auditor of an entity cannot undertake GST Audit of the same entity.

In the instant case, WCP & Co LLP are the internal auditors of DEF Ltd. and it also agreed to undertake Goods and Service Tax (GST) Audit of DEF Ltd simultaneously. WCP & Co LLP will be held guilty for misconduct.

- (d) Printing of QR Code on Visiting Cards: As per Clause (7) 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 advertises his professional attainments or services.

Ethical Standards Board has also clarified that a member in practice is allowed to print Quick Response Code (QR Code) on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card.

In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice.

Thus, Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Q40. RTP Nov 2018

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) CA Kumar who is contesting Central Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period.
- (b) A Chartered Accountant in practice, empanelled as IP (Insolvency Professional) has mentioned the same on his visiting cards, letter heads and other communications also. Mr. A, who is residing in his neighbourhood has filed a complaint for professional misconduct against the said member for such mention of insolvency professional on circulations.
- (c) Mr. P, a Chartered Accountant in practice entered into a partnership with Mr. L, an advocate for sharing of fees for work sent by one to the other. However, due to some disputes, the partnership was dissolved after 1 month without any fees having been received.
- (d) Mr. D, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.

Answer:

- (a) Other Misconduct: CA Kumar has engaged his Articled Assistant for his own election campaigning for the central Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does

not arise out of his professional work This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'.

Hence, CA Kumar is guilty of 'Other Misconduct'.

- (b) As per the Clause 7 of Part 1 of the First Schedule, if any Chartered Accountant advertises his professional attainments or services, or uses any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the ICAI of any other institution that has been recognized by the Central Government or may be recognized by the council, will be guilty of professional misconduct.

Here A Chartered Accountant empanelled as IP (Insolvency Professional) can mention 'Insolvency Professional' on his visiting cards, Letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause-7 of Part-1 of First Schedule to the Chartered Accountants Act, 1949. Thus, complaint of neighbour is not enforceable/valid.

- (c) Partnership with an Advocate: As per Clause (4) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant will be guilty of professional misconduct if he enters into partnership with any person other than a chartered accountant in practice or a person resident without India who but for his residence abroad would be entitled to be registered as a member under Clause (v) of Sub-section (1) of Section 4 or whose qualification are recognized by the Central Government or the Council for the purpose of permitting such partnership.

However, Regulation 53B of the Chartered Accountants Regulations, 1988 permits a Chartered Accountant in practice to enter into partnership with other prescribed Professionals which includes an Advocate, a member of Bar Council of India.

In the instant case, Mr. P, a chartered accountant, has entered into partnership with Mr. L, an advocate.

Thus, he would not be guilty of professional misconduct as per Clause (4) of Part I of First Schedule read with Regulation 53B.

- (d) Not Exercising Due Diligence: According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard. He was guilty of professional misconduct under Clause (7).

Since Mr. D has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, therefore, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Q41. RTP Nov 2018

Write a short note on the following:

- (a) Auditor's responsibilities regarding comparatives.

Answer:

- (a) Auditor's responsibilities regarding comparatives: SA 710, "Comparative Information – Corresponding Figures and Comparative Financial Statements", establishes standards on the auditor's responsibilities regarding comparatives.

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. For this purpose, the auditor shall evaluate whether:

- (i) The comparative information agrees with the amounts and other disclosures presented in the prior period; and
- (ii) 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. 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. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 (Revised).

As required by SA 580 (Revised), 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.

Q42. RTP May 2018

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) Mr. Brilliant, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in blue colour. He also circulated the information contained in the website through E-mail to acknowledge public at large about his expertise. However, due to shortage of time, he could not intimate his website address to the Institute.
- (b) CA. Raj is a leading income tax practitioner and consultant for derivative products. He resides in Bangalore near to the XYZ commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 50% of his time to settle the commodity transactions, though he has not taken any permission for this. Is CA. Raj liable for professional misconduct?
- (c) CA. Elegant is in practice for two years and runs his proprietorship firm in the name of "Elegant & Co.". He maintains notes in his mobile in which he writes the fees received from various clients. Based on his record, he prepares and files his income tax return.

- (d) The manager of ZedEx (P) Ltd. approached CA. Vineet in the need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA. Vineet issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute.

Answer:

- (a) Circulating Information Contained in Own Website: As per clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the guidelines approved by the Council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request.

Further, members are not required to intimate the Website address to the Institute. Members are only required to comply with the Website Guidelines issued by the Institute in this regard.

In the given case, Mr. Brilliant has circulated the information contained in the website through E-mail to public at large. Therefore, he is guilty of professional misconduct under clause (6) of Part I of the First Schedule to the said Act. However, there is no such misconduct for not intimating website address to the Institute.

- (b) Engaging into a Business: As per clause (11) 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 engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, CA. Raj is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.

- (c) Maintenance of Books of Account by a CA in Practice: Chapter V of the Council General Guidelines, 2008 specifies that a member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his/its professional practice, proper books of accounts including the following-

- (i) a Cash Book
- (iii) a Ledger

Thus, a Chartered Accountant in practice is required to maintain proper books of accounts.

In the instant case, CA. Elegant does not maintain proper books of accounts and writes the fees received from various clients in notes in his mobile. Notes maintained by him in mobile cannot be treated as books of accounts.

Hence, CA. Elegant, being a practicing Chartered Accountant will be held guilty of misconduct for violation of Council General Guidelines, 2008.

- (d) Issuing Certificate without having Certificate of Practice: As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, CA. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, CA. Vineet will be held guilty of professional misconduct in terms of clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

Q43. RTP May 2018

Write a short note on the following:

- (a) Key Audit Matters and Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report.

Answer:.

- (a) Key Audit Matters— As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report (New)", those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.
- Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report: The auditor shall describe each key audit matter in the auditor's report unless:
- (i) Law or regulation precludes public disclosure about the matter; or
 - (ii) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

Q1. Exam Nov 2022, 5 marks

ABC Limited holds 51% equity of BBB Limited, 63% equity of TTT Limited. There are different information and explanations which are disclosed by the respective companies in the notes to their financial statements. At the time of consolidation, management of ABC Limited has consolidated all the information and explanations disclosed in the notes as well. The principal auditor is of the view that only those information and explanations should form part of the notes to the consolidated financial statements which are relevant at group level. Please mention any five aspects which are given in the notes to the separate financial statements of the parent and the subsidiaries, need not be included in the consolidated financial statements.

Answer:

The Ind AS 110 does not give a list of information which is part of the separate financial statement of the components but that need not be reported in the notes and other explanatory material of the consolidated financial statements, however, based on section 129(4) and circular issued by MCA, it can be construed that, even in consolidated financial statements under Ind AS, only those disclosures should be given which are relevant to consolidated financial statements.

Based on the above discussion, in case of companies, the information such as the following given in the notes to the separate financial statements of the parent and/or the subsidiary, need not be included in the consolidated financial statements.

- (i) Source from which bonus shares are issued, e.g., capitalization of profits or reserves or from securities premium account.
- (ii) Disclosure of all unutilized monies out of the issue indicating the form in which such unutilized funds have been invested.
- (iii) Disclosure required under Micro, Small and Medium Enterprises Development Act, 2006.
- (iv) A statement of investments (whether shown under "financial assets or non-financial assets as stock-in-trade) separately classifying trade investments and other investments, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate.
- (v) Value of imports calculated on C.I.F. basis by the company during the financial year in respect of:
 - (a) raw materials;
 - (b) components and spare parts;
 - (c) capital goods.
- (vi) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters.
- (vii) Value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.
- (viii) The amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.
- (ix) Earnings in foreign exchange classified under the following heads, namely:
 - (a) export of goods calculated on F.O.B. basis;
 - (b) royalty, know-how, professional and consultation fees;
 - (c) interest and dividend;
 - (d) other income, indicating the nature thereof.

Q2. Exam Dec 2021, 5 marks

M & B Investments Ltd. is a company having paid up share capital of Rs.1 Crore, It has a subsidiary, Investors Fund Management Ltd. Major business of M & B Investments Ltd. is to pool money from investors on a collective basis and invest this money in various funds. This company pooled Rs.10 Crore from a number of clients, which represent the Company's shareholders.

While auditing books of accounts of M & B Investments Ltd. CA X observed that whole amount of Rs.10 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company.

Now, CA X raised an issue while auditing financial statements of M & B Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013 ?

Analyse the above issue and give your opinion.

Answer:

According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder.

An investment entity is an entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

However, as per paragraph 33 of Ind AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Applying the above to the given case of M&B Investment Ltd, which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 and 33 of Ind AS 110, it can be concluded that M&B Investment Ltd is not required to consolidate as per Section 129

(3) of the Companies Act, 2013.

Q3. Exam Jan 2021, 5 marks

JRS Limited holds the majority ownership of R Ltd. & K Ltd. S Ltd. is an intermediate subsidiary of JRS Limited in Surat. The JRS Limited presents the consolidated financial statements for audit purposes to MMT & Co. As a statutory auditor MMT & Co. obtain a listing of all the components and verify that all the components included in financial statements unless any component meet criterion for exclusion. Explain any two reasons which are considered by MMT & Co. for exclusion of components from the consolidated financial statements and reporting of reasons of exclusion thereof.

Answer:

Where a component is excluded from the consolidated financial statements, the auditor should examine the reasons for exclusion and whether such exclusion is in conformity with the applicable financial reporting framework.

- (i) Under Companies (Accounting Standards) Rules, 2006, there could be two reasons for exclusion of subsidiary, associate or jointly controlled entity- one, that the relationship of parent with the subsidiary, associate or jointly controlled entity is intended to be

- temporary or the subsidiary, associate or joint venture operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.
- (ii) Similarly, under the Companies Act, 2013, intermediate subsidiary in India is not required to present consolidated financial statements. Ind AS 110 also prescribes certain criteria where consolidated financial statements are not required. In such cases, the auditor should satisfy himself that the exclusion made by the management falls within these categories, example in the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary, associate or joint venture is temporary, the auditor should verify that the intention of the parent, to dispose off the subsidiary, investment in associate or interest in jointly controlled entity, in the near future, existed at the time of acquisition of the subsidiary, making investment in associate or jointly controlled entity.
 - (iii) The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements. If an entity is excluded from the consolidated financial statements for reasons other than those allowed by the applicable financial reporting framework, the auditor should consider its effect on the auditor's report to be issued.

Q4. Exam Nov 2020, 5 marks

CA. Vimal is the auditor of Excellent Ltd., a parent company which presents Consolidated Financial Statements. The management of Excellent Ltd. has provided the list of the components included in the Consolidated Financial Statements. As an auditor of Consolidated Financial Statements, CA Vimal has to verify that all the components have been included in the Consolidated Financial Statements and review the information provided by the management in identifying the components. State the procedures to be followed by CA. Vimal in respect of completeness of this information.

Answer:

(b) A parent which presents consolidated financial statements is required to consolidate all its components in the consolidated financial statements other than those for which exceptions have been provided in the relevant accounting standards under the applicable financial reporting framework.

The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion.

In the given case, Excellent Ltd has provided the list of components included in the consolidated financial statements (CFSs). CA Vimal shall verify that all the components have been included in the CFSs.

Further, in respect of completeness of this information, CA Vimal should perform the following procedures:

- i. review his working papers for the prior years for the known components;
- ii. review the parent's procedures for identification of various components;
- iii. make inquiries of the management to identify any new components or any component which goes out of consolidated financial statements;
- iv. review the investments of parent as well as its components to determine the shareholding in other entities;
- v. review the joint ventures and joint arrangements as applicable;
- vi. review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group;
- vii. review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013;
- viii. Identify the changes in the shareholding that might have taken place during the reporting period.

Q5. Exam May 2019, 4 marks

ALM Associates has been appointed as auditor of M/s Hary Ltd. which acquired 55% shares-in M/s Sam Ltd. on 15th October, 2018. During audit of Harry Ltd., the auditors found that the company

has not prepared consolidated financial statements because on the date of acquisition the fair value of certain assets & liabilities has not been ascertained which is significant and are accounted for on estimated basis only. Help ALM Associates in framing opinion paragraph of audit report.

