

## PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

### PART – I : ACADEMIC UPDATE

(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

#### I. Statements and Standards

1. Statement on Reporting under Section 227(1A) of the Companies Act, 1956 (Section 143(1) of the Companies Act, 2013).
2. Framework for Assurance Engagements.

#### II. Engagements and Quality Control Standards on Auditing

| S.No | SA     | Title of Standard on Auditing   |
|------|--------|---|
| 1    | SQC 1  | Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements |
| 2    | SA 200 | Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing                                  |
| 3    | SA 210 | Agreeing the Terms of Audit Engagements   |
| 4    | SA 220 | Quality Control for Audit of Financial Statements   |
| 5    | SA 230 | Audit Documentation   |
| 6    | SA 240 | The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements  |
| 7    | SA 250 | Consideration of Laws and Regulations in An Audit of Financial Statements   |
| 8    | SA 260 | Communication with Those Charged with Governance <b>(Revised)</b>   |
| 9    | SA 265 | Communicating Deficiencies in Internal Control to Those Charged with Governance and Management  |
| 10   | SA 299 | Responsibility of Joint Auditors  |
| 11   | SA 300 | Planning an Audit of Financial Statements   |
| 12   | SA 315 | Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment                                   |
| 13   | SA 320 | Materiality in Planning and Performing an Audit   |
| 14   | SA 330 | The Auditor's Responses to Assessed Risks   |
| 15   | SA 402 | Audit Considerations Relating to an Entity Using a Service Organization   |

|    |        |  |
|----|--------|--|
| 16 | SA 450 | Evaluation of Misstatements Identified during the Audits   |
| 17 | SA 500 | Audit Evidence   |
| 18 | SA 501 | Audit Evidence - Specific Considerations for Selected Items  |
| 19 | SA 505 | External Confirmations   |
| 20 | SA 510 | Initial Audit Engagements-Opening Balances   |
| 21 | SA 520 | Analytical Procedures  |
| 22 | SA 530 | Audit Sampling   |
| 23 | SA 540 | Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures                                      |
| 24 | SA 550 | Related Parties  |
| 25 | SA 560 | Subsequent Events  |
| 26 | SA 570 | Going Concern <b>(Revised)</b>   |
| 27 | SA 580 | Written Representations  |
| 28 | SA 600 | Using the Work of Another Auditor  |
| 29 | SA 610 | Using the Work of Internal Auditors <b>(Revised)</b>   |
| 30 | SA 620 | Using the Work of an Auditor's Expert  |
| 31 | SA 700 | Forming an Opinion and Reporting on Financial Statements <b>(Revised)</b>  |
| 32 | SA 701 | Communicating Key Audit Matters in the Independent Auditor's Report <b>(New)</b>   |
| 33 | SA 705 | Modifications to the Opinion in the Independent Auditor's Report <b>(Revised)</b>  |
| 34 | SA 706 | Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report <b>(Revised)</b>                         |
| 35 | SA 710 | Comparative Information – Corresponding Figures and Comparative Financial Statements   |
| 36 | SA 720 | The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements                     |
| 37 | SA 800 | Special Considerations-Audits of Financial Statements Prepared in Accordance with Special Purpose Framework                            |
| 38 | SA 805 | Special Considerations-Audits of Single Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement |
| 39 | SA 810 | Engagements to Report on Summary Financial Statements  |

|    |          |   |
|----|----------|---|
| 40 | SRE 2400 | Engagements to Review Historical Financial Statements <b>(Revised)</b>  |
| 41 | SRE 2410 | Review of Interim Financial Information Performed by the Independent Auditor of the Entity                                  |
| 42 | SAE 3400 | The Examination of Prospective Financial Information  |
| 43 | SAE 3402 | Assurance Reports on Controls At a Service Organisation   |
| 44 | SAE 3420 | Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus <b>(New)</b> |
| 45 | SRS 4400 | Engagements to Perform Agreed Upon Procedures Regarding Financial Information   |
| 46 | SRS 4410 | Compilations Engagements <b>(Revised)</b>   |

### III. Guidance Notes and other publications

1. Code of Ethics
2. Guidance Note on Independence of Auditors.
3. Guidance Note on Audit under Section 44AB of the Income-tax Act.
4. Guidance Note on Audit of Inventories.
5. Guidance Note on Audit of Debtors, Loans and Advances.
6. Guidance Note on Audit of Investments.
7. Guidance Note on Audit of Cash and Bank Balances.
8. Guidance Note on Audit of Liabilities.
9. Guidance Note on Audit of Revenue.
10. Guidance Note on Audit of Expenses.
11. Guidance Note on Computer Assisted Audit Techniques (CAATs).
12. Guidance Note on Audit of Payment of Dividend.
13. Guidance Note on Audit of Capital and Reserves.
14. Guidance Note on Audit of Banks.
15. Guidance Note on Audit of Internal Financial Controls over Financial Reporting.
16. Guidance Note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013.
17. Guidance Note on Reporting on Fraud under section 143(12) of the Companies Act, 2013.
18. Guidance Note on the Companies (Auditor's Report) Order, 2016.

**IV Applicability of the Companies Act, 2013:**

- (i) The relevant notified Sections of the Companies Act, 2013 and other legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authorities, cut-off date will be 31<sup>st</sup> October, 2017.
- (ii) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and Companies (Auditor's Report) Order, 2016 are applicable for May, 2018 Examination.
- (iii) Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 issued by RBI are applicable for May, 2018 Examination.
- (iv) Audit provision under GST Laws are applicable for May 2018 Examination.

**Chapter 6 - The Company Audit**

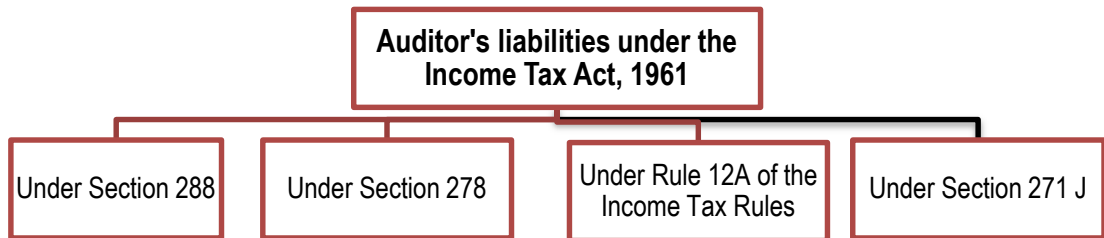
1. In exercise of powers conferred by section 143 read with sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby inserted the **clause “(d) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30th December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company.”**, after clause (c) in rule 11 of the Companies (Audit and Auditors) Rules, 2014. (Insertion in point no. (j) on page no. 6.29 of Module 1 of Study Material)
2. In exercise of the powers conferred by section 139 read with sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby amend Rule 5 of the Companies (Audit and Auditors) Rules, 2014 i.e. in rule 5, in clause (b), for the word “twenty”, the word “**fifty**” shall be substituted. **(amendment in point no. (b) of sub heading 6.3.1 on page no. 6.12 of Module 1 of Study Material)**
3. MCA vide Notification S.O. 2218(E) dated 13<sup>th</sup> July 2017 with respect to the Notification G.S.R. 583(E) Dated 13<sup>th</sup> June, 2017 (Corrigendum), stated that for the words “statement or” to read as “statement and” under section 143(3)(i).
4. Notification No. G.S.R. 583(E) dated 13<sup>th</sup> June, 2017 stated that requirements of reporting under section 143(3)(i) read Rule 10 A of the Companies (Audit and Auditors) Rules, 2014 of the Companies Act 2013 shall not apply to certain private companies. Clarification regarding applicability of exemption given to certain private companies under section 143(3)(i) (vide circular no. 08/2017 dated 25<sup>th</sup> July 2017) clarified that the exemption shall be applicable for those audit reports in respect of financial statements pertaining to financial year, commencing on or after 1<sup>st</sup> April, 2016, which are made on or after the date of the said notification.
5. The Central Government amends the Notification G.S.R. 464(E), dated 5<sup>th</sup> June 2015 Vide Notification G.S.R. 583(E) Dated 13<sup>th</sup> June, 2017. Amendments are given below:
  - (1) Section 143(3)(i), shall not apply to a private company:-

- (i) which is a one person company or a small company; or which has turnover less than rupees fifty crore as per latest audited financial **statement** or which has aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than rupees twenty five crore."