Answer:

Opinion Paragraph of Audit Report: In the instant case, M/s Hary Ltd. acquired 55% shares in M/s Sam Ltd. and the company did not prepare the consolidated financial statements because on the date of acquisition the fair value of certain assets and liabilities has not been ascertained. Therefore, accounting is done on estimate basis only which is not correct as the financial statements are materially misstated due to non-consolidation of subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. Thus, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidences, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Adverse Opinion

In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2019, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

Basis for Adverse Opinion is given below:

As explained in Note X, the M/s Hary Ltd. has not consolidated subsidiary M/s Sam Ltd. that the M/s Hary Ltd acquired during 2018 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on an estimate basis. Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had M/s Sam Ltd. been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

Q6. RTP May 2023

CA. Vishudh is the auditor of Brilliant Ltd., a parent company which presents Consolidated Financial Statements. The management of Brilliant Ltd. has provided the list of the components included in the Consolidated Financial Statements. As an auditor of Consolidated Financial Statements, CA Vishudh has to verify that all the components have been included in the Consolidated Financial Statements and review the information provided by the management in identifying the components. State the procedures to be followed by CA. Vishudh in respect of completeness of this information.

Answer:

18. A parent which presents consolidated financial statements is required to consolidate all its components in the consolidated financial statements other than those for which exceptions have been provided in the relevant accounting standards under the applicable financial reporting framework.

The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion.

In the given case, Brilliant Ltd has provided the list of components included in the consolidated financial statements (CFSs). CA Vishudh shall verify that all the components have been included in the CFSs.

Further, in respect of completeness of this information, CA Vishudh should perform the following procedures:

- (i) review his working papers for the prior years for the known components;
- (ii) review the parent's procedures for identification of various components;
- (iii) make inquiries of the management to identify any new components or any component which goes out of consolidated financial statements;
- (iv) review the investments of parent as well as its components to determine the shareholding in other entities;
- (v) review the joint ventures and joint arrangements as applicable;
- (vi) review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group;
- (vii) review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013;
- (viii) Identify the changes in the shareholding that might have taken place during the reporting period.

Q7. RTP Nov 2023

Subahu Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of Subahu Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your views.

Answer:

Consolidated Financial Statements: According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

However, an investment entity need not present consolidated financial statements if it is required, in accordance with Ind AS 110 'Consolidated Financial Statements', to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

(An investment entity is an entity that (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.)

In the given case, Subahu Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the

company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption, it should be followed. If out of exemption some subsidiaries are not consolidated, then list should be disclosed in notes to accounts with reason.

Q8. RTP Nov 2022

Jambu & Sudharma Investments Ltd. is a company having paid up share capital of ₹ 1 crore, it has a subsidiary, Investors Fund Management Ltd. Major business of Jambu & Sudharma Investments Ltd. is to pool money from investors on a collective basis and invest this money in various funds. This company pooled ₹ 12 crore from a number of clients, which represent the Company's shareholders.

While auditing books of accounts of Jambu & Sudharma Investments Ltd. CA Vardhman observed that whole amount of ₹ 12 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company. Performance of all of its investments is measured on fair value basis.

Now, CA Vardhman raised an issue while auditing financial statements of Jambu & Sudharma Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013? Analyse the above issue and give your opinion.

Answer:

According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the Rules made thereunder.

An investment entity is an entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

However, as per paragraph 33 of Ind AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Applying the above to the given case of Jambu & Sudharma Investments Ltd., which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 and 33 of Ind AS 110, it can be concluded that Jambu & Sudharma Investments Ltd. is not required to consolidate as per Section 129 (3) of the Companies Act, 2013

Q1. Exam Nov 2022, 4 marks

While evaluating the risks and control at the entity level, the Auditor should take cognizance of the prevalent direct and indirect entity level control operating in the entity. Explain, what are such controls with few examples.

Answer:

Entity Level Controls: There are direct entity level controls and indirect entity level controls.

- (i) Direct ELCs operate at a level higher than business activity or transaction level such as a business process or sub-process level, account balance level, at a sufficient level of precision, to prevent, detect or correct a misstatement in a timely manner.

Examples include:

- a. Business performance reviews;
- b. Monitoring of effectiveness of controls activities by Internal Audit function;

- (ii) Indirect ELCs do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements. However, they contribute indirectly to the effective operation of direct ELC and other control activities.

Examples include:

- a. Company code of conduct and ethics policies;
- b. Human resource policies;
- c. Employee job roles & responsibilities.

Q2. Exam Dec 2021, 5 marks

During the course of audit of Fortune Ltd., CA Prasad is concerned with the quality and effectiveness of internal control. Towards achieving his objective he wants to assess and evaluate the control environment. Guide CA Prasad with well-defined set of the Standard Operating Procedures in the assessment and evaluation of control.

Answer:

Guidance to CA Prasad with well defined set of Standard Operating Procedure is given hereunder:

- (i) Standard Operating Procedures (SOPs): A well defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover.
- (ii) Enterprise Risk Management: An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.
- (iii) Segregation of Job Responsibilities: A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person.

A buyer should not be involved in receiving of materials or passing of bills. Similarly bank reconciliation should be prepared by a person other than the one who maintains bank book

- (iv) Job Rotation in Sensitive Areas: Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example, if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.
- (v) Delegation of Financial Powers Document: As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.
- (vi) Information Technology based Controls: With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system

instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

Q3. Exam July 2021, 5 marks

One of the objectives of Internal control relating to accounting system is that all transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability of assets. To achieve this objective, certain matters should be ensured by accounting controls. List down matters to be ensured by accounting controls.

Answer:

Matters to be ensured by accounting controls -

Basic Accounting Control Objectives: The basic accounting control objectives which are sought to be achieved by any accounting control system are -

- (i) Transactions are executed in accordance with management's general or specific authorisation;
- (ii) Transactions and other events are real & promptly/timely recorded at correct amounts;
- (iii) Transactions should be classified in appropriate accounts and in the appropriate period to which it relates;
- (iv) Transactions are properly posted.
- (v) Transactions should be recorded in a manner so as to facilitate preparation of financial statements in accordance with applicable accounting standards, other accounting policies and practices and relevant statutory requirements;
- (vi) Transactions are properly disclosed.
- (vii) Recording of transactions should facilitate maintaining accountability for assets;
- (viii) Assets and records are required to be protected from unauthorized access, use or disposition;
- (ix) Records of assets, such as sufficient description of the assets (to facilitate identification, its location should also be maintained, so that the assets could be physically verified periodically.
- (x) Transactions are properly summarized.

Q4. Exam May 2019, 5 marks

A professional accountant is often required to give certificates or report for special purposes required by various authorities and statute and he needs to take careful evaluation of such engagement. However, issuing such special purpose certificates or reports has some inherent limitations which could limit his review and evaluation. Enumerate some of the limitations associated with such special purpose report or certificates.

Answer:

Inherent Limitations: A practitioner is expected to provide either a reasonable assurance (about whether the subject matter of examination is materially misstated) or a limited assurance (stating that nothing has come to the practitioner's attention that causes the practitioner to believe that the subject matter is materially misstated) since it is difficult to reduce engagement risk to zero due to inherent limitations of the audit. The inherent limitations could arise from:

- (i) the nature of financial reporting;
- (ii) the use of selective testing;
- (iii) the inherent limitations of internal controls;
- (iv) the fact that much of the evidence available to the practitioner is persuasive rather than conclusive;
- (v) the nature of procedures to be performed in a specific situation;
- (vi) the use of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence;
- (vii) in some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria; and
- (viii) the need for the engagement to be conducted within a reasonable period of time and at a reasonable cost.

Therefore, whenever a practitioner is required to give a “certificate” or a “report” for special purpose, the practitioner needs to undertake a careful evaluation of the scope of the engagement, i.e., whether the practitioner would be able to provide reasonable assurance or limited assurance on the subject matter.

Q5. RTP May 2023

- (a) During the course of audit of Treasure Ltd., CA Gautam is concerned with the quality and effectiveness of internal control. Towards achieving his objective, he wants to assess and evaluate the control environment. Guide CA Gautam with well-defined set of the Standard Operating Procedures in the assessment and evaluation of control.
- (b) Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the audit of Acharya Ltd., you observed that significant deficiency exists in the internal control system, and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization.

Answer:

Guidance to CA Gautam with well defined set of Standard Operating Procedure is given hereunder:

- (i) Standard Operating Procedures (SOPs): A well defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover.
 - (ii) Enterprise Risk Management: An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.
 - (iii) Segregation of Job Responsibilities: A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person.
A buyer should not be involved in receiving of materials or passing of bills. Similarly bank reconciliation should be prepared by a person other than the one who maintains bank book
 - (iv) Job Rotation in Sensitive Areas: Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example, if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.
 - (v) Delegation of Financial Powers Document: As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.
 - (vi) Information Technology based Controls: With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example, at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.
- (b) In the given case of Acharya Ltd, Auditors, while conducting audit has come across significant deficiency existing in the internal control system and also auditors wanted to ascertain that deficiency.

As per SA 265, “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management”, Indicators of significant deficiencies in internal control include, for example:

- (i) Evidence of ineffective aspects of the control environment, such as:
 - (a) Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.

- (b) Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
- (c) Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- (ii) Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- (iii) Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- (iv) Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- (v) Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- (vi) Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- (vii) Evidence of management's inability to oversee the preparation of the financial statements.

Q6. RTP May 2022

One of the independent directors sought information regarding the appointment of internal auditors for following Group Companies in accordance with the Companies Act, 2013 of which certain Financial Information are given below:

Figures are in Rs.crore and correspond to the previous year.

Name	Nature	Equity Share Capital	Turnover	Loan from Bank and PFI	Public Deposits
AADI Ltd.	Listed	100	190	50	24
AJIT Ltd.	Unlisted Public	60	190	50	24
NEMI Ltd.	Unlisted Private	60	190	50	-

You are required to evaluate the requirements of the Companies Act, 2013 regarding the appointment of internal Auditors for the Group Companies. Discuss.

Answer:

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

- (A) every listed company;
- (B) every unlisted public company having-
 - (2) paid up share capital of fifty crore rupees or more during the preceding financial year; or
 - (3) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (4) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
 - (5) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- (C) every private company having-
 - (1) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (2) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, AADI Ltd. is a listed company. As per section 138 of the Companies Act, 2013, every listed company is required to appoint an internal auditor or a firm of internal auditors. Thus, in view of the above, AADI Ltd. is required to appoint an internal auditor.

Further, AJIT Ltd. is unlisted public company. The company is having Rs.60 crore as equity share capital which is exceeding the prescribed limit of rupees fifty crore as per section 138. Thus, AJIT Ltd. is required to appoint an internal auditor as per section 138 of the Companies Act, 2013.

NEMI Ltd. is unlisted private company and having Rs.60 crore as equity share capital,

Rs.190 crore as turnover and Rs.50 crore loan from Bank and PFI. In view of provisions of section 138 of the Companies Act, 2013 discussed above, all the limits are below the prescribed limit for a private company. Therefore, NEMI Ltd. is not required to appoint an internal auditor. It can be concluded that AADI Ltd. and AJIT Ltd. is required to appoint the internal auditor as per the provisions of the Companies Act, 2013 whereas NEMI Ltd. is not required to do the same.

Q7. RTP May 2020

During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

Answer:

Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and
- (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
- (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

Q8. RTP Nov 2019

BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2018-19. In order to review internal controls of the sales department of the company, you visited the department and noticed the work division as follows:

- (1) An officer was handling the sales ledger and cash receipts.
- (2) Another official was handling dispatch of goods and issuance of Delivery challans.
- (3) One more officer was there to handle customer/ debtor accounts and issue of receipts.
 - (a) As an internal auditor you are required to briefly discuss the general condition pertaining to the internal check system.
 - (b) Do you think that there was proper division of work? If not, why?

Answer:

- (a) Internal Check System: The general condition pertaining to the internal check system may be summarized as under:
 - (i) no single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
 - (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
 - (iii) Every member of the staff should be encouraged to go on leave at least once a year.
 - (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
 - (v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.

- (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
 - (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
 - (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
 - (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
 - (x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.
- (b) Division of Work: Company has not done proper division of work as:
- I. the receipts of cash should not be handled by the official handling sales ledger.
 - II. delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

Q9. RTP May 2019

ST Ltd is a growing company and currently engaged in the business of manufacturing of tiles. The company is planning to expand and diversify its operations. The management has increased the focus on the internal controls to ensure better governance. The management had a discussion with the statutory auditors to ensure the steps required to be taken so that the statutory audit is risk based and focused on areas of greatest risk to the achievement of the company's objectives. Please advise the management and the auditor on the steps that should be taken for the same.

Answer:

Audit should be risk-based or focused on areas of greatest risk to the achievement of the audited entity's objectives. Risk-based audit (RBA) is an approach to audit that analyzes audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas.

RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable level and the reporting to auditee of audit results. These are achieved through the following:

Step 1 - Understand auditee operations to identify and prioritize risks: Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

Step 2 - Assess auditee management strategies and controls to determine residual audit risk: Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.

Step 3 - Manage residual risk to reduce it to acceptable level: Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.

Step 4 - Inform auditee of audit results through appropriate report: The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of

internal controls that affect the organization's ability to record, process, summarize and report financial data.