**Chapter 7: Liabilities of Auditor**

**Liabilities under Income Tax Act 1961**

In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal. His liabilities under the Income Tax Act of 1961 are as below:



- (i) **Under Section 288:** A person who has been convicted of any offence connected with any Income Tax proceeding or on whom a penalty has been imposed under the said Act (except under clause (ii) of sub section (1) of Section 271) is disqualified from representing an assessee. The Chief Commissioner/Commissioner of Income Tax has been given powers to determine the period of such disqualification of a person.

| <b><u>Section 288 (4) &amp; (5) of the Income Tax Act, 1961</u></b>  |
|--|
| <p><b>Sub section 4 of Section 288 of the Income Tax Act:</b></p> <p>No person-</p> <p>(a) who has been dismissed or removed from Government service after the 1<sup>st</sup> day of April, 1938; or</p> <p>(b) Who has been convicted of an offence connected with any income tax proceeding or on whom a penalty has been imposed under this Act, other than a penalty imposed on him under [clause(ii) of sub section (1) of section 271 [or clause(d) of sub-section (1) of section 272A]; or</p> <p>(c) who has become an insolvent; or</p> <p>(d) who has been convicted by a court for an offence involving fraud, shall be qualified to represent an assessee under sub-section (1), for all times in the case of a person referred to in clause(a), for such time as the Principal Chief Commissioner or Chief Commission or Principal Commissioner or Commissioner may, by order determine</p> |

in the case of a person referred to in clause (b), for the period during which the insolvency continues in the case of a person referred to in clause (c), and for a period of ten years from the date of conviction in the case of a person referred to in clause (d).

**Sub section 5 of Section 288 of the Income Tax Act:**

If any person-

- (a) who is a legal practitioner or an accountant is found guilty of misconduct in his professional capacity by any authority entitled to institute disciplinary proceedings against him, an order passed by that authority shall have effect in relation to his right to attend before an income-tax authority as it has in relation to his right to practice as a legal practitioner or account, as the case may be;
- (b) Who is not a legal practitioner or an accountant, is found guilty of misconduct in connection with any income-tax proceedings by the prescribed authority, the prescribed authority (Chief Commissioner or Commissioner having requisite jurisdiction) may direct that he shall thenceforth be disqualified to represent an assessee under sub section (1).

A Chartered Accountant found guilty of professional misconduct in his professional capacity by the Council of the Institute of Chartered Accountants of India, can not act as an authorised representative (for any matter within the definition of a member in practice) for such time that the order of the Council disqualifies him from practising.

- (ii) **Under Section 278:** "If a person abets or induces in any manner another person to make and deliver an account or a statement or declaration relating to any income [or any fringe benefits] chargeable to tax which is false and which he either knows to be false or does not believe to be true or to commit an offence under sub-section (1) of section 276C, he shall be punishable,-

**Section 278 of the Income Tax Act, 1961:**

- (i) in a case where the amount of tax, penalty or interest which would have been evaded, if the declaration, account or statement had been accepted as true, or which is willfully attempted to be evaded, exceeds [twenty five] hundred thousand rupees, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;
- (ii) in any other case, with rigorous imprisonment for a term which shall not be less than three months but which may extend to [two] yeas and with fine

- (iii) **Under Rule 12A of the Income Tax Rules:** Under this rule a Chartered Accountant who as an authorised representative has prepared the return filed by the assessee, has to furnish to the Assessing Officer, the particulars of accounts, statements and other documents supplied to him by the assessee for the preparation of the return.

Where the Chartered Accountant has conducted an examination of such records, he has also to submit a report on the scope and results of such examination. The report to be submitted will be a statement within the meaning of Section 277 of the Income Tax Act. Thus if this report contains any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years and to a fine.

- (iv) **Under Section 271J of the Income Tax Act:** As per new section inserted by the Finance Act, 2017 if an accountant or a merchant banker or a registered valuer, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of ten thousand rupees for each such report or certificate by way of penalty. [ section 271J]

#### Chapter 14 - Audit of Non-Banking Financial Companies :

1. **Compliance with NBFC Auditors Report - RBI Directions:** Report to Board of Directors under RBI Directions as per Master Direction No. DNBS. PPD.03/66.15.001/2016-17 dated September 29, 2016
2. **Auditors to submit additional Report to the Board of Directors:** In addition to the Report made by the auditor under Section 143 of the Companies Act, 2013 or section 227 of the Companies Act, 1956 (Act 1 of 1956) on the accounts of a non-banking financial company examined for every financial year ending on any day on or after the commencement of these Directions, the auditor shall also make a separate report to the Board of Directors of the Company on the matters specified in paragraphs 3 and 4 below.
3. **Material to be included in the Auditor's report to the Board of Directors:** The auditor's report on the accounts of a non-banking financial company shall include a statement on the following matters, namely -

**(A) In the case of all non-banking financial companies:**

- I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the Bank is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the Bank's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the Bank.
- II. In case of a company holding CoR issued by the Bank, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.

III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

**Note:** Every non-banking financial company shall submit a Certificate from its Statutory Auditor that it is engaged in the business of non-banking financial institution requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act and is eligible to hold it. A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, within one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year. The format of Statutory Auditor's Certificate (SAC) to be submitted by NBFCS has been issued vide DNBS. PPD.02/66.15.001/2016-17 Master Direction- Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016.

**(B) In the case of a non-banking financial companies accepting/holding public deposits:**

Apart from the matters enumerated in (A) above, the auditor shall include a statement on the following matters, namely-

- (i) Whether the public deposits accepted by the company together with other borrowings indicated below viz.
  - (a) from public by issue of unsecured non-convertible debentures/bonds;
  - (b) from its shareholders (if it is a public limited company); and
  - (c) which are not excluded from the definition of 'public deposit' in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, are within the limits admissible to the company as per the provisions of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;
- (ii) Whether the public deposits held by the company in excess of the quantum of such deposits permissible to it under the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are regularised in the manner provided in the said Directions;
- (iii) Whether the non banking financial company is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency as per the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

- (iv) Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein;
- (v) In respect of non-banking financial companies referred to in clause (iii) above,
  - (a) whether the credit rating, for each of the fixed deposits schemes that has been assigned by one of the Credit Rating Agencies listed in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 is in force; and
  - (b) whether the aggregate amount of deposits outstanding as at any point during the year has exceeded the limit specified by the such Credit Rating Agency;
- (vi) Whether the company has violated any restriction on acceptance of public deposit as provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;
- (vii) Whether the company has defaulted in paying to its depositors the interest and/or principal amount of the deposits after such interest and/or principal became due;
- (viii) Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/investments as specified in the Directions issued by the Bank in terms of the Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016;
- (ix) Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-IB of the RBI Act and whether the details of the designated bank in which the approved securities are held is communicated to the office concerned of the Bank in terms of NBS 3; Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;
- (x) Whether the company has furnished to the Bank within the stipulated period the return on deposits as specified in the NBS 1 to – Non- Banking Financial Company Returns (Reserve Bank) Directions, 2016;
- (xi) Whether the company has furnished to the Bank within the stipulated period the quarterly return on prudential norms as specified in the Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;
- (xii) Whether, in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/offices or in the case of appointment of agent, the company has complied with the requirements

contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

**(C) In the case of a non-banking financial company not accepting public deposits:**

Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matters, namely: -

- (i) Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;
- (ii) Whether the company has accepted any public deposits during the relevant period/year;
- (iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016;
- (iv) In respect of Systemically Important Non-deposit taking NBFCs as defined in Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016:
  - (a) Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in form NBS- 7, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the Bank;
  - (b) Whether the company has furnished to the Bank the annual statement of capital funds, risk assets/exposures and risk asset ratio (NBS-7) within the stipulated period.
- (v) whether the non banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI) as defined in the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

**(D) In the case of a company engaged in the business of non-banking financial institution not required to hold CoR subject to certain conditions:** Apart from the matters enumerated in (A)(i) above where a company has obtained a specific advice from the Bank that it is not required to hold CoR from the Bank, the auditor shall include a statement that the company is complying with the conditions stipulated as advised by the Bank.