Q10. RTP Nov 2018

During the course of audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

Answer:

Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and
- (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
- (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

Q11. RTP May 2018

Prabhu Ltd., a manufacturing concern wants to develop internal control system. You are an expert in developing the internal control system, hereby called to brief about the same. In view of above, you are required to brief about internal control system and inherent limitations of the internal control?

Answer:

Internal Control System and its Inherent Limitations: As per Guidance Note on Audit of Internal Financial Control over Financial Reporting, internal controls are a system consisting of specific policies and procedures designed to provide management with reasonable assurance that the goals and objectives it believes important to the entity will be met.

"Internal Control System" means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

To state whether a set of financial statements presents a true and fair view, it is essential to benchmark and check the financial statements for compliance with the framework. The Accounting Standards specified under the Companies Act, 1956 (which are deemed to be applicable as per Section 133 of the 2013 Act, read with Rule 7 of Companies (Accounts) Rules, 2014) is one of the criteria constituting the financial reporting framework on which companies prepare and present their financial statements under the Act and against which the auditors evaluate if the financial statements present a true and fair view of the state of affairs and the results of operations of the company in an audit of the financial statements carried out under the Act.

The fundamental therefore is that effective internal control is a process effected by people that supports the organization in several ways, enabling it to provide reasonable assurance regarding risk and to assist in the achievement of objectives.

Fundamental to a system of internal control is that it is integral to the activities of the company, and not something practiced in isolation.

An internal control system:

- Facilitates the effectiveness and efficiency of operations.
- Helps ensure the reliability of internal and external financial reporting.
- Assists compliance with laws and regulations.
- Helps safeguarding the assets of the entity.

Limitations of Internal Control - Internal control, no matter how effective, can provide an entity with only reasonable assurance and not absolute assurance about achieving the entity's operational, financial reporting and compliance objectives. Internal control systems are subject to certain inherent limitations, such as:

- Management's consideration that the cost of an internal control does not exceed the expected benefits to be derived.
- The fact that most internal controls do not tend to be directed at transactions of unusual nature. The potential for human error, such as, due to carelessness, distraction, mistakes of judgement and misunderstanding of instructions.
- The possibility of circumvention of internal controls through collusion with employees or with parties outside the entity.
- The possibility that a person responsible for exercising an internal control could abuse that responsibility, for example, a member of management overriding an internal control.
- Manipulations by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

Q1. Exam Dec 2021, 5 marks

The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG.

Answer:

To facilitate a proper consideration, the reports of the C&AG on the audit of PSUs are presented to the Parliament in several parts consisting of the following:

- (i) Introduction containing a general review of the working results of Government companies, deemed Government companies and corporations;
- (ii) Results of comprehensive appraisals of selected undertakings conducted by the Audit Board;
- (iii) Resume of the company auditors' reports submitted by them under the directions issued by the C&AG and that of comments on the accounts of the Government companies; and
- (iv) Significant results of audit of the undertakings not taken up for appraisal by the Audit Board.

For certain specified states, the C&AG submits a separate audit report (commercial) to the legislature, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, and a general review of the working results of Government companies and corporations.

Q2. Exam Jan 2021, 5 marks

The Comptroller and Auditor General of India has appointed a chartered accountant firm to conduct the comprehensive audit of Metro Company Limited (a listed government company) which is handling the Metro project of the metropolitan city for the period ending 31-03-2020. The work to be conducted under Project A handled by the Metro Company Limited was of laying down railway line of 124 kilometres. [The chartered accountant firm reviewed the internal audit report and observed the shortcoming reported about the performance of Project A regarding the understatement of the Current liabilities and Capital work in progress by ~ 84.68 crore.] Explain some of the matters to be undertaken by the chartered accountant firm while conducting the comprehensive audit of Metro Company Limited.

Answer:

(b) A CA Firm has been appointed to conduct comprehensive audit of Metro Company Limited, which is a listed Govt Company handling the Metro project. CA firm has observed the shortcomings as stated in internal audit report regarding understatement of Current liabilities and CWIP by ₹ 84.68 crore.

Matters to be undertaken by the CA Firm while conducting the comprehensive audit of Metro Company Limited are:

- (i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?
- (ii) Have the accepted production or operational outputs been achieved? Has there been under-utilisation of installed capacity or shortfall in performance and, if so, what has caused it?
- (iii) Has the planned rate of return been achieved?
- (iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
- (v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
- (vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?

- (vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?
- (viii) If the enterprise has an adequate system of repairs and maintenance?
- (ix) Are procedures effective and economical?
- (x) Is there any poor or insufficient or inefficient project planning?

Q3. Exam Nov 2019, 5 marks

The C & AG may direct the appointed auditor about the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India". What are the relevant sections of the Companies Act, 2013 and steps involved in the audit of Government Companies?

Answer:

The following steps are involved in the audit of government companies:

- (i) Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013 - Statutory auditors of Government Companies are appointed or re-appointed by the C&AG. There is thus, a departure from the practice in vogue in the case of private sector companies where appointment or re- appointment of the auditors and their remuneration are decided by the members at the annual general meetings. In the case of government companies, though the appointment of statutory auditors is done by the C&AG, the remuneration is left to the individual companies to decide based on certain guidelines given by the C&AG in this regard.
- (ii) The C&AG may direct the appointed auditor on the manner in which the accounts of the Government company are required to be audited and the auditor so appointed has to submit a copy of the audit report to the Comptroller and Auditor-General of India. The report, among other things, includes the directions, if any, issued by the C&AG, the action taken thereon and its impact on the accounts and financial statement of the company. The report under section 143(5) is in addition to the reports issued by the Statutory Auditors under various other clauses of section 143.
- (iii) Supplementary audit under section 143(6)(a) of the Companies Act, 2013 -The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statements of the government company by such person or persons as he may authorize in this behalf and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the C&AG may direct.
- (iv) Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013 - Any comments given by the C&AG upon, or in supplement to, the audit report issued by the statutory auditors shall be sent by the company to every person entitled to copies of audited financial statements under sub- section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.
- (v) Test audit under section 143(7) of the Companies Act, 2013 -Without prejudice to the provisions relating to audit and auditor, the C&AG may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor- General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

Q4. Exam May 2019, 5 marks

On receipt of statutory audit report on 30-03-2018 of M/s Sunlight Ltd., a government company, C&AG on 25-05-2018 appointed M/s Veeru & Associates to conduct supplementary audit u/s 143(6)(a) of the Companies Act, 2013. They submitted their report to C&AG as per their scope of

work. The Company held its AGM on 01-09-2018 but directors did not think it necessary to discuss supplementary auditor's report and comment of the C&AG. Is the approach of the directors of Sunlight Ltd. correct? Guide the company with the provisions related to supplementary audit.

Answer:

- (c) The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,
- (i) conduct a supplementary audit under section 143(6)(a), of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
 - (ii) comment upon or supplement such audit report under section 143(6)(b): It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

In view of above provisions, the approach of directors of Sunlight Ltd. is not correct. They are required to mandatorily send the Supplementary Audit Report and comments of C&AG to every member of the company etc. as prescribed and also be placed before the annual general meeting of the company in the same manner as in case of audit report. Since in the given case neither the report has been distributed nor discussed in the Annual General Meeting, the directors of the company will be liable for contravention of aforesaid sections.

Q5. RTP May 2023

Siddha Ltd., a company wholly owned by central government was disinvested during the previous year, resulting in 40% of the shares being held by public. The shares were also listed on the BSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the BSE etc.

Mahavir, the FM of the company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

Answer:

Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them.

In the given situation, Siddha Ltd is a company wholly owned by central government was disinvested during the previous year, resulting in 40% of the shares being held by public. The shares were also listed on the BSE. The listing of company's shares on a stock exchange is irrelevant for this purpose and hence, Mahavir's opinion is not correct.

Q6. RTP Nov 2022

Comptroller & Auditor General appointed Sambhav & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government 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.

Answer:

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

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

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG. Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

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

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

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

Q7. RTP May 2022

The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:

- (i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;
- (ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;
- (iii) metering, billing and collection was managed efficiently and effectively;
- (iv) monitoring and internal controls were efficient.

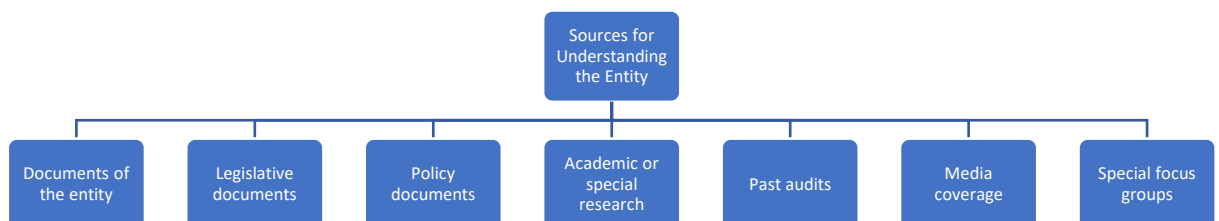
What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

Answer:

In the given scenario, in view of the objectives discussed, performance audit is being referred.

The following steps are suggested to the auditors for planning while conducting the performance audit:

- (A) Understanding the Entity/Programme - It is the starting point for planning individual performance audit.



The auditor may use the following sources for understanding the entity:

- (i) Documents of the entity: Documents on administration and functions of the entity, policy files, annual reports, budget documents, accounts, minutes of meetings, information on the website, internal audit reports, electronic databases and MIS reports, RTI material etc.
- (ii) Legislative documents: Legislation, parliamentary questions and debates, reports of the Public Accounts Committee, the Committee on Public Undertakings, the Estimates Committee, and letters from Members of Parliament.
- (iii) Policy documents: Documents of Planning Commission, Ministry of Finance etc.
- (iv) Academic or special research: Independent evaluations on the entity, academic research and similar work done by other governments and other SAls.
- (v) Past audits: Past financial and performance audits of the entity provide a major source of information and understanding.
- (vi) Media coverage: Print and electronic media - their systematic documentation on regular basis in a transparent manner.
- (vii) Special focus groups: Audit Advisory Committee concerns, annual and special reports of World Bank, Reserve Bank of India, reports by special interest groups, NGOs, etc.

(B) Defining the Objectives and the Scope of Audit - The audit objectives should be defined in a succinct manner as they will impact the nature of the audit, govern its conduct and affect audit conclusions. Setting audit objectives ensures good quality performance audits. It facilitates clarity, demonstrates the consistent quality of audit and serves as a measure of quality assurance of the audit.

Defining the scope constricts the audit to significant issues that relate to the audit objectives. It mainly focuses on the extent, timing and nature of the audit.

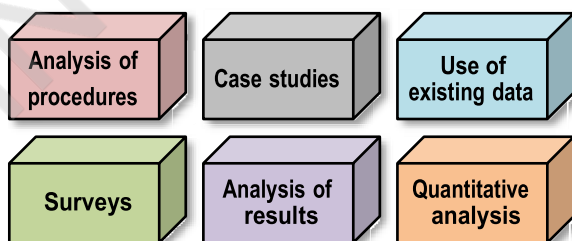
(C) Determining Audit Criteria - Audit criteria are the standards used to determine whether a program meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit criteria are reasonable and attainable standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed.

The audit criteria may be sought to be obtained from the following sources:

- (i) procedure manuals of the entity.
- (ii) policies, standards, directives, and guidelines.
- (iii) criteria used by the same entity or other entities in similar activities or programmes.
- (iv) independent expert opinion and know how.
- (v) new or established scientific knowledge and other reliable information.
- (vi) general management and subject matter literature and research papers.

(D) Deciding Audit Approach - There is no uniform audit approach prescribed that can be applicable to all types of subjects of performance audits. The selection of approach also determines methods and means used for conducting the audit.

Some of the methods which could be used in conducting performance audits include:



- (i) Analysis of procedures: It involves review of the systems in place for planning, conducting, checking and monitoring the activity. This would consist of examination of documents such as financial reports, budgets, programme guidelines, procedure manuals, etc.
- (ii) Case studies: A case study is a descriptive analysis of an entity, scheme or programme. It involves analysis of a particular issue within the context of the whole area under review.
- (iii) Use of existing data: The audit staff should investigate the data held by entity management and by other relevant sources. Audit conclusions based on testing of available data for correctness and completeness enhances the assurance level.

- (iv) Surveys: Survey is a method of collecting information from members of a population to assess the interrelation of events and conditions. Surveys on predetermined parameters can supplement the audit findings and conclusions adding value to the performance audits.
- (v) Analysis of results: It requires the auditor to carry out actual output-input analysis to determine the efficiency of the programme.
- (vi) Quantitative analysis: It involves an examination of available data relating to financials like earnings, revenue, or data relating to programme implementation like details of beneficiaries etc. However, it may not be possible for the auditor to work with complete data due to its high volume. In such cases, sampling techniques are required to be used.
- (E) Developing Audit Questions - Subsequent to designing of audit objectives and determination of audit criteria, the audit team is required to prepare a list of questions to which they would seek answers. The questions should be framed in a comprehensive manner involving a detailed hierarchy of questions.
- (F) Assessing Audit Team Skills and whether Outside Expertise required - It is essential that the performance auditors possess special aptitude and knowledge. The Auditing Standards of C&AG of India provide that the audit institution should develop and train the auditors to enable them to perform their tasks effectively & efficiently and should prepare manuals & other written guidance notes & instructions concerning the conduct of audits.
Given the diverse range of subjects of performance auditing, the audit team needs to develop a sound understanding of the programme or entity proposed to be audited.
The audit team needs to decide at the planning stage on which aspect of expertise is required. Though the Accountant General may use the work of an expert, he retains full responsibility for the expression of opinion in the auditor's report.
- (G) Preparing Audit Design Matrix (ADM) - Having determined the audit objective, audit criteria, audit approach, data collection etc., the audit team should prepare an Audit Design Matrix. It is a structured and highly focused approach to designing a performance audit study. The ADM highlights the data collection and analysis method as well as the type and sources of evidence required to support audit opinion/findings.

A specimen of ADM is given as under:

Audit Objective (1)	Audit Questions (2)	Audit Criteria (3)	Evidence (4)	Data Collection and Analysis Method (5)

An ADM is prepared on the basis of information and knowledge obtained during the planning stage. A well-designed ADM leads to effective audits thus providing the highest assurances to the auditing entities. It is desirable to prepare ADM for each of the audit objectives.

- (H) Establishing Time-Table and Resources - It is significant to determine the timetable and desirable resources. Selection of an appropriate audit team is the most vital component in planning an audit. Considerations for the selection of an appropriate audit team should be recorded along with the proposed timelines for various activities to be undertaken as a part of the audit process. The progress should also be monitored against these timelines. The Accountant General would be liable for ensuring that the performance audit is completed on time. The variations between the required and actual time spent should be compared and approved from the competent authority. The team should build time for translation, approval and possible delays in their own schedule in order to meet the targets.
- (I) Intimation of Audit Programme to Audit Entities - Audited entities must be intimated about the intention of taking up planned performance audit with the scope and extent of audit including the constitution of an audit team and the tentative time schedule, well before the commencement of Audit. Acknowledgement of this may be requested and placed on record.

It may be required to refine an audit's objectives as the audit progresses for gathering the requisite information to fulfil the audit. The reasons for such changes in the objectives should also be recorded and approved by the competent authority.

The audit programme should be flexible and reviewed from time to time as it is not possible to anticipate all the contingencies at the early stage.

The Accountant General should share all significant refinements in the approach and additional tests and findings, concurrently with other audit teams when different persons conduct the audit at different locations. The system of sharing of the significant field audit experience should be documented and reviewed.

Q8. RTP May 2020

- (a) XYZ & Co., a CA. firm was appointed by C&AG to conduct comprehensive audit of ABC Public undertaking. C&AG advised to cover areas such as investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc. Discuss stating the issues examined in comprehensive audit.
- (b) 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." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

Answer:

- (a) Issues examined in Comprehensive Audit: Some of the issues examined in comprehensive audit are-
- (i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?
 - (ii) Have the accepted production or operational outputs been achieved? Has there been under utilisation of installed capacity or shortfall in performance and, if so, what has caused it?
 - (iii) Has the planned rate of return been achieved?
 - (iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
 - (v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
 - (vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?
 - (vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?
 - (viii) If the enterprise has an adequate system of repairs and maintenance?
 - (ix) Are procedures effective and economical?
 - (x) Is there any poor or insufficient or inefficient project planning?
- (b) According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:
- (i) Economy - It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (e.g. human, financial and material) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

- (ii) Efficiency - It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

Auditing efficiency embraces aspects such as whether:

- (a) sound procurement practices are followed;
 - (b) resources are properly protected and maintained;
 - (c) human, financial and other resources are efficiently used;
 - (d) optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;
 - (e) public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
 - (f) efficient operating procedures are used; and
 - (g) the objectives of public sector programmes are met cost-effectively.
- (iii) Effectiveness - It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

In auditing effectiveness, performance audit may, for instance:

- (h) assess whether the objectives of and the means provided (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;
- (i) determine the extent to which a program achieves a desired level of program results;
- (j) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to the policy or to other causes;
- (k) identify factors inhibiting satisfactory performance or goal-fulfilment;
- (l) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes;
- (m) assess the effectiveness of the program and/or of individual program components;
- (n) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- (o) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;
- (p) assess compliance with laws and regulations applicable to the program; and
- (q) identify ways of making programmes work more effectively.

Q9. RTP Nov 2018

"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." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

Answer:

According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:

- (i) Economy- It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (e.g. human, financial and material) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

- (ii) Efficiency- It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

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- (f) assess the effectiveness of the program and/or of individual program components;
- (g) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- (h) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;
- (i) assess compliance with laws and regulations applicable to the program; and
- (j) identify ways of making programmes work more effectively.

Q10. RTP May 2018

Being an expert in the field of government audit, you are required to briefly explain the powers of Comptroller and Auditor General of India with respect to supplementary audit and test audit as stated under section 143(6) and 143(7) of the Companies Act, 2013.

Answer:

Powers of Comptroller and Auditor-General of India

- (i) Supplementary audit under section 143(6)(a) of the Companies Act, 2013:

The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or

persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct.

Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013: Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

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

Q1. Exam Nov 2022, 5 marks

You have been appointed as an Auditor of LOC Bank, a nationalized bank. LOC Bank also deals in providing credit card facilities to its account holders. The bank is aware of the fact that there should be strict control over the storage and issuance of credit cards. How will you evaluate the internal control system in the area of credit card operations of the Bank?

Answer:

Credit Card Operations System of Internal Control in Banks: The auditor should evaluate the internal control in the area of credit card operations of LOC Bank as under:

- There should be effective screening of applications with reasonably good credit assessments.
- There should be strict control over storage and issue of cards.
- There should be a system whereby a merchant confirms the status of unutilized limit of a credit-card holder from the bank before accepting the settlement, in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.
- All the reimbursement (gross of commission) should be immediately charged to the customer's account.
- There should be a system to ensure that statements are sent regularly and promptly to the customer.
- There should be a system to monitor and follow-up customers' payments.
- Payments overdue beyond a reasonable period should be identified and attended to carefully. For defaulting customers, credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

Q2. Exam May 2022, 5 marks

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank for the financial year 2021-22. During the course of audit your audit team observed that a lump sum amount has been disclosed as Contingent Liability collectively though the components are correctly identified. In respect of contingent liabilities, the auditor is primarily, concerned with seeking reasonable assurance that all the contingent liabilities are identified and properly valued and the audit firm intends to obtain a representation from the 'management. Highlight the points/checklists that are to be covered in the management representation.

Answer:

Contingent Liabilities: In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should obtain representation from management that: -

- (i) all off-balance sheet transactions have been accounted in the books of accounts as and when such transaction has taken place;
- (ii) all off balance sheet transactions have been entered into after following due procedure laid down;
- (iii) all off balance sheet transactions are supported by the underlying documents;
- (iv) all year end contingent liabilities have been disclosed;
- (v) the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/ expense and which, therefore, require creation of a provision/adjustment in the financial statements;

- (vi) the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement;
- (vii) in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) and that no violation of section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; and
- (viii) such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities.

Note: Students may be given due credit for any other relevant point quoted.

Q3. Exam Dec 2021, 5 marks

You have been appointed as Concurrent auditor of one of the branches of Coin Bank Ltd. This branch is dealing mainly in foreign exchange. State the suggested audit procedures to be covered by you to check the foreign exchange transactions of this branch while doing Concurrent audit.

Answer:

Suggested audit procedure to be covered by the Concurrent Auditor to check the foreign exchange transactions of one of the branches of Coin Bank Ltd is given hereunder:

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

Q4. Exam July 2021, 5 marks

M/s GH & Associates have been appointed as Central Statutory Auditors of BNB Bank, a nationalized bank, headquartered in New Delhi for the F.Y 2020 -2021. Bank functions in automated environment using "FLC Software". While preparing audit report, one of the partner highlighted that some matters covered by Companies Act, 2013 and the requirements of Companies (Auditor's Report), Order, 2016 reporting:

You are required to answer the following:

- (i) To which authority auditors should submit their audit report?
- (ii) List the matters covered under Companies Act, 2013 and
- (iii) Reporting under Companies (Auditor's Report), Order, 2016.

Answer:

- (i) Authority to whom Auditors to submit their Audit Report -
In the case of a nationalised bank, the auditor is required to make a report to the Central Government.
So, GH & Associates, Central Statutory Auditors of BNB Bank- a nationalized bank, would be required to submit their report to Central Govt.
- (ii) The auditor of a banking company is also required to state in the report the matters covered by Section 143 of the Companies Act, 2013.
 - i. Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in

terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.

- ii. Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention (in accordance with sec 143(12) of the Companies Act, 2013.)
- iii. As per reporting requirements cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 the auditor's report shall also include their views and comments on the following matters, namely:
 1. Whether the bank has disclosed the impact, if any, of the pending litigations on its financial position in its financial statements.
 2. Whether the bank has made provision, as required under the law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts.
 3. Whether there has been any delay in transferring amounts, required to be transferred to the Investor Education and Protection Fund by the bank.
- (iii) Reporting requirements relating to the Companies (Auditor's Report) Order, 2016 are not applicable to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

Q5. Exam Jan 2021, 5 marks

CA K have been doing audit of branch of LUD Bank Ltd. The principal business of the branch is lending advances to large corporates. Since last one year, many large accounts have become Non-Performing Asset (NPA) as per guidelines. The Management of the Bank decided to sell one of the NPA account and consequently one NPA namely DEF Ltd. amounting to ~ 10.00 Crores was sold to Asset Reconstruction Company. What audit points CA K should keep in mind while doing audit of this transaction?

Answer:

CA K conducting audit of branch of LUD Bank Ltd. whose principal business is lending money to large corporates. Many large accounts of this branch have turned NPA category and Management sold DEF Ltd.'s NPA account amounting to ~ 10 Crores to Asset Reconstruction Company.

CA K should proceed as under:

In case of Sale of NPA by Bank, the auditor should examine

- (i) the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers.
- (ii) only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- (iii) the assets have been sold "without recourse" only.
- (iv) subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- (v) the NPA has been sold at cash basis only.
- (vi) on the sale of the NPA, the same has been removed from the books of the account.
- (vii) the short fall in the net book value has been charged to the profit and loss account.
- (viii) where the sale is for a value higher than the NBV, no profit is recognised and the excess provision has not been reversed but retained to meet the shortfall/ loss because sale of other non-performing financial assets.

Q6. Exam Nov 2020, 5 marks

In the course of statutory Branch audit of KS Bank Ltd, you observe that some borrower accounts have been regularised before Balance sheet date by payment of overdue amount. Narrate the audit procedures to be carried out with special focus on the Classification of advances and Provisioning for Non-Performing assets of the Branch.

Answer:

The Audit procedures that need to be carried out with special focus on classification of advances and provisioning for NPAs of KS Bank Ltd, in which the auditor has observed that some borrower accounts have been regularized before balance sheet date by payment of overdue amount shall be carried out as under :

- (i) As per the Reserve Bank guidelines, if an account has been regularised before the balance sheet date by payment of overdue amount through genuine sources, the account need not be treated as NPA.
- (ii) Where subsequent to repayment by the borrower (which makes the account regular), the branch has provided further funds to the borrower (including by way of subscription to its debentures or in other accounts of the borrower), the auditor should carefully assess whether the repayment was out of genuine sources or not.
- (iii) Where the account indicates inherent weakness based in the data available, the account shall be deemed as a NPA.

Classification and Provision

- a. Examine whether the classification made by the branch is appropriate. Particularly, examine the classification of advances where there are threats to recovery.
- b. Examine whether the secured and the unsecured portions of advances have been segregated correctly and provisions have been calculated properly.
- c. It is to be ensured that the classification is made as per the position as on date and hence classification of all standard accounts be reviewed as on balance sheet date.
- d. The date of NPA is significant to determine the classification and hence specific care be taken in this regard.
- e. NPA should be recognized only based on concept of Past Due/ Overdue concept, and not based on the Balance Sheet date.