**4. Reasons to be stated for unfavourable or qualified statements**

Where, in the auditor's report, the statement regarding any of the items referred to in paragraph 3 above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred to in paragraph 3 above, his report shall indicate such fact together with reasons therefor.

**5. Obligation of auditor to submit an exception report to the Bank**

(I) Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is unfavorable or qualified, or in the opinion of the auditor the company has not complied with:

- (a) the provisions of Chapter III B of RBI Act (Act 2 of 1934); or
- (b) Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
- (c) Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the Bank under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

(II) The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

**Chapter 15 - Audit under Fiscal Laws:****I. Audit Provisions Under Direct Tax Law**

Section 44AB of the Income Tax Act, 1961 relating to Audit of accounts of certain persons carrying on business or profession, the following may be noted: (1) Under clause (b), the gross receipts for person carrying on profession shall be read as exceeding fifty lakhs rupees in any previous year. (2) Under clause (d), the word "business" to be read as "profession" and "section 44AD" to be read as "section 44ADA" (3) After clause (d), a new clause (e) shall be inserted as follows: "(e) carrying on the business shall, if the provisions of sub-section (4) of section 44AD

are applicable in his case and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year”

**Note:**

- (1) Sub-section (4) of section 44AD of the Income Tax Act, 1961 states that where an eligible assessee declares profit for any Previous Year in accordance with the provisions of this section 44AD and he declares profit for any of the 5 Assessment Years relevant to the Previous Year succeeding such Previous Year not in accordance with the provisions of sub-section (1) of section 44AD, he shall not be eligible to claim the benefit of the provisions of this section for 5 Assessment Years subsequent to the Assessment Year relevant to the Previous Year in which the profit has not been declared in accordance with the provisions of sub-section (1) of section 44AD.]”
- (2) Higher threshold for non-audit of accounts for assesseees opting for presumptive taxation under section 44AD: Section 44AB makes it obligatory for every person carrying on business to get his accounts of any previous year audited if his total sales, turnover or gross receipts exceed ₹ 1 crore. However, if an eligible person opts for presumptive taxation scheme as per section 44AD(1), he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed ₹ 2 crore. The CBDT, has vide its Press Release dated 20th June, 2016, clarified that the higher threshold for non-audit of accounts has been given only to assesseees opting for presumptive taxation scheme under section 44AD.
- (3) Reduction in the existing rate of deemed profit under section 44AD in respect of amounts/receipts through banking channel/digital means [Press Release, dated 19-12-2016]<sup>1</sup>

Under the existing provisions of section 44AD of the Income-tax Act, 1961, in case of certain assesseees (i.e. an individual, HUF or a partnership firm other than LLP) carrying on any business (other than transportation, agency, brokerage and commission) and having a turnover of Rs.2 crore or less, the profit is deemed to be 8% of the total turnover.

In order to achieve the Government’s mission of moving towards a less cash economy and to incentivise small traders / businesses to proactively accept payments by digital means, with effect from A.Y. 2017-18 the existing rate of deemed profit of 8% under section 44AD of the Act has been reduced to 6% in respect of the amount of total turnover or gross receipts received through banking channel/digital means i.e., by an A/c payee cheque/bank draft or use of ECS through a bank A/c during the previous year or before the due specified in section 139(1) in respect of that previous year.

---

<sup>1</sup> The Finance Act, 2017 has, with effect from A.Y. 2017-18, inserted a proviso to section 44AD(1) to provide for a presumptive rate of 6% (instead of 8%) in respect of the amount of total turnover or gross receipts received by an A/c payee cheque/bank draft or use of ECS through a bank account.

However, the existing rate of deemed profit of 8% referred to in section 44AD of the Act, shall continue to apply in respect of total turnover or gross receipts received in cash.

**AMENDMENT IN CLAUSE 31 OF FORM 3CD**

- **Clause 31 (a)\*: Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year:-**
  - (i) name, address and permanent account number (if available with the assessee) of the lender or depositor;
  - (ii) amount of loan or deposit taken or accepted;
  - (iii) whether the loan or deposit was squared up during the previous year;
  - (iv) maximum amount outstanding in the account at any time during the previous year;
  - (v) whether the loan or deposit was taken or accepted by cheque or bank draft or use of electronic clearing system through a bank account;
  - (v) in case the loan or deposit was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or an account payee bank draft.

**\*(These particulars need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)**

Section 269SS prescribes the mode of taking or accepting certain loans and deposits. As per this section, no person shall take or accept from any other person any loan or deposit otherwise than by an account payee cheque or account payee bank draft if,-

- (a) the amount of such loan or deposit or the aggregate amount of such loan and deposit; or
- (b) on the date of taking or accepting such loan or deposit, any loan or deposit taken or accepted earlier by such person from the depositor is remaining unpaid (whether repayment has fallen due or not), the amount or the aggregate amount remaining unpaid; or
- (c) the amount or the aggregate amount referred to in clause (a) together with the amount or the aggregate amount referred to in clause (b),

is twenty thousand rupees or more.

For the purposes of section 269SS "loan or deposit" means loan or deposit of money.

If the total of all loans/deposits from a person exceed ₹ 20,000 but each individual item is less than ₹ 20,000, the information will still be required to be given in respect of all such entries starting from the entry when the balance reaches ₹ 20,000 or more and until the balance goes down below ₹ 20,000. As such the tax auditor should verify all loans/deposits

taken or accepted where balance has reached ₹ 20,000 or more during the year for the purpose of reporting under this clause.

- **Clause 31 (b): Particulars of each specified sum in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year: -**
  - (i) name, address and Permanent Account Number (if available with the assessee) of the person from whom specified sum is received;
  - (ii) amount of specified sum taken or accepted;
  - (iii) whether the specified sum was taken or accepted by cheque or bank draft or use of electronic clearing system through a bank account;
  - (iv) in case the specified sum was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or an account payee bank draft.

(Particulars at (a) and (b) need not be given in the case of a Government company, a banking company or a corporation established by the Central, State or Provincial Act.)

- **Clause 31 (c): Particulars of each repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T made during the previous year:-**
  - (i) name, address and Permanent Account Number (if available with the assessee) of the payee;
  - (ii) amount of the repayment;
  - (iii) maximum amount outstanding in the account at any time during the previous year;
  - (iv) whether the repayment was made by cheque or bank draft or use of electronic clearing system through a bank account;
  - (i) in case the repayment was made by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or an account payee bank draft.

This sub-clause requires particulars of each repayment of loan or deposit in an amount exceeding the limits specified in section 269T made during the previous year. Section 269T is attracted where repayment of the loan or deposit is made to a person, where the aggregate amount of loans or deposits held by such person either in his own name or jointly with any other person on the date of such repayment together with interest, if any, payable on such deposit is ₹ 20,000 or more. The tax auditor should verify such repayments and report accordingly.

- **Clause 31 (d): Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year:-**

- (i) name, address and Permanent Account Number (if available with the assessee) of the lender, or depositor or person from whom specified advance is received;
  - (ii) amount of loan or deposit or any specified advance received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year.
- **Clause 31 (e):** Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received by a cheque or bank draft which is not an account payee cheque or account payee bank draft during the previous year:
    - (i) name, address and Permanent Account Number (if available with the assessee) of the lender, or depositor or person from whom specified advance is received;
    - (ii) amount of loan or deposit or any specified advance received by a cheque or a bank draft which is not an account payee cheque or account payee bank draft during the previous year.