Q7. Exam Nov 2019, 5 marks

You have been appointed as an auditor of LCO Bank, a nationalized bank. LCO Bank also deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over storage and issue of credit cards. How will you evaluate the Internal Control System in the area of Credit Card operations of a Bank?

Answer:

Evaluation of the Internal Control System in the area of Credit Card Operations of a bank:

- (i) There should be effective screening of applications with reasonably good credit assessments.
- (ii) There should be strict control over storage and issue of cards.
- (iii) There should be a system whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- (iv) There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- (v) Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.
- (vi) All the reimbursement (gross of commission) should be immediately charged to the customer's account.
- (vii) There should be a system to ensure that statements are sent regularly and promptly to the customer.
- (viii) There should be a system to monitor and follow-up customers' payments.
- (ix) Items overdue beyond a reasonable period should be identified and attended to carefully. Credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- (x) There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

Q8. Exam Nov 2019, 4 marks

Banks, because of certain characteristics, are distinguished from other commercial enterprises and hence it needs special audit consideration.

As an auditor of a bank, specify the various peculiarities which may necessitate special audit consideration to be taken care by you.

Answer:

Special audit considerations arise in the audit of banks because of:

- (i) the particular nature of risks associated with the transactions undertaken;
- (ii) the scale of banking operations and the resultant significant exposures which can arise within short period of time;
- (iii) the extensive dependence on IT to process transactions;
- (iv) the effect of the statutory and regulatory requirements;
- (v) which may not be matched by the concurrent development of accounting principles and auditing practices;
- (vi) Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk.

The auditor should consider the effect of the above factors in designing his audit approach. It is imperative for Branch Auditor and SCAs to have detailed knowledge of the products offered and risks associated with them, and appropriately address them in their audit plan to the extent they give rise to the risk of material misstatements in the financial statements.

In today's environment, the banks use different applications to carry out different transactions which may include data flow from one application to other application; the auditor while designing his plans should also understand interface controls between the various applications.

Q9. RTP Nov 2023

QS & Associates are one of the joint auditors of KNO Bank for the year 2022-23. While auditing KNO Bank, they are analysing industry data relating to NPAs in select public sector banks as part of risk assessment procedures: -

Name of Bank	Gross NPAs (in crore)	Net NPAs (in crore)	Ratio of Net NPAs to Net advances
BBJ Bank	55,000	13,000	1.72%
DAB Bank	45,000	10,000	2.34%
CNI Bank	55,000	18,000	2.65%
KNO Bank	28,000	6,500	3.97%
BRB Bank	35,000	8,800	2.27%

In the above context, what do you understand by "Gross NPAs" and "Net NPAs" as on reporting date in the context of financial statements of a Bank? As an auditor of KNO Bank, what inference would you draw by comparing the "Ratio of net NPAs to net advances" with other public sector banks?

Answer:

Gross NPAs represent opening balances of NPAs as increased by fresh NPAs during the year and reduced by upgradations, recoveries and write-offs during the year.

Net NPAs are arrived at after deducting amounts on account of the total provision held against NPAs/ balance in the interest suspense account to park accrued interest on NPAs and certain other adjustments.

The Net NPAs to Net advances ratio is higher in the case of KNO Bank as compared to other public sector banks. It shows that there is a risk that the bank could not have made the required provisions in accordance with RBI guidelines. A higher net NPAs to Net advances ratio indicates the probability and risk of under-provisioning. Keeping in view the above, audit procedures have to be tailored towards the examination and verification of this crucial area.

Q10. RTP Nov 2023

CA. Sundaram is an engagement partner conducting a statutory audit of a nationalised bank. The bank operates on the CBS platform, and the identification of NPAs is system based in accordance with RBI guidelines on asset classification. He wants to be assured of satisfactory operation of internal control in this respect. He wants to be sure that there exists an internal control system in the bank which not only prevents and reduces the risk of loan assets becoming non-performing at the initial stages but also sends out timely signals to the bank subsequently. He is putting considerable importance on effective credit appraisals due to their role in preventing NPA slippages.

While carrying out a walk-through of internal control over advances of banks especially in areas of “credit appraisals” and “credit monitoring”, identify any four specific controls which you may be looking for.

Answer:

The following controls may be considered by auditor in areas of credit appraisals and credit monitoring for ensuring that internal control over advances is effective and the system is capable of not only preventing and reducing the risk of NPAs at the sanction stage itself but also sending out timely signals to the bank subsequently.

- (i) Use of third-party data sources in the bank for comprehensive due diligence at the sanction stage itself to mitigate risk on account of misrepresentation and fraud.
- (ii) Classification of accounts as special mentioned accounts (SMA) for early recognition of signs of incipient stress resulting in default in timely servicing of debt obligations. It can enable banks to initiate timely remedial actions to prevent potential slippages into NPAs.
- (iii) Institution of comprehensive, automated Early Warning Systems (EWS) in banks with EWS triggers to detect stress and reduce slippage into NPAs
- (iv) Reporting of repayment behaviour of borrowers in their loan accounts to credit information companies and inclusion of this information in the credit appraisal and decision-making process for further sanctioning of loans to borrowers.

Q11. RTP May 2023

BOT Limited is enjoying cash credit facility sanctioned from Nariman Point, Mumbai branch of KNB Bank for Rs.250 crore. However, for practical considerations, various sub-limits have been fixed for the borrower company for operation at Solapur, Pune and Nashik branches of the same bank. The manager of the Solapur branch notices that there are no credit transactions in sub-limit account being operated at the Solapur branch for more than 90 days as on 31st March, 2022. Discuss the approach of CA. Muni, statutory branch auditor of Nariman Point branch, Mumbai of KNB Bank, in the matter of asset classification of the above borrower account. Also discuss considerations for classifying said account at the Solapur branch.

Answer:

Sometimes, a customer is sanctioned a cash credit limit at one branch but is authorised to utilise such overall limit at several other branches also, for each of which a sub-limit is fixed.

In such a case, the determination of status of the account as NPA or otherwise should be determined at the limit-sanctioning branch with reference to the overall sanctioned limit/drawing power and not by each of the other branches where a sub-limit has been fixed.

The auditor of the limit-sanctioning branch should examine whether it receives particulars of all transactions in the account at sub-limit branches and whether status of the account has been determined considering the total position of operation of the account at all concerned branches. The standalone matter of no credit transactions for more than 90 days as on 31st March, 2022 at Solapur branch is irrelevant.

Hence, keeping in view above, CA. Muni should consider asset classification considering the total position of operation of the account at all concerned branches.

Regarding sub-limit at branches, the classification adopted by the limit-sanctioning branch should be followed. Hence, the Solapur branch has to follow asset classification made by the limit-sanctioning branch.

Q12. RTP Nov 2022

CA Prachi was conducting statutory audit of branch of a nationalized bank for the year 2021-22. While reviewing operations and documents/papers of a borrower enjoying overdraft credit facilities of ₹ 50 crore (availed against security of stocks and book debts), following observations were jotted down by her: -

- (i) The balance in overdraft credit facility as on 31st March, 2022 was ₹ 55.65 crore. The balance in account exceeded sanctioned limit during the whole month of March 2022.
- (ii) As per terms of sanction letter, stock/book debt statements were required to be submitted monthly. Latest available stock/book debt statement for the month of February, 2022 showed drawing power of ₹ 48.50 crore only. However, stock/book debt statements of previous months showed adequate drawing power.

- (iii) Stock audit of borrower was also conducted during the year by one of empanelled stock auditors of the bank. Stock audit report dated 31st December, 2021 placed on the record showed adequate drawing power in the account. However, it has commented adversely on the declining turnover of borrower in year 2021 -22 (till the date of stock audit report) as compared to proportionate turnover in preceding year.
- (iv) The renewal of overdraft facilities was due on 20th October, 2021. The account was short renewed by competent authority for a period of 3 months pending submission of complete papers.

However, borrower has not submitted complete renewal papers till 31st March, 2022. There is a request letter from borrower on record stating that valuation report of a property located at a faraway location was taking time.

The branch has classified the account as 'Standard Asset'. Considering above, CA Prachi is in dilemma relating to proper classification of above advance. Guide her.

Answer:

The borrower was enjoying overdraft credit facilities of ₹ 50 crore against security of stocks and debts. Further, though latest available stock statement for the month of February, 2022 showed inadequate drawing power, there was adequate drawing power available throughout the year. Stock audit report dated 31.12.2021 also reflected adequate drawing power. Hence, it shows that borrower had adequate drawing power during the year. Further, comment on declining sales is of general informative value to management for making credit decisions.

The fact of over drawings in account during the month of March, 2022 and inadequate drawing power in a month are in nature of temporary deficiencies and do not require account to be classified as NPA in accordance with asset classification and provisioning norms of RBI.

RBI instructions lay down that ordinarily credit limits need to be reviewed not later than three months from the due date. As per Guidance note on Audit of Banks, in case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is underway and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the credit limits have not been reviewed/ renewed within 180 days from the due date will be treated as NPA.

It would be pertinent to note that the counting of 180 days would be required to be done from the date of original due date for renewal and not from the date of expiry of short reviews / technical reviews. In the instant case, the original date of renewal was 20th October, 2021 and period of 180 days has still not expired as on balance sheet date.

Keeping in view all above factors, CA Prachi should accept classification of account as 'Standard Asset' made by branch.

Q13. RTP May 2022

You have been appointed as an auditor of OM Bank, a nationalized bank. OM Bank also deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over the storage and issue of credit cards. How will you evaluate the Internal Control System in the area of Credit Card operations of a Bank?

Answer:

Credit Card Operations:

- There should be an effective screening of applications with reasonably good credit assessments.
- There should be strict control over storage and the issue of cards.
- There should be a system whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement, in case the amount to be settled exceeds a specified percentage of the total limit of the cardholder.
- There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- Reimbursement to merchants should be made only after verification of the validity of the merchant's acceptance of cards.
- All the reimbursement (gross of commission) should be immediately charged to the customer's account.

- There should be a system to ensure that statements are sent regularly and promptly to the customer.
- There should be a system to monitor and follow-up customers' payments.
- Payments overdue beyond a reasonable period should be identified and attended to carefully. For defaulting customers, credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

Q14. RTP Nov 2021

Gupta & Co. has been appointed as a statutory auditor of TCB Bank Ltd., a private sector bank, registered with RBI. Mr. Kaival Gupta, the engagement partner, while performing the audit as per the checklist, noted down the following points, which would be part of the audit queries, as tabulated below:

Sr.No.	Query
1	Interest on State Government Guaranteed advance has been taken to income even though such advance has remained overdue for more than 90 days.
2	There is an account for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction and such account has been treated as a performing asset in the books.
3	One of the NPAs was sold for a value higher than the net book value. Profit was not recognized but the excess provision in respect of the same has been reversed.
4	In case of one of the accounts, an additional temporary limit has been sanctioned for 25% of the existing limit and for 120 days tenure.
5	On verification of outstanding forward exchange contracts, the 'net position' in respect of one of the foreign currencies was not squared and was uncovered by a substantial amount.

You are required to provide the reasons due to which such queries would have been raised by Mr. Kaival and describe the actions that may be taken by the person responsible on behalf of TCB Bank Ltd. for solving such queries.

Answer:

Sr.No.	Reason for such Query	Action that may be taken in response to the query
1	A State Government Guaranteed advance has to be treated as NPA even if it remains overdue for more than 90 days and in case of NPA, for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized.	Interest income recognized on such advance would be reversed and would be taken to income only when it is realized.
2	Accounts for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction, should be considered as NPA.	It's treatment in the books would be changed from performing asset to a non-performing asset from the date when such change in the treatment was required.
3	In case of sale of NPA, where the sale is for a value higher than the NBV, the auditor is required to ensure that no profit is recognized, and the excess provision has not been reversed but retained to meet the shortfall/ loss that may arise because of the sale of other non- performing financial assets.	The entry for reversal of the excess provision would be cancelled in the books and such excess provision would be retained to meet the shortfall/ loss that may arise because of the sale of other non-performing financial assets.

4	Additional temporary limit may be sanctioned, for a maximum of 20% of the existing limit and 90 days maximum tenure.	The terms of additional temporary limit in case of such account would be revised to 20% of the existing limit and for 90 days maximum tenure.
5	Net position in respect of each of the foreign currencies should be generally squared and should not be uncovered by a substantial amount.	The net "position" of the branch in relation to each foreign currency should be squared off and get covered by a substantial amount.

Q15. RTP Nov 2020

BN Bank was engaged in the business of providing Portfolio Management Services to its customers, for which it took prior approval from RBI. Your firm has been appointed as the statutory auditors of the Bank's financial statements for the year 2019-20. Your senior has instructed you to verify the transactions of Portfolio Management Services (PMS). While verifying the transactions you noticed that the bank has not maintained separate record for PMS transactions from the Bank's own investments. As a statutory auditor what methodology will be adopted by you for verification of PMS transactions?

Answer:

Separation of Investment Functions: The auditor needs to examine whether the bank, as required by the RBI, is maintaining separate accounts for the investments made by it on their own Investment Account, PMS clients' account, and on behalf of other Constituents (including brokers). As per the RBI guidelines, banks are required to get their investments under PMS separately audited by external auditors.

Thus, in the instant case, ABN Bank is required to prepare separate records for PMS and as per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions and advise the bank to segregate the PMS transactions from its own investments and provide the certificate of external auditor as described above. In case ABN Bank does not provide the same the auditor may report accordingly.

Q16. RTP May 2020

In course of audit of Good Samaritan Bank as at 31st March, 2019 you observed the following:

- (1) In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government?
- (2) The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.

Answer:

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

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

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

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

- (2) The Audit Programme to Verify Advances against Life Insurance Policies is as under-

- (i) The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer.
- (ii) The auditor should also examine whether premium has been paid on the policies and whether they are in force.
- (iii) Certificate regarding surrender value obtained from the insurer should be examined.
- (iv) The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

Q17. RTP Nov 2019

- (a) In course of audit of True Princi Bank as at 31st March, 2019, you observed that in a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Comment. Would your answer be different if the advance is guaranteed by a State Government?
- (b) While auditing FAIR Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks.

Answer:

- (a) Government Guaranteed Advance: If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.
Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.
The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.
In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.
- (b) Contingent Liabilities for Banks: The Third Schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet-
 - (A) Contingent liabilities
 - (i) Claims against the bank not acknowledged as debts.
 - (ii) Liability for partly paid investments.
 - (iii) Liability on account of outstanding forward exchange contracts.
 - (iv) Guarantees given on behalf of constituents-
 - (1) In India.
 - (2) Outside India.
 - (v) Acceptances, endorsements and other obligations.
 - (vi) Other items for which the bank is contingently liable.
 - (B) Bills for collection.

Q18. RTP May 2019

- (a) ABC Chartered Accountants have been appointed as concurrent auditors for the branches of Effective Bank Ltd. for the year 2017-18. You are part of the audit team for Agra branch of the bank and have been instructed by your senior to verify the advances of the audit period. You are required to guide your assistant about the areas to be taken care while doing verification during the concurrent audit.
- (b) Write a short note on reversal of income under bank audit.

Answer:

- (a) Verification of Advances as a Concurrent Auditor:

- (i) Ensure that loans and advances have been sanctioned properly (i.e. after due scrutiny and at the appropriate level).
 - (ii) Verify whether the sanctions are in accordance with delegated authority.
 - (iii) Ensure that securities and documents have been received and properly charged/ registered.
 - (iv) Ensure that post disbursement supervision and follow-up is proper, such as receipt of stock statements, instalments, renewal of limits, etc.
 - (v) Verify whether there is any mis utilisation of the loans and whether there are instances indicative of diversion of funds.
 - (vi) Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions.
 - (vii) Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates.
 - (viii) Ensure proper follow-up of overdue bills of exchange.
 - (ix) Verify whether the classification of advances has been done as per RBI guidelines.
 - (x) Verify whether the submission of claims to DICGC and ECGC is in time.
 - (xi) Verify that instances of exceeding delegated powers have been promptly reported to controlling/Head Office by the branch and have been got confirmed or ratified at the required level.
 - (xii) Verify the frequency and genuineness of such exercise of authority beyond the delegated powers by the concerned officials.
- (b) 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 realised. 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).

Q19. RTP Nov 2018

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager:

- (a) The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year.
- (b) The bank is a consortium member of Cash Credit Facilities of ` 50 crores to X Ltd. Bank's own share is ` 10 crores only. During the last two quarters against a debit of Rs.1.75 crores towards interest the credits in X Ltd's account are to the tune of Rs. 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing.

Answer:

- (a) It is not a prudent practice to treat dividend on shares of corporate bodies and units of mutual funds as income unless these are actually received. Accordingly, income from dividend on shares of corporate bodies and units of mutual funds should be booked on cash basis. In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government. Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This

is also in accordance with AS 9 as well. In the instant case, therefore, the recognition of income by the bank on accrual basis is not in order.

- (b) The bank is a consortium member of cash credit facilities of Rs.50 crores to X Ltd. Bank's own share is Rs.10 crores only. During the last two quarters against a debit of Rs.1.75 crores towards interest, the credits in X Ltd's account are to the tune of Rs.1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.

Q20. RTP May 2018

Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

As an expert in bank audit, you are required to briefly discuss the area of focus and suggested audit procedures regarding evaluation of internal controls over advances, substantive audit procedures and recoverability of advances.

Answer:

Audit Procedures -In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

Area of Focus	Suggested Audit Procedures
Evaluation of Internal Controls over Advances	<ul style="list-style-type: none"> Examine loan documentation; Examine the validity of the recorded amounts; Examine the existence, enforceability and valuation of the security; Ensure compliance with the terms of sanction and end use of funds. Ensure compliance with Loan Policy of Bank as well as RBI norms including appropriate classification and provisioning Review the operation of the accounts;
Substantive Audit Procedures	<ul style="list-style-type: none"> Check that amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet. Check that advances represent amount due to the bank. Verify that amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances. Ensure there are no unrecorded advances. Check that the stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation. Verify that the advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements. Check that appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices. Examine all large advances while other advances may be examined on a sample basis

	<ul style="list-style-type: none"> • Verify completeness and accuracy of interest being charged
Recoverability of Advances	<ul style="list-style-type: none"> • Review periodic statements submitted by the borrowers indicating the extent of compliance with terms and conditions. • Review latest financial statements of borrowers. • Review reports on inspection of security. • Review Auditors' reports in the case of borrowers enjoying aggregate credit limits of Rupees 10 lakh or above for working capital from the banking system.

Q1. Exam May 2023, 5 marks

RB & Co. are the statutory auditors of Legal Finance Ltd., an NBFC engaged in the business of accepting public deposits and giving loans. Auditors are concerned that the format of the financial statements should be prepared as per the notification issued by the Ministry of Corporate Affairs dated 11th October, 2018. While auditing there was a difference of opinion between CA R and CA B regarding the disclosure of "Other Income" in the financial statements. CA R believes that there is no difference in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Is the contention of CA R correct?

Answer:

Though presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent however there are certain following differences in the same:

- (a) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or ` 10 lakhs, whichever is higher.
- (b) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II.
- (c) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.
- (d) NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of showing those only as part of the notes.
- (e) Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired.
- (f) The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.

In view of the above, contention of CA R that there is no difference in the presentation requirement between Division II and Division III of the Companies Act, 2013 is not correct.

Q2. Exam Dec 2021, 4 marks

ABC Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by Government or local authorities. For the year ended 31st March, 2021 following are some extracts from the financial statements:

(i) Paid-up share capital	Rs.40.53 Cr.
(ii) Non-Current Assets - Loans & Advances	Rs.55.90 Cr.
(iii) Current Assets - Loans and advances	Rs.344.47 Cr.
(iv) Total assets of the company	Rs.530 Cr.
(v) Intangible assets	Rs.3 Cr.
(vi) Profit for the Year	Rs. 7.25 Cr.
(vii) Income from interest and dividends	Rs. 52 Cr.
(viii)Gross income	Rs.102.57 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise.

Answer:

In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's

- (i) Financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and
- (ii) Income from financial assets constitute more than 50 per cent of the gross income.

A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

In the given case of ABC Ltd, its Financial Assets are =Rs.55.90 + Rs.344.47= Rs.400.37 Cr

Total Assets (netted off by intangible assets) = Rs.527 Cr

Income from financial assets = Rs.52 Cr

Gross Income = Rs.102.57 Cr

From the above, it is clear that ABC Ltd.'s financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitutes more than 50 per cent of the gross income. Hence, ABC Ltd. fulfills both these criteria to qualify as an NBFC.

Thus ABC Ltd. can apply for registration under Section 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

Q3. Exam Nov 2020, 5 marks

CA Nadar is conducting the statutory audit of RHL Ltd., a non-banking financial company. It has branches in various parts of India. The company with a focus on housing finance, has outstanding non convertible debentures worth ` 150 Crores. The company reportedly missed interest payments of INR 15 Crores on its debts because of inadequate liquidity. As a result, RHL Ltd. faced a series of downgrades by rating agencies on its debts over the past two months. Rating was cut to D from A4 implying that the company was in default or expected to be in default soon. What aspects CA Nadar should look into in relation to the activity of mobilization of public deposits (particularly in relation to downgrading of credit facilities) by RHL Ltd?

Answer:

CA Nadar has to ascertain whether the company has complied with the following aspects in relation to the activity of mobilization of public deposits:-

- i. The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will have to increase/reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame and should ensure that the NBF Chas informed about the same to the RBI inwriting.
- ii. In the event of downgrading of credit rating below the minimum specified investment grade, a non-banking financial company, being an investment and credit company or a factor, shall regularise the excess deposit as provided hereunder:
 - a. with immediate effect, stop accepting fresh public deposits and renewing existing deposits;
 - b. all existing deposits shall run off to maturity; and
 - c. report the position within 15 working days, to the concerned Regional Office of the RBI where the NBFC is registered.
 - d. No matured public deposit shall be renewed without the express and voluntary consent of the depositor.

Q4. Exam Nov 2019, 5 marks

Mr. G. has been appointed as an auditor of LMP Ltd., a NBFC company registered with RBI. Mr. G is concerned about whether the format of financial statements prepared by LMP Ltd. is as per notification issued by the Ministry of Corporate Affairs (MCA) dated October 11, 2018. The notification prescribed the format in Division III under Schedule III of the Companies Act, 2013 applicable to NBFCs complying with Ind-AS. Mr. G wants to know the differences in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Help Mr. G.

Answer:

Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III –The Ministry of Corporate Affairs (MCA) vide notification dated October 11, 2018 introduced Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs complying with Ind- AS has been prescribed.

The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

- (i) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II.
- (ii) Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.
- (iii) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or . 10 lakhs, whichever is higher.
- (iv) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.
- (v) NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of as part of the notes.

Q5. RTP May 2023

Write a short note on the following:

- (a) Categorisation of NBFCs carrying out specific activity.
- (b) Role of the Risk Management Committee.
- (c) Qualities of Operational Auditor.

Answer:

- (a) Categorisation of NBFCs carrying out specific activity: As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs
 - (i) NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure.
 - (ii) NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer.
 - (iii) The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework.
 - (iv) Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice.
- (a) Role of the Risk Management Committee: The role of the Risk Management Committee shall, inter alia, include the following:
 - (i) To formulate a detailed risk management policy which shall include: (a) A framework for identification of internal and external risks specifically faced by the listed entity, in particular including financial, operational, sectoral, sustainability (particularly, ESG related risks), information, cyber security risks or any other risk as may be determined by the Committee. (b) Measures for risk mitigation including systems and processes for internal control of identified risks.
Business continuity plan.
 - (ii) To ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company.
 - (iii) To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management systems.
 - (iv) To periodically review the risk management policy, at least once in two years, including by considering the changing industry dynamics and evolving complexity.
 - (v) To keep the board of directors informed about the nature and content of its discussions, recommendations and actions to be taken.
 - (vi) The appointment, removal and terms of remuneration of the Chief Risk Officer (if any) shall be subject to review by the Risk Management Committee. The Risk Management Committee shall coordinate its activities with other committees, in instances where

there is any overlap with activities of such committees, as per the framework laid down by the board of directors.

- (b) Qualities of Operation Auditor: The operational auditor should possess some very essential personal qualities to be effective in his work:
- In areas beyond accounting and finance, his knowledge ordinarily would be rather scanty, and this is a reason which should make him even more inquisitive.
 - He should ask the who, why, how of everything. He should try to visualise whether simpler alternative means are available to do a particular work.
 - He should try to see everything as to whether that properly fits in the business frame and organisational policy. He should be persistent and should possess an attitude of skepticism.
 - He should imbibe a collaborative and constructive approach rather than a fault - finding approach and should give a feeling that his efforts are to help to attain an improved operation and not merely fault finding.
 - If the auditor succeeds in giving a feeling of help and assistance through constructive criticism, he will be able to obtain the co-operation of the persons who are involved in the operations. This will itself be a tremendous achievement of the operational auditor. He should try to develop a team comprised of people of different backgrounds. The involvement of technical people in operational auditing is generally helpful.