(Particulars at (c), (d) and (e) need not be given in the case of a repayment of any loan or deposit or any specified advance taken or accepted from the Government, Government company, banking company or a corporation established by the Central, State or Provincial Act).

## II. Audit provisions under Indirect Tax Laws



The GST roll out on 1<sup>st</sup> July 2017 has paved the way for realization of the goal of “one nation-one tax-one market”. GST is expected to benefit Indian economy overall with most tax compliant businesses getting favourably impacted. It is a trust based taxation regime wherein the assessee is required to self-assess his

returns and determine tax liability without any intervention by the tax official. Therefore, a tax regime that relies on self-assessment has to put in place a robust audit mechanism to measure and ensure compliance of the provisions of law by the taxable person.

Definition of “Audit” has been as per section 2(13) of the CGST Act, 2017 is given below:

“audit” means the examination of records, returns and other documents maintained or furnished by the registered person under this Act or the rules made thereunder or under any other law for the time being in force to verify the correctness of turnover declared, taxes paid, refund claimed and input tax credit availed, and to assess his compliance with the provisions of this Act or the rules made thereunder.”

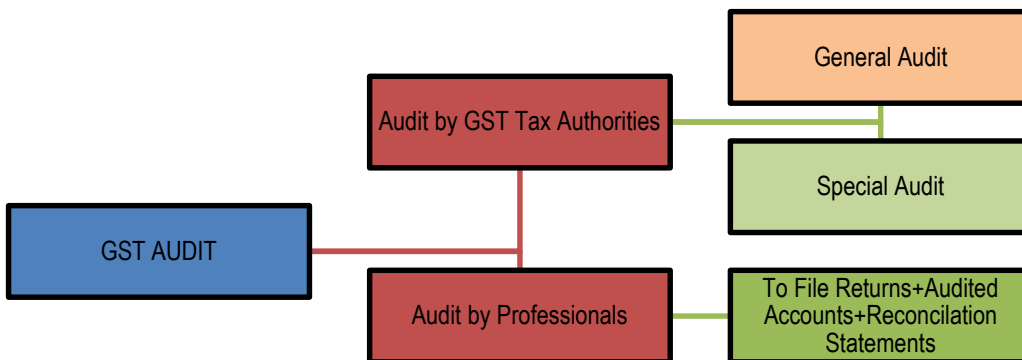
The definition of ‘audit’ under the Act is a wide term covering the examination of records, returns

and documents maintained/ furnished under this Act or Rules and under any other law in force. Any document, record maintained by a registered person under any law can thus be called upon and audited. It becomes critical for the person to maintain true documents/ records to ensure correctness and smooth conduct of audit.

### 1. Types of Audit under GST

GST envisages three types of Audit.

- (1) Audit of accounts [Section 35(5) read alongwith section 44(2) and rule 80]
- (2) Audit by Tax Authorities wherein the Commissioner or any officer authorised by him, can undertake audit of any registered person for such period, at such frequency and in such manner as may be prescribed. [Section 65 and rule 101]
- (3) Special Audit wherein the registered person can be directed to get his records including books of account examined and audited by a chartered accountant or a cost accountant during any stage of scrutiny, inquiry, investigation or any other proceedings; depending upon the complexity of the case. [Section 66 and rule 102]



#### 1.1. Audit of Accounts [Section 35(5) read alongwith section 44(2) and rule 80]

As per sub-section 5 of section 35 read alongwith section 44(2) and rule 80 of the CGST Rules, 2017 stipulates as follows:

|  |  |
|--|--|
| <p>(i) Every registered person must get his accounts audited by a Chartered Accountant or a Cost Accountant if his aggregate turnover* during a FY exceeds ₹ 2 crores.</p> | <p>Such registered person is required to furnish electronically through the common portal alongwith Annual Return a copy of:</p> <p><input type="checkbox"/> Audited annual accounts</p> |
|--|--|

|  |  |
|--|--|
|  | <input type="checkbox"/> A Reconciliation Statement, duly certified, in prescribed FORM GSTR-9C. |
|--|--|

\*Meaning of **Aggregate Turnover** as defined under section 2(6) of the CGST Act:

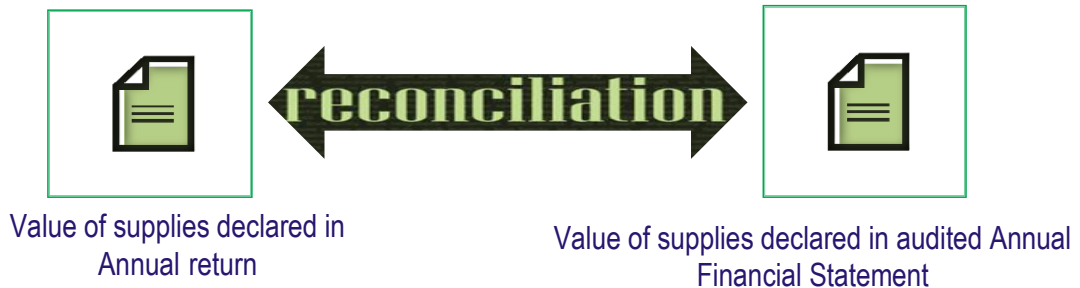
**Includes Value of all outward supplies**

- Taxable supplies
- Exempt supplies
- Exports
- Inter-State supplies of persons having the same PAN be computed on all India basis.

**Excludes the following:**

|                   |   |
|-------------------|---|
| CGST              | SGST  |
| UTGST             | IGST  |
| Compensation cess | Value of inward supplies on which tax is payable under reverse charge |

**Reconciliation Statement** will reconcile the value of supplies declared in the return furnished for the financial year with the audited annual financial statement and such other particulars, as may be prescribed.



**1.2. Audit under section 65:**

| Section    | Description              | Remarks   |
|------------|--------------------------|---|
| Section 65 | Audit by tax authorities | The audit under Section 66 is a special audit to be conducted by a Chartered Accountant or Cost Accountant nominated by the Commissioner whereas the audit under Section 65 is a routine audit by the tax office. |

### 1.3. Special Audit under section 66:

Availing the services of experts is an age old practice of due process of law. These experts have done yeoman service to the process of delivering justice. One such facility extended by the Act is in Section 66 where an officer not below the rank of Assistant Commissioner, duly approved, may avail the services of a Chartered Accountant or Cost Accountant to conduct a detailed examination of specific areas of operations of a registered person. Availing the services of the expert be it a Chartered Accountant or Cost Accountant is permitted by this section only when the officer considering the nature & complexity of the business and in the interest of revenue is of the opinion that:

- ☞ Value has not been correctly declared; or
- ☞ Credit availed is not within the normal limits.

It would be interesting to know how these 'subjective' conclusions will be drawn and how the proper officers determines what is the normal limit of input credit availed.

**Circumstances for Notice for Special Audit:** An Assistant Commissioner who nurses an opinion on the above two aspects, after commencement and before completion of any scrutiny, enquiry, investigation or any other proceedings under the Act, may direct a registered person to get his books of accounts audited by an expert. Such direction is to be issued in accordance with the provision of Rule 102 (1) FORM GST ADT-03

The Assistant Commissioner needs to obtain prior permission of the Commissioner to issue such direction to the taxable person.

Identifying the expert is not left to the registered person whose audit is to be conducted but the expert is to be nominated by the Commissioner.

**Time Limit to Submit the Audit Report:** The Chartered Accountant or the Cost Accountant so appointed shall submit the audit report, mentioning the specified particulars therein, within a period of 90 days, to the Assistant Commissioner in accordance with provision of Rule 102(2) FORM GST ADT-04.

**Extension in Submission of Audit Report:** In the event of an application to the Assistant Commissioner by Chartered Accountant or the Cost Accountant or the registered person seeking an extension, or for any material or sufficient reason, the due date of submission of audit report may be extended by another 90 days.