Q6. RTP Nov 2022

Sudarshan Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by Government or local authorities. For the year ended 31st March, 2022 following are some extracts from the financial statements:

(i)	Paid-up share capital	40.53 Cr.
(ii)	Non-Current Assets - Loans & Advances	75.50 Cr.
(iii)	Current Assets - Loans and advances	294.33 Cr.
(iv)	Total assets of the company	618.55 Cr.
(v)	Intangible assets	6.35 Cr.
(vi)	Profit for the Year	8.15 Cr.
(vii)	Income from interest and dividends	62.31 Cr.
(viii)	Gross income	111.23 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise.

In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's

- Financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and
- Income from financial assets constitute more than 50 per cent of the gross income.

Answer:

A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

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

A. Financial Assets of Sudarshan Ltd. are =

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

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

Total assets of the company	618.55 Cr.
Less: Intangible assets	6.35 Cr.

Total Assets (netted off by intangible assets)	612.20 Cr.
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In view of above, Financial assets of Sudarshan Ltd. constitute more than 50 per cent of the total assets (netted off by intangible assets).

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

Income from financial assets = 62.31 Cr

Gross Income = 111.23 Cr

From the above, it is clear that Sudarshan Ltd.'s financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitutes more than 50 per cent of the gross income. Hence, Sudarshan Ltd. fulfills both these criteria to qualify as an NBFC.

Thus Sudarshan Ltd. can apply for registration under Section 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

Q7. RTP May 2020

Write a short note on the following:

- (a) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III

Answer:

- (a) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III –The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:
- NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.
 - An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or ` 10 lakhs, whichever is higher.
 - NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member. NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of as part of the notes.

Q8. RTP Nov 2019

Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC).

Answer:

Some points that may be covered in the audit of NBFC - Investment and Credit Company (NBFC-ICC):

- Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- Verify whether the NBFC has not advanced any loans against the security of its own shares.

- iii. Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.
- iv. Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
- v. Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.
- vi. Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
- vii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- viii. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- ix. An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- x. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- xi. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).
- xii. Verify charges received or paid in respect of securities lend/borrowed.
- xiii. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
- xiv. An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.
- xv. An auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which an advance could be considered realisable.
- xvi. Obtain balance confirmations from the concerned parties.
- xvii. As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscounted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.
- xviii. Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.
- xix. An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.
- xx. Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful

Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

(Note: The above checklist is not exhaustive. It is only illustrative. There could be various other audit procedures which may be performed for audit of an NBFC.)

Q9. RTP May 2019

Write a short note on the following:

- (a) Classification of Frauds by NBFC

Answer:

- (a) Classification of Frauds by NBFC: In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:
- (i) Misappropriation and criminal breach of trust.
 - (ii) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
 - (iii) Unauthorised credit facilities extended for reward or for illegal gratification.
 - (iv) Negligence and cash shortages.
 - (v) Cheating and forgery.
 - (vi) Irregularities in foreign exchange transactions.
 - (vii) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

- (i) cases of cash shortages more than Rs.10,000/- and
- (ii) cases of cash shortages more than RS.5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the prescribed format and procedures.

Q10. RTP Nov 2018

You are appointed as the auditor of a NBFC which is an Investment company registered with RBI. What shall be the special points to be covered for the audit of NBFC in case of Investment companies?

Answer:

Special points that may be covered in the audit of NBFCs in case of Investment Companies are given below:

- i. Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- ii. NBFC Prudential Norms stipulates that NBFCs should not lend more than 15% of its owned funds to any single borrower and not more than 25% to any single group of borrower. The ceiling on investments in shares by a NBFC in a single entity and the aggregate of investments in a single group of entities has been fixed at 15% and 25% respectively. Moreover, a composite limit of credit to and investments in a single entity/group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC. Verify that the credit facilities extended and investments made by the concerned NBFC are in accordance with the prescribed ceiling.
- iii. Verify whether the NBFC has not advanced any loans against the security of its own shares.
- iv. Verify that dividend income wherever declared by a company, has been duly received by a NBFC and interest wherever due [except in case of NPAs] has been duly accounted for.

- v. Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
- vi. Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.
- vii. Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
- viii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- ix. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- x. An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- xi. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- xii. In the case of securities lent/borrowed under the Securities Lending Scheme of SEBI, verify the agreement entered into with the approved intermediary (i.e. the person through whom the lender will deposit and the borrower will borrow the securities for lending/borrowing) with regards to the period of depositing/lending securities, fees for depositing/lending, collateral securities and provision for the return including pre-mature return of the securities deposited/lent.
- xiii. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.)
- xiv. Verify charges received or paid in respect of securities lent/borrowed.
- xv. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.

Q1. Exam Nov 2022, 5 marks

NR Ltd., a leading manufacturer of kids garments has decided to acquire TP Ltd. TP Ltd. is currently engaged in the manufacture of ladies garments. NR Ltd, entrusted you to carry out the due diligence and value TP Ltd. The valuation of TP Ltd. is dependent on future maintainable sales of the company. Discuss the factors that you would consider in assessing the future maintainable sales of TP Ltd.

Answer:

In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

- (i) Trend: Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
- (ii) Marketability: Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- (iii) Political and economic considerations: Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
- (iv) Competition: What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

Q2. Exam Jan 2021, 5 marks

A European company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of 51% and assets over ` 1000 Crores. It requests you to conduct "Due Diligence" of assets of this Indian Company to find out, if any of the assets is overvalued. List down the areas of due diligence exercise to find out overvalued assets.

Answer:

A European company which is manufacturing and distributing industrial gases is looking forward to acquire an Indian company having 51% market share and assets beyond ` 1000 crores. Areas to be covered as a part of due diligence exercise to find out over valued assets would be as under:

1. Uncollected/uncollectable receivables.
2. Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company..
3. Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
4. Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
5. Litigated assets and property.
6. Investments carried at cost though realizable value is much lower.
7. Investments carrying a very low rate of income / return.
8. Infertuous project expenditure/deferred revenue expenditure etc.
9. Group Company balances under reconciliation etc.
10. Intangibles of no value.

Q3. RTP May 2023

CA. Sanjana is acting as Credit manager in branch of DFC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth ` 10 crore for meeting usual business requirements. It is a prospective new client. She checks past history of the company, back ground of promoters & directors, shareholding pattern and nature of business. Assessment of financial

results of past years and future projections is also undertaken. She also carries out SWOT analysis of the company.

Besides, assessment of net worth of directors is also undertaken. Status of CIBIL score and position of name of promoters/directors in RBI defaulter list is also verified.

She also makes discreet inquiries from few clients of the branch engaged in similar line of activity regarding credit worthiness of company, its promoters and directors.

Based on above-

- (a) Identify activity being performed by CA Sanjana and discuss its nature.
- (b) Would your answer be different if this activity was to be performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.
- (c) Name any three other areas where identified activity can be undertaken.

Answer:

- (a) The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.

Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

- (b) There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.
- (c) The areas where due diligence may be undertaken are: -
- (i) Corporate restructuring
 - (ii) Venture capital financing
 - (iii) Public offerings

Q4. RTP Nov 2020

APK Bank Ltd., received an application from a Pharmaceutical Company for takeover of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. APK Bank Ltd., requires you to conduct a due diligence audit in the areas of assets of Pharmaceutical Company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.

Answer:

Over-Valued Assets : The areas of analysis in order to ensure that the assets are not stated at overvalued amounts during conduct of Due Diligence are:

- Uncollected/uncollectable receivables.
- Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- Litigated assets and property.
- Investments carried at cost though realizable value is much lower.

- Investments carrying a very low rate of income / return.
- Infertuous project expenditure/deferred revenue expenditure etc.
- Group Company balances under reconciliation etc.
- Intangibles of no value.

Q5. RTP Nov 2019

Beta Ltd. is anticipating taking over a manufacturing concern and appoints you for due diligence review. While reviewing, it requests you to look specifically for any hidden liabilities and overvalued assets. State in brief the major areas you would examine for hidden liabilities and overvalued assets.

Answer:

Major areas to examine in course of Due Diligence Review: 'Due Diligence' is a term that is often heard in the corporate world these days in relation to corporate restructuring. The purpose of due diligence is to assist the purchaser or the investor in finding out all he can, reasonably about the business he is acquiring or investing in prior to completion of the transaction including its critical success factors as well as its strength and weaknesses.

Due diligence is an all pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review of Financial Statements. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does not involve examination from the view point of extraordinary items, analysis of significant deviations, etc.

However, in order to investigate hidden liabilities, the auditor should pay his attention to the following areas:

- The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
- The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
- Tax liabilities under direct and indirect taxes.
- Long pending sales tax assessments.
- Pending final assessments of customs duty where provisional assessment only has been completed.
- Agreement to buy back shares sold at a stated price.
- Future lease liabilities.
- Environmental problems/claims/third party claims.
- Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
- Huge labour claims under negotiation when the labour wage agreement has already expired.
- Contingent liabilities not shown in books.

Regularly Overvalued Assets:

The auditor shall have to specifically examine the following areas:

- Uncollected/uncollectable receivables.
- Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- Litigated assets and property.
- Investments carried at cost though realizable value is much lower.

- Investments carrying a very low rate of income / return.
- Infructuous project expenditure/deferred revenue expenditure etc.
- Group Company balances under reconciliation etc.
- Intangibles of no value.

Q1. Exam May 2023, 4 marks

AB Ltd wants to acquire a unit of CT Ltd. AB Ltd is uncertain about the future viability of the unit under consideration. You are appointed to investigate economic and financial position of the unit. What are the factors that you shall consider while studying the economic and financial position of the business?

Answer:

For studying the economic and financial position of the business, the following should be considered:

- (i) The adequacy or otherwise of fixed and working capital. Are these sufficient for the growth of the business?
- (ii) What will be the trend of the sales and profits in the future? Establishing the trend of sales, product-wise and area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in the future.
- (iii) Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?
- (iv) Whether the business is operating at its 100

Q2. Exam July 2021, 5 marks

Milk Ltd. is engaged in the business of manufacturing and distribution of various milk products like cheese, curd, paneer, etc. Government made certain changes in rules and regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor, who can fund some part of the proposed expansion. Mr. X is interested in the venture and appoints you to act as an advisor to the proposed investment in the business of Milk Ltd. You have to investigate the audited financial statements and ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking and whether you can put reliance on already audited statement of accounts?

Answer:

Process used for checking and reliance on already audited statement of accounts -

Following process may be carried out-

1. If the statements of account produced before the investigator were not audited by a qualified accountant, then of course there arises a natural duty to get the figures in the accounts properly checked and verified.
2. However, when the accounts produced to the investigator have been specially prepared by a professional accountant, who knows or ought to have known that these were prepared for purposes of the investigation, he could accept them as correct relying on the principle of liability to third parties.
3. Nevertheless, it would be prudent to see first that such accounts were prepared with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared.

Whether the investigator can put reliance on the already audited statement of account If the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require t o test everything afresh.

Q3. RTP Nov 2023

CA. Kushal has been appointed as an Investigator by M/s. XYZ and Associates. While undertaking this assignment of investigation, the subordinate staff of CA. Kushal inquired about the following issues:

- (i) Whether an investigator is required to undertake the cent per cent verification approach or whether he can adopt selective verification?
- (ii) Whether an investigator necessarily requires assistance of expert?
- (iii) Whether an investigator can retain working papers or not?

Guide CA. Kushal in solving the queries raised by his sub-ordinate staff.

Answer:

23. Investigations broadly range between two extremes; on the one hand there are those in respect of which complete accounts, documents, records and other information are available, and on the other, those in respect of which little information, besides published accounts and statistical data, is available. Then again, investigation may cover the whole of accounting or may relate to only a part or parts of accounting as may be specified. Some more issues often arise in investigation. They are stated below:

- (a) Whether an investigator is required to undertake a cent per cent verification approach or whether he can adopt selective verification - The answer to this question depends on the exact circumstances of the case under investigation. If the investigator has to establish the amount of cash defalcated by the cashier, he has probably no option but to carefully examine all the cash vouchers and related records. On the other hand, if he is to arrive at the profitability of a concern, he may verify constituent transactions on a selective basis taking extreme care to see that no material transaction that affects profit has remained concealed from his eyes. In investigation, it is always safer to go by statistically recognised sampling methods than to depend on the so-called "test checks" where circumstances permit selective verification.
- (b) Whether an investigator necessarily requires assistance of expert - Often an investigator may feel the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation. It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation and he should settle the question of costs for obtaining the views and other related implications.
- (c) Whether to retain working papers or not - Another important precaution is that the investigating accountant should retain in his files full notes of the work carried out, copies of schedules and all working papers, annexures, facts, figures, record of conversations and the like. Also, the working papers should link up the figures as shown by the books of business with the final figures produced by the investigating accountant. Wherever required the investigator should take representation letter from the appointing authority. In the absence thereof, he would not be able to explain the figures when he is called upon to give evidence in a court of law to support his figures; for quite often the conclusions of the accountant are challenged by parties whose interest is adversely affected by his findings, for example, when the value of shares of a company taken over by the Government has been determined by him. This will also be of immense help to the investigator in correlating facts and events and later in drafting the report.