Considering the special nature of this audit, i.e. audit having been conducted under other proceedings or under other laws; this does not preclude the proper officer from exercising this option.

While the report in respect of the special audit under this section is to be submitted directly to the Assistant Commissioner, the registered person is to be provided an opportunity of being heard in respect of any material gathered in the special audit which is proposed to be used in any proceedings under this Act. This provision does not appear to clearly state whether the

registered person is entitled to receive a copy of the entire audit report or only extracts or merely inferences from the audit. However, the observance of the principles of natural justice in the proceedings arising from this audit would not fail the taxable person on this aspect.

**Expenses for Examination and Remuneration for Audit:** The expenses for examination and audit including the remuneration payable to the auditor will be determined and borne by the Commissioner.

As in the case of audit under section 65, no demand of tax, even *ad interim*, is permitted on completion of the special audit under this section. In case any possible tax liability is identified during the audit, procedure under section 73 or 74 as the case may be is to be followed.

During the course of audit, the registered person to afford the auditor with the necessary facility to verify the books of account and also to furnish the required information and render assistance for timely completion of the audit. As per the CGST Rules on Assessment and Audit Rules, the auditor shall verify the documents on the basis of which the accounts are maintained and the periodical returns/statements are furnished. While conducting the audit, the auditor is authorized to:

- ☒ Verify books & records
- ☒ Returns & statements
- ☒ Correctness of turnover, exemptions & deductions
- ☒ Rate of tax applicable in respect of supply of goods and/or services
- ☒ The input tax credit claimed/availed/unutilized and refund claimed.

Some of the best practices to be adopted for GST audit among others could be:

The evaluation of the internal control *viz-a-viz* GST would indicate the area to be focused. This could be done by verifying:

- (a) The Statutory Audit report which has specific disclosure needs in regard to maintenance of record, stock and fixed assets.
- (b) The Information System Audit report and the internal audit report.
- (c) Internal Control questionnaire designed for GST compliance.
  - (i) The use of generalised audit software to aid the GST audit would ensure modern practice of risk based audit are adopted.
  - (ii) The reconciliation of the books of account or reports from the ERP's to the return is imperative.
  - (iii) The review of the gross trial balance for detecting any incomes being set off with expenses.
  - (iv) Review of purchases/expenses to examine applicability of reverse charge applicable to goods/services. The foreign exchange outgo reconciliation would also be necessary for identifying the liability of import of services.
  - (v) Quantitative reconciliation of stock transfer within the State or for supplies to job workers under exemption.
  - (vi) Ratio analysis could provide vital clues on areas of non-compliance.

**2. Format of Audit report under the GST law:**

| Form GST ADT-04  |                |             |              |      |
|--|----------------|-------------|--------------|------|
| [See Rule 102(2)]  |                |             |              |      |
| Reference No. :  |                |             |              |      |
| Date :   |                |             |              |      |
| To,  |                |             |              |      |
| -----  |                |             |              |      |
| GSTIN .....  |                |             |              |      |
| Name .....   |                |             |              |      |
| Address .....  |                |             |              |      |
| Information of Findings upon Special Audit   |                |             |              |      |
| Your books of account and records for the F.Y..... has been examined by<br>..... (chartered accountant/cost accountant) and this Audit Report is prepared<br>on the basis of information available/documents furnished by you and the<br>findings/discrepancies are as under : |                |             |              |      |
| Short payment of   | Integrated tax | Central tax | State/UT tax | Cess |
| Tax  |                |             |              |      |
| Interest   |                |             |              |      |
| Any other amount   |                |             |              |      |
| [Upload pdf file containing audit observation]   |                |             |              |      |
| You are directed to discharge your statutory liabilities in this regard as per the provisions of<br>the Act and the rules made thereunder, failing which proceedings as deemed fit may be<br>initiated against you under the provisions of the Act.                            |                |             |              |      |
| Signature .....  |                |             |              |      |
| Name .....   |                |             |              |      |
| Designation .....  |                |             |              |      |

**Chapter 18 - Audit of Public Sector Undertakings**

**Elements of PSU Audits:** Public sector auditing augments the confidence of the intended users by providing relevant information and independent and objective assessments concerning deviations from accepted standards or principles of good governance.

Audit of all public-sector undertakings has the following basic elements:

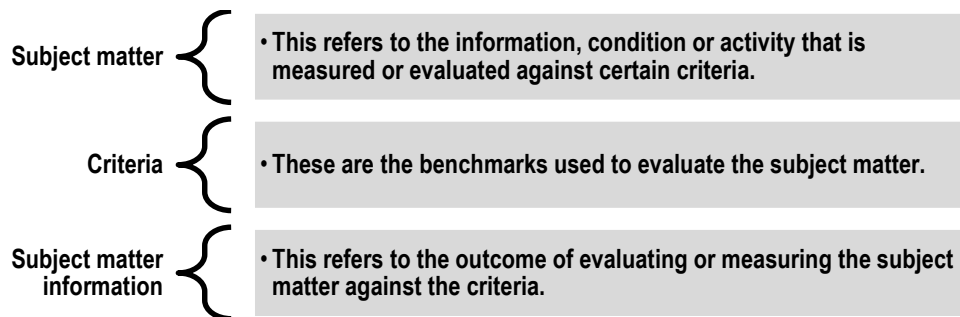
- (a) **The Three parties - Auditor, Responsible party and Intended users.**

**Auditor:** The role of auditor is fulfilled by Supreme Audit Institution (SAI), India and by its personnel delegated with the duty of conducting audits.

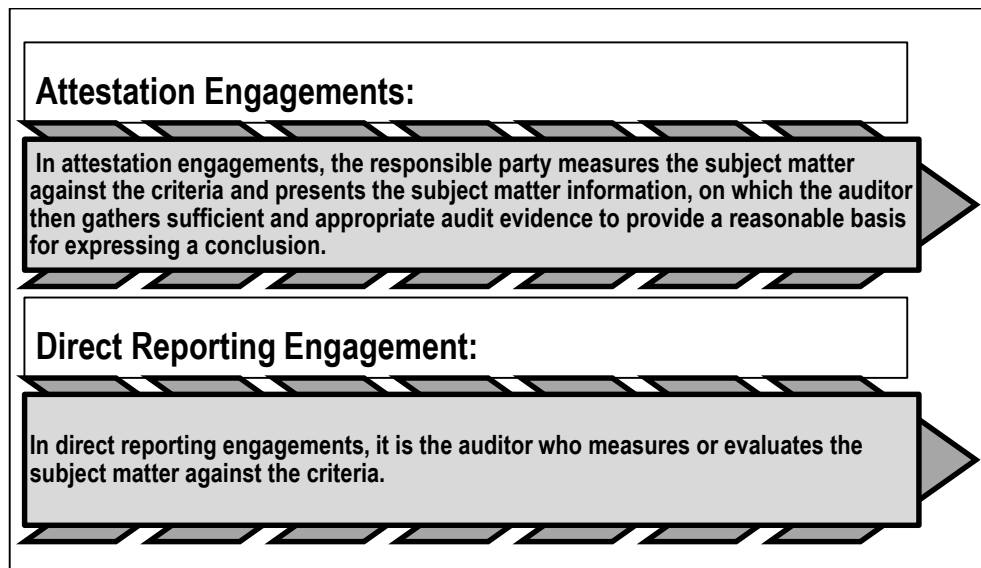
**Responsible party:** The relevant responsibilities are determined by constitutional or legislative arrangement. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations.

**Intended users:** Intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report.

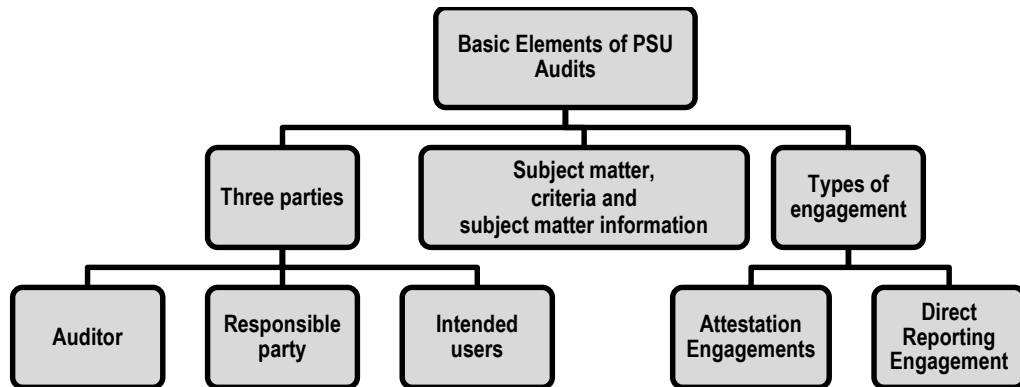
(b) **Subject matter, criteria and subject matter information.**



(c) **Types of engagement - Attestation Engagements and Direct Reporting Engagement.**



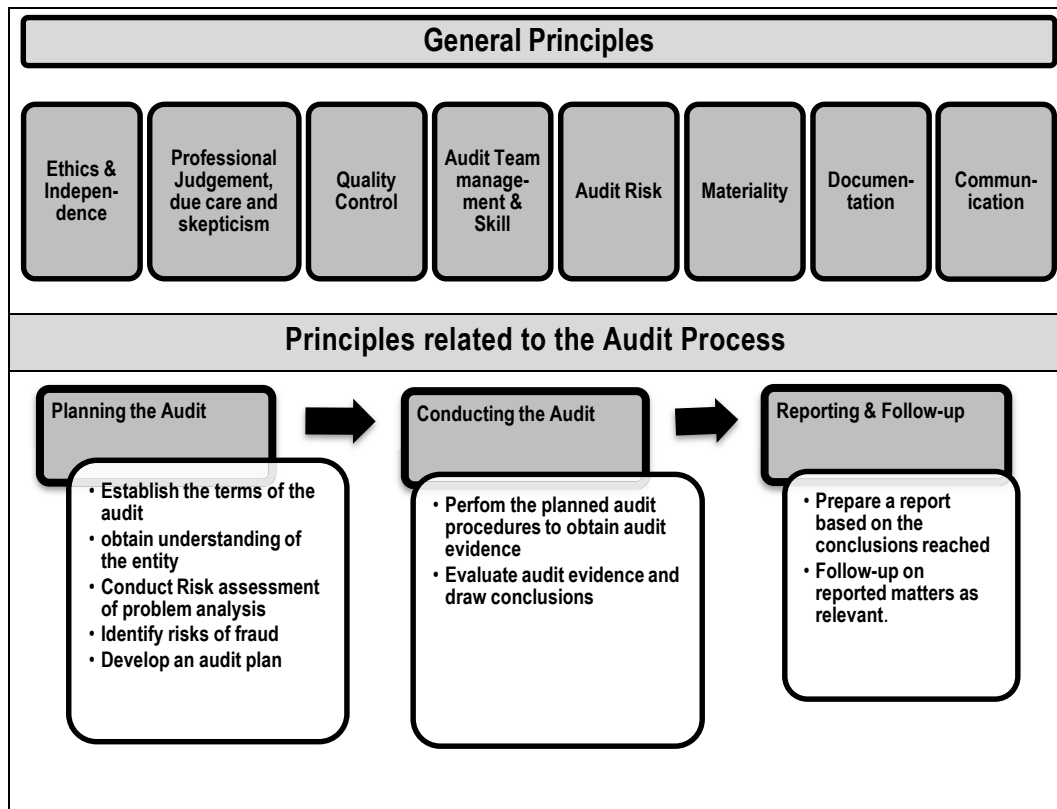
*Financial audits are always attestation engagements, as they are based on financial information presented by the responsible party.  
Performance audits and compliance audits are generally direct reporting engagements.*



**Principles of PSU Audits:** The principles of PSU Audits constitute the general standards that apply to SAI India's personnel as auditors and are fundamental to the conduct of all types of PSU Audits.

The principles are categorized into two distinct groups as below:

- I. General Principles
- II. Principles related to the Audit Process



**Financial Audit:** Financial audit is primarily conducted to:

- ✔ express an audit opinion on the financial statements
- ✔ enhance the degree of confidence of intended users in the financial statements.

The C&AG shall express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In the case of financial statements prepared in accordance with a fair presentation financial reporting framework, whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

**Compliance Audit:** Compliance audit is the independent assessment of whether a given subject matter is in compliance with the applicable authorities identified as criteria.

This audit is carried out by assessing whether activities, financial transactions and information comply in all material respects, with the regulatory and other authorities which govern the audited entity.

**Compliance audit is concerned with:**

- (a) **Regularity-** adherence of the subject matter to the formal criteria emanating from relevant laws, regulations and agreements applicable to the entity.
- (b) **Propriety-** observance of the general principles governing sound financial management and the ethical conduct of public officials.

While regularity is emphasized in compliance auditing, propriety is equally pertinent in the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials.

**Perspective of Compliance Audit:** Compliance Audit is part of a combined audit that may also include other aspects. Compliance auditing is generally conducted either-

- (i) in relation with the audit of financial statements, or
- (ii) separately as individual compliance audits, or
- (iii) in combination with performance auditing.

## Chapter 22 - Code of Ethics

### KYC Norms for CA in Practice

The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI thought it necessary to issue such norms to be observed by the members of the profession who are in practice.

In light of this background, the Council of ICAI approved the following KYC Norms which are

mandatory in nature and shall apply in all assignments pertaining to attest functions.

The KYC Norms approved by the Council of ICAI are given below:

|  |
|--|
| <p><b>1. Where Client is an Individual/ Proprietor</b></p> <p>A. General Information</p> <ul style="list-style-type: none"> <li>✎ Name of the Individual</li> <li>✎ PAN No. or Aadhar Card No. of the Individual</li> <li>✎ Business Description</li> <li>✎ Copy of last Audited Financial Statement</li> </ul> <p>B. Engagement Information</p> <ul style="list-style-type: none"> <li>✎ Type of Engagement</li> </ul>  |
| <p><b>2. Where Client is a Corporate Entity</b></p> <p>A. General Information</p> <ul style="list-style-type: none"> <li>✎ Name and Address of the Entity</li> <li>✎ Business Description</li> <li>✎ Name of the Parent Company in case of Subsidiary</li> <li>✎ Copy of last Audited Financial Statement</li> </ul> <p>B. Engagement Information</p> <ul style="list-style-type: none"> <li>✎ Type of Engagement</li> </ul> <p>C. Regulatory Information</p> <ul style="list-style-type: none"> <li>✎ Company PAN No.</li> <li>✎ Company Identification No.</li> <li>✎ Directors' Names &amp; Addresses</li> <li>✎ Directors' Identification No.</li> </ul> |
| <p><b>3. Where Client is a Non-Corporate Entity</b></p> <p>A. General Information</p> <ul style="list-style-type: none"> <li>✎ Name and Address of the Entity</li> <li>✎ Copy of PAN No.</li> <li>✎ Business Description</li> <li>✎ Partner's Names &amp; Addresses (with their PAN/Aadhar Card/DIN No.)</li> <li>✎ Copy of last Audited Financial Statement</li> </ul> <p>B. Engagement Information</p> <ul style="list-style-type: none"> <li>✎ Type of Engagement</li> </ul>  |

**Recent Decisions of Ethical Standards Board**

1. A Chartered Accountant in practice may be an equity research adviser, but he cannot publish retail report, as it would amount to other business or occupation.
2. A Chartered Accountant, who is a member of a Trust, cannot be the auditor of the said trust.
3. A Chartered Accountant in practice may engage himself as Registration Authority (RA) for obtaining digital signatures for clients.
4. A Chartered accountant can hold the credit card of a bank when he is also the auditor of the bank, provided the outstanding balance on the said card does not exceed Rs 10000 beyond the prescribed credit period limit on credit card given to him.
5. A Chartered Accountant in practice can act as mediator in Court, since acting as a “mediator” would be deemed to be covered within the meaning of “arbitrator”; which is inter-alia permitted to members in practice as per Regulation 191 of the Chartered Accountants Regulations, 1988.
6. A Chartered Accountant in practice is not permitted to accept audit assignment of a bank in case he has taken loan against a Fixed Deposit held by him in that bank.
7. The Ethical Standards Board in 2013 generally apply the stipulations contained in the then amended Rule 11U of Income Tax generally, wherein statutory auditor /tax auditor cannot be the valuer of unquoted equity shares of the same entity.

The Board has at its recent Meeting (January, 2017) has reviewed the above, and decided that where law prohibits for instance in the Income Tax Act and the rules framed thereunder, such prohibition on statutory auditor/tax auditor to be the valuer will continue, but where there is no specific restriction under any law, the said eventuality will be permissible, subject to compliance with the provisions, as contained in the Code of Ethics relating to independence.

8. The Ethical Standards Board had in 2011 decided that it is not permissible for a member who has been Director of a Company, upon resignation from the Company to be appointed as an auditor of the said Company, and the cooling period for the same may be 2 years.

The Board has at its recent Meeting (January, 2017) has reviewed the above, and noted that the Section 141 of Companies Act, 2013 on disqualification of auditors does not mention such prohibition; though threats pertaining to the said eventuality have been mentioned in Code of Ethics.

Further, the Board was of the view that a member may take decision in such situation based on the provisions of Companies Act, 2013 and provisions of Code of Ethics.

9. A chartered accountant in practice cannot become Financial Advisors and receive fees/commission from Financial Institutions such as Mutual Funds, Insurance Companies, NBFCs etc.
10. A chartered accountant cannot exercise lien over the client documents/records for non-payment of his fees.
11. It is not permissible for CA Firm to print its vision and values behind the visiting cards, as it would result in solicitation and therefore would be violative of the provisions of Clause (6) of Part-I of First Schedule to the Chartered Accountants Act, 1949.
12. It is not permissible for chartered accountants in practice to take agencies of UTI, GIC or NSDL.
13. It is permissible for a member in practice to be a settlor of a trust.
14. A member in practice cannot hold Customs Brokers Licence under section 146 of the Customs Act, 1962 read with Customs Brokers Licensing Regulations, 2013 in terms of the provisions of Code of Ethics.
15. A Chartered accountant in service may appear as tax representative before tax authorities on behalf of his employer, but not on behalf of other employees of the employer.
16. A chartered accountant who is the statutory auditor of a bank cannot for the same financial year accept stock audit of the same branch of the bank or any of the branches of the same bank or sister concern of the bank, for the same financial year.
17. A CA Firm which has been appointed as the internal auditor of a PF Trust by a Government Company cannot be appointed as its Statutory Auditor.
18. A concurrent auditor of a bank 'X' cannot be appointed as statutory auditor of bank 'Y', which is sponsored by 'X'.
19. A CA/CA Firm can act as the internal auditor of a company & statutory auditor of its employees PF Fund under the new Companies Act (2013).
20. The Ethical Standards Board while noting that there is requirement for a Director u/s 149(3) of the Companies Act, 2013 to reside in India for a minimum period of 182 days in the previous calendar year, decided that such a Director would be within the scope of Director Simplicitor (which is generally permitted as per ICAI norms), if he is non – executive director, required in the Board Meetings only, and not paid any remuneration except for attending such Board Meetings.

**Note:** Students are also advised to refer RTP of Paper 1 Financial Reporting (for AS, Ind AS and NBFCs updates) and Paper 4 Corporate and Allied Laws (for academic updates relating to Company Law).

## PART – II : QUESTIONS AND ANSWERS

## QUESTIONS

## Standards on Auditing, Statements and Guidance Notes

1. (a) 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?
  - (b) In the course of audit of RKP Ltd., its auditor Mr. 'Noor' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'Noor' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'Noor'.
  - (c) 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 ₹ 25 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.
  - (d) 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.
2. 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?

**Audit Strategy Planning and Programming**

3. (a) What are the considerations to be kept in mind while performing analytical procedures on data prepared by the client?
- (b) You have been appointed as the auditor of a Multiplex Cinema House. Draw an audit programme in respect of its Revenue and Expenditure.
- (c) M/s Sodhi & Associates have been appointed as the auditor of Raheja Ltd. engaged in the business of manufacturing and export of handloom goods. The partner of the firm explains to the audit team that the formulation of audit strategy shall form the basis of audit planning to achieve the audit objectives in the most effective and efficient manner. As head of the audit team, narrate the steps involved in the formulation of audit strategy.

**Risk Assessment and Internal Control**

4. (a) 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.
- (b) Y Co. Ltd. has five entertainment centers to provide recreational facilities for public especially for children and youngsters at 5 different locations in the peripheral of 200 kilometers. Collections are made in cash. Specify the adequate system towards collection of money.

**Audit under CIS Environment**

5. "The objective of auditing, do not undergo a sea change in a CIS environment. Auditor must provide a competent, independent opinion as to whether the financial statements records and report a true and fair view of the state of affairs of an entity. However, computer systems have affected how auditors need to collect and evaluate evidence." In view of above explain how the method of collecting Audit evidence and evaluating the same changes drastically under CIS Environment".

**The Company Audit**

6. (a) Excellent Limited, a Company incorporated in India and listed with SEBI, has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for the class they are entitled to as per company rules and regulations. Employees are also entitled to claim a lump-sum payment to cover expenses on food and stay during the travel. The Company also gives option to employees that they can claim a lump-sum amount equal to three months pay last drawn.

Excellent Limited have following accounting policies to record these travel expenses:

- (i) Settlement allowance does not depend upon the length of service of employee.

It is restricted to employee's eligibility under the travel rule of the company therefore all travel expenses fall under the category of defined contribution plans.

- (ii) Since it is not related to the length of service of the employees, it is difficult to estimate reliably and there is no present obligation to pay employees as per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", hence it is accounted for on claim basis.

You are statutory auditor of Excellent Limited. What would be your guidance to audit team?

- (b) Contravene Ltd. appointed CA Innocent as a statutory auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors.
- (c) Ram Ltd. is a private company. Its balance sheet shows paid up share capital of ₹ 5 crore and public borrowings of ₹ 100 crore. The company appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its annual general meeting held at the end of September, 2017 for 11 years. You are required to state the provisions related to - rotation of auditors and cooling off period as per the section 139(2) of the Companies Act, 2013 in case of an individual auditor or an audit firm, both, and comment upon the facts of the case provided above with respect to aforesaid provisions.

### Audit Report

7. (a) Compare and explain the following:
- (i) Reporting to Shareholders vs. Reporting to those Charged with Governance
- (ii) Audit Qualification vs. Emphasis of Matter.
- (b) C Limited has defaulted in repayments of dues to a financial institution during the financial year 2016-17 and the same remained outstanding as at March 31, 2017. However, the Company settled the total outstanding dues including interest in April, 2017 subsequent to the year end and before completion of the audit. Discuss how you would deal with this matter and draft a suitable Auditor's Report.
- (c) Relevant Notes given by the management in the financial statements of India Branch Office of ABC Limited are:
- Income tax authorities have raised demands (including interest upto the date of demand) aggregating to ₹ 100 crores and ₹ 40 crores respectively for assessment year 2013-14 based on report by auditors consequent to conduct of special audit as directed under section 142(2A) of the Income tax Act, 1961 and in addition, have also initiated penalty proceedings against the Company. The

Company has contested these demands before the Commissioner of Income tax (Appeals) and has also filed applications for stay of penalty proceedings and the same are currently pending disposal.

Based on review of underlying documents and legal inputs, the management has assessed that there is probability of likely outflow to the extent of ₹ 50 crores (including interest liability till date of stay of payment of ₹ 15 crores) in relation to the above demands and has accounted for the same in these financial statements. With respect to further liability of ₹ 50 crores, the management believes that it has the necessary documents to furnish to the tax authorities and basis the expert's inputs believes that Company has good chances of success of receiving the judgments in its favour. Further, the management believes that the likelihood of penalties being imposed against the Company is not probable and accordingly, no adjustments are considered necessary in these financial statements.

- As at March 31, 2017, the Company has accumulated losses of ₹ 150 crores against equity of ₹ 100 crores and also net current liabilities of ₹ 35 crores. The management is of the view that the current year losses are primarily attributable to income tax liabilities devolving on the Company, as discussed under paragraph XX. As per the management assessment, it is likely to generate ₹ \_\_\_ and ₹ \_\_\_ from the operations during the financial years ending March 31, 2018 and March 31, 2019 respectively. Further, the Company's key shareholders have confirmed that they shall provide continuing financial support to the Company's day to day operations so as to enable the Company to pay off its debts, as and when they fall due. Accordingly, these financial statements have been prepared on a going concern basis.

As an auditor of ABC Limited, you are required to draft emphasis of matter para in the given situation on the basis of analysis of above notes (when there is material tax litigation that casts significant doubt on the entity being regarded as going concern)

#### **Liabilities of Auditor**

8. In assessment procedure of M/s Cloud Ltd., Income Tax Officer observed some irregularities. Therefore, he started investigation of Books of Accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through books he found that M/s Cloud Ltd. used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the Institute of Chartered Accountants of India saying Mr. Old had negligently performed his duties. Comment.

#### **Audit of Consolidated Financial Statements**

9. A Ltd. holds the ownership of 51% of voting power and control over the composition of Board of Directors of B Ltd. You have been appointed to audit consolidated financial statements of A Ltd. for the financial year 2016-17. While conducting its audit, you observed that intra-group transactions have not been eliminated.

You are, therefore, required to guide the management by explaining what are current period adjustments and list out the same.

#### **Audit of Banks**

10. (a) M/s SAM & Co. has been appointed as an auditor of a nationalized bank. The records of the bank have some inter branch adjustments. Being an auditor you are required to state the points which require special attention.
- (b) Explain the reversal of income in case of Banks.
- (c) Ms. Richa has been appointed as an auditor of branch of SBI. She wants to know the aspects which will be considered while reporting on credit appraisal, sanctioning/disbursement and documentation in respect of advances in the LFAR. Suggest.

#### **Audit of Insurance Company**

11. Mr. Bhavya is appointed as an auditor of National Insurance Company limited. State the verification procedure to be followed by Mr. Bhavya in case of:
  - (a) Agents' Balances;
  - (b) Re-insurance outward.

#### **Audit of Non-Banking Financial Companies**

12. In the case of companies carrying on the business of a non-banking financial institution, the auditor needs to report under CARO, 2016 whether the registration has been obtained under section 45-IA of the Reserve Bank of India Act, 1934, if required.

You are required to state in brief the audit procedure to be followed while reporting under above mentioned circumstances.

#### **Audit under Fiscal Laws**

13. (a) Concession Ltd. is engaged in the business of manufacturing of threads. The company recorded the turnover of ₹ 1.13 crore during the financial year 2017-18 before adjusting the following:

|                                       |            |
|---------------------------------------|------------|
| Discount allowed in the Sales Invoice | ₹ 8,20,000 |
| Cash discount (other than allowed in  |            |
| Cash memo/ sales invoice)             | ₹ 9,20,000 |
| Trade discount                        | ₹ 2,90,000 |
| Commission on Sales                   | ₹ 6,00,000 |
| Sales Return (F.Y. 2016-17)           | ₹ 1,60,000 |
| Sale of Investment                    | ₹ 6,60,000 |

You are required to ascertain the effective turnover to be considered for the prescribed limit of tax audit under the relevant Act and guide the company whether the provisions relating to tax audit applies.

- (b) XYZ Limited is looking for an auditor for getting its accounts audited as per GST. Being an expert in the indirect taxes field XYZ Limited is seeking your advice on types of audit discussed as per GST Law. Explain

### **Cost Audit**

14. On 30.08.2017, the Board of SRE Ltd. proposed to appoint Mr. Elex, a Cost Accountant in practice, for conducting cost audit for the financial year 2017-18. The management came to know about the certificate which needs to be obtained from the auditor before such appointment is made. However, the management is unaware about what certification is required from the auditor. Please guide.

### **Special Audit Assignments**

15. (a) Energy shortage and the cost of environmental quality control have made the use of energy very costly to many industrial establishments which encouraged Green Ltd. to opt for energy audit being first step of any energy management programmes.

The management of the company consults you to guide regarding key functions of the energy auditor so that the management may appoint the same for the company.

- (b) In order to check and prevent the diversion of funds in case of non-corporate borrowers, the lending bank sometimes obtains special report from the auditor on quarterly basis.

Describe the details to be given in special report in respect of –

- (i) Operating data
- (ii) Inventory
- (iii) Information in respect of other items

### **Audit of Public Sector Undertaking**

16. 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.

### **Internal Audit, Management and Operational Audit**

17. (a) Mr. Anand is appointed as statutory auditor of Xerox Ltd. Xerox Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhanu as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant

accounting estimates by the management and assessing the risk of material misstatements.

Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhanu, internal auditor as stated above in view of auditing standards.

- (b) DLF Ltd., a manufacturing unit does not accept the recommendations for improvements made by the Operational Auditor. Suggest an alternative way to tackle the hostile management.

### Investigation and Due Diligence

18. J Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd. what factors would you consider in assessing the future maintainable turnover ?

### Professional Ethics

19. 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.
20. Write a short note on the following:
- (a) Technical, ethical and professional standards as per statement on peer review.

- (b) Under what circumstances, an auditor is required to submit a special report to the registrar of Co-operative Societies?
- (c) Key features of the Qualified and Independent Audit Committee set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- (d) Key audit matters and Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report.

### SUGGESTED ANSWERS/HINTS

1. (a) **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.

- (b) **Auditor's Responsibilities Relating to Fraud:** As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

As per SA 580 "Written Representations", if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.

In the instant case, the auditor observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

It may be noted that, if management does not provide one or more of the requested written representations, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ₹ 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ₹ 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, Whether any fraud by the company or any fraud on the company by its officers

or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
  - (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
  - (iii) If the auditor withdraws:
    - (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
    - (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
- (c) **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 ₹ 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.

- (d) **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.

2. (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.

3. (a) As per “**SA 520 Analytical Procedure**”, when the auditor intends to perform analytical procedures on data prepared by the client, he should consider the following:
- (i) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
  - (ii) Evaluate the reliability of data from which the auditor’s expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
  - (iii) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
  - (iv) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation and if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:
    - (1) Inquiring of management and obtaining appropriate audit evidence relevant to management’s responses; and

(2) Performing other audit procedures as necessary in the circumstances.

**(b) Audit Programme of Multiplex**

- (i) Peruse the Memorandum of Association and Articles of Association of the entity.
- (ii) Ensure the object clause permits the entity to engage in this type of business.
- (iii) In the case of income from sale of tickets:
  - (1) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
  - (2) Verify the system of relating to online booking of various shows and the system of realization of money.
  - (3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
- (iv) Verify the internal control system and its effectiveness relating to the income from cafe shops, pubs etc., located within the multiplex.
- (v) Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
- (vi) Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.
- (vii) In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
- (viii) Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.
- (ix) Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.

**(c) Audit strategy is concerned with designing optimised audit approaches** that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available. The formulation of audit strategy as shall be evident from the process as explained in the following paragraphs in fact shall form the basis of audit planning to achieve the audit objectives in the most efficient and effective manner. Audit strategy generally involves the following steps:

- (i) **Obtaining Knowledge of Business:** SA