Q4. RTP May 2020

ABC nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in-charge of advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

Decide the points you will cover in your investigation before submitting your report to the General Manager.

Answer:

Investigation on Behalf of the Bank for Advances: A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations,

the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points:

- (i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan
- (ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.
- (iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.
- (iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- (v) The history of growth and development of the company and its performance during the past 5 years.
- (vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

- (a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
 - (i) Sales to Average Inventories held.
 - (ii) Sales to Fixed Assets.
 - (iii) Equity to Fixed Assets.
 - (iv) Current Assets to Current Liabilities.
 - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
 - (vi) Equity to Long Term Loans.
 - (vii) Sales to Book Debts.
 - (viii) Return on Capital Employed.
- (c) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank- The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

- 1. Fixed assets - A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.
- 2. Inventory - The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued.

Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.

If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

3. Trade Receivables, including bills receivable - Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

- a. debts due in respect of which the period of credit has not expired;
- b. debts due within six months; and
- c. debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

4. Investments - The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.
5. Secured Loans - Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.
6. Provision of Taxation - The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears to be inadequate, the fact should be stated along with the extent of the shortfall.
7. Other Liabilities - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.
8. Insurance - A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.
9. Contingent Liabilities - By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.
10. The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

Q5. RTP Nov 2019

General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose.

In view of the above, you are required to brief out the difference between Audit and Investigation.

Answer:

Etymologically, auditing and investigation are largely overlapping concepts because auditing is nothing but an investigation used in a broad sense. Both auditing and investigation are fact finding techniques but their basic nature and objectives differ as regards scope, frequency, basis, thrust, depth and conclusiveness. Audit and investigation differ in objectives and in their nature. Auditing is general while investigation is specific.

Basis of Difference	Investigation	Audit
(i) Objective	An investigation aims at establishing a fact or a happening or at assessing a particular situation.	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.
(ii) Scope	The scope of investigation may be governed by statute or it may be non- statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.
(iii) Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either quarterly, half- yearly or yearly.
(iv) Nature	Requires a detailed study and examination of facts and figures.	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion.
(v) Inherent Limitations	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent limitation.
(vi) Evidence	It seeks conclusive evidence.	Audit is mainly concerned with prima- facie evidence.
(vii) Observance of Accounting Principles	It is analytical in nature and requires a thorough mind capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements.
(viii) Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

Q6. RTP May 2019

Mr Sharma is reviewing the anti-fraud controls for a construction company. The company has witnessed a few frauds in the past mainly in the nature of material stolen from the sites and fake expense vouchers.

Mr. Sharma is evaluating options for verifying the process to reveal fraud and the corrective action to be taken in such cases. As an expert, you are required to brief Mr. Sharma about the inventory fraud and verification procedure with respect to defalcation of inventory?

Answer:

Inventory frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

- (i) Employees may simply remove goods from the premises.
- (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
- (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (a) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (b) availability of sufficient data from which such a record can be constructed.

The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

Q7. RTP Nov 2018

A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

List out the points you will cover in your investigation before submitting your report to the General Manager.

Answer:

Investigation on Behalf of the Bank for Advances: A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points:

- (i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.
- (ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.
- (iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.
- (iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- (v) The history of growth and development of the company and its performance during the past 5 years.
- (vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

- (a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
 - (i) Sales to Average Inventories held.
 - (ii) Sales to Fixed Assets.
 - (iii) Equity to Fixed Assets.
 - (iv) Current Assets to Current Liabilities.
 - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
 - (vi) Equity to Long Term Loans.
 - (vii) Sales to Book Debts.
 - (viii) Return on Capital Employed.
- (c) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank - The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

- (a) Fixed assets - A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.
- (b) Inventory - The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued.
Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in

important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.

If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

- (c) Trade Receivables, including bills receivable - Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

- (i) debts due in respect of which the period of credit has not expired;
- (ii) debts due within six months; and
- (iii) debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

- (d) Investments - The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.
- (e) Secured Loans - Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re - payment of a liability should be disclosed.
- (f) Provision of Taxation - The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears to be inadequate, the fact should be stated along with the extent of the shortfall.
- (g) Other Liabilities - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.
- (h) Insurance - A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance- cover appears to be adequate, having regard to the value of assets.
- (i) Contingent Liabilities - By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.
- (j) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

Forensic Accounting
Past Exams and RTP Questions Compiler

Q1. Exam Nov 2022, 4 marks

You have been requested to carry out a forensic audit of a listed entity by the Board of Directors, based on a whistle blower complaint received. Before the commencement of the forensic audit, you and your team, are discussing the various aspects relating to the scope and the procedures to be carried out. What would be the items of discussion with respect to the differences between forensic audit and other audit?

Answer:

Difference between forensic audit and other audit is as under:

Sr. No.	Particulars	Other Audits	Forensic Audit
1	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually taken place in books
2	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
3	Period	Normally for a particulars accounting period.	No such limitations
4	Verification of stock, Estimation realizable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
5	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined
6	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

Q2. Exam May 2022, 5 marks

TQR Limited is engaged in the business of garment manufacturing having registered office at Mumbai and branches across India. Mr. Shyam, one of the senior Managers was involved in creating false documents and legitimate documents were altered to support fictitious transactions. Consequently, the management appointed you to get forensic audit done based on the digital footprint of transactions handled by Mr. Shyam. The use of sound techniques will enable to discover the defalcations on a timely basis. As a forensic auditor how will you deal and suggest Technology based/Digital forensic techniques.

Answer:

(b) Technology based /Digital Forensics Techniques: Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target company hard drives is a requisite facet of any modern forensic audit.

Before taking steps such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy.

Digital investigations can become quite complex and require support from trained digital investigators.

Many open-source digital forensics tools are now available to assist you in this phase of the investigation.

- | | | |
|---------------------------|---------------------------|---------------------|
| (i) Cross Drive Analysis | (ii) Live Analysis | (iii) Deleted Files |
| (iv) Stochastic Forensics | (v) Steganography | (vi) EnCase |
| (vii) MD5 | (viii) Tracking Log Files | (ix) PC System Log |
| (x) Free Log Tools | | |

Q3. Exam Dec 2021, 5 marks

(b) ACT Silk Industries is a leading textile manufacturing listed company. In the course of evidence collection and analysis, it was observed that the company is involved in siphoning of funds through payments to shell companies. Hence, SEBI appointed B & S Associates, Chartered Accountants, as forensic auditors of the company.

Enumerate in brief the steps to be taken by B & S Associates in forensic audit process.

Answer:

Each Forensic accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. Steps to be taken by B & S Associates, as Forensic auditors of the company are:

Step 1. Initialization

It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand. A conflict check should be carried out as soon as the relevant parties are established. It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. Develop Plan

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event. In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- calculating economic damages;
- summarizing a large number of transactions;
- performing a tracing of assets;
- performing present value calculations utilizing appropriate discount rates;
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model; and
- Utilizing charts and graphics to explain the analysis.

Step 5. Reporting

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

Q4. Exam July 2021, 5 marks

M/s GSB Limited is into the business of construction for the past 25 years. Management of the Company came to know that building material sent to construction sites are of substandard quality whereas the payment released by the accounts department of the Company are on the higher side. Forensic Auditor was asked to carry out detailed investigation. Forensic auditor completed his investigation and now preparing his report. What are the broad areas of information that needs to be incorporated in the report of forensic auditor?

Answer:

Broad areas of information to be incorporated in the report of Forensic auditor -

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud.

The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.

Q5. Exam Nov 2020, 4 marks

CA Robo has been appointed as Forensic Auditor by BMV Bank Limited for one of its borrowal accounts WRONG Ltd. CA Robo started the audit by first reviewing the transactions of the borrower in Bank statement as per Bank records to identify any hidden patterns in that information. She had to review huge volume of data, as the number of transactions per day were in hundreds and the data was to be reviewed for the last three years. So, she was stuck up as to how to proceed further to identify any hidden patterns in information, if any. Guide CA Robo, suggesting which technique to be used for identifying any hidden patterns in the information.

Answer:

Data Mining Techniques:

- i. Data mining technique is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns.
- ii. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud.
- iii. It explains various affinities, association, trends and variations in the form of conditional logic.
- iv. Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis.

In the given case of BMV Bank Ltd., CA Robo appointed as forensic auditor for its borrower, WRONG Ltd, shall use above stated data mining techniques to identify any hidden patterns of information.

Q6. Exam May 2019, 4 marks

You have been appointed as a forensic accountant in M/s Secure Ltd. to carry out various analysis as a part of your assignment to arrive at a particular result. Specify the various analysis which might have to be carried out by you to arrive at your result.

Answer:

Perform the Analysis: The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- (i) calculating economic damages;
- (ii) summarizing a large number of transactions;
- (iii) performing a tracing of assets;
- (iv) performing present value calculations utilizing appropriate discount rates;
- (v) performing a regression or sensitivity analysis;
- (vi) utilizing a computerized application such as a spread sheet, data base or computer model; and
- (vii) utilizing charts and graphics to explain the analysis.

Q7. RTP May 2022

Shipra recently qualified as a Chartered Accountant and started her own practice. One of her friends told her that Forensic Audit is a new area and has a lot of potential in terms of professional opportunities and remuneration. Seema said that there is nothing new in this as ultimately forensic audit is also like other audits. Do you agree with the views of Seema? Support your answer with relevant explanation.

Answer:

A forensic accountant will often look for indications of fraud that are not subject to the scope of a financial statement audit. Forensic Accounting has an "Investigative mentality" however auditing is done with "professional scepticism". A forensic accountant will often require more extensive corroboration. A forensic accountant may focus more on seemingly immaterial transactions. Therefore, the contention of Seema is not correct that ultimately forensic audit is also like other audits.

Difference between forensic audit and other audits

Sr. No.	Particulars	Other Audits	Forensic Audit
1	Objectives	Express an opinion as to 'True & Fair' presentation.	Whether fraud has actually taken place in books.
2	Techniques	Substantive & Compliance. Sample based.	Investigative, substantive or in-depth checking.
3	Period	Normally for a particular accounting period.	No such limitations.
4	Verification of stock, Estimation of the realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation.	Independent/verification of suspected/selected items where misappropriation is suspected.
5	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification.	Legal determination of fraud impact and identification of perpetrators depending on scope.

Q8. RTP May 2018

ABC Ltd. is a listed company having turnover of ` 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of ` 20 crore.

Rupees (In crore)	Purpose
10.0	- for Building
8.5	- for Machinery
1.5	- for Working Capital

20 Crore

Project gets implemented in 2017-18 and one of the accountants points out to Managing Director that something wrong has happened in the purchase of building material.

On hearing this, the management is planning to appoint Forensic Auditor. Advise management that how is a forensic accounting analysis is different from an audit.

Answer:

18. Difference between a forensic accounting analysis and an audit: The general public believes that a financial auditor would detect a fraud if one were being perpetrated during the financial auditor's audit. The truth, however, is that the procedures for financial audits are designed to detect material misstatements, not immaterial frauds. While it is true that many of the financial statements and frauds could have, perhaps should have, been detected by financial auditors, the vast majority of frauds could not be detected with the use of financial audits. Reasons include the dependence of financial auditors on a sample and the auditors' reliance on examining the audit trail versus examining the events' and activities behind the documents. The latter is simply resource prohibitive in terms of costs and time.

There are some basic differences today between the procedures of forensic auditors and those of financial auditors. In comparison, forensic accounting and audit differ in specific ways, as shown below:

Forensic Accounting	Audit
<ul style="list-style-type: none"> *In response to an event *Financial investigation *Finding used as evidence in court or to resolve disputes 	<ul style="list-style-type: none"> *Mandatory *Measures compliance with reporting standards •Obtain reasonable assurance that financial statements are free of material misstatement In practice, there are difference in mind set between forensic accounting and audit: •"Investigative mentality" vs. "professional scepticism". A forensic accountant will often require more extensive corroboration. •A forensic accountant may focus more on seemingly immaterial transactions.

forensic accountant will often look for indications of fraud that are not subject to the scope of a financial statement audit.

Sr.No.	Particulars	Other audit	Forensic audit
1	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has taken place in books
2	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in depth checking
3	Period	Normally for a particular accounting period.	No such limitations
4	Verification of stock, Estimation realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where

			misappropriation in suspected
5	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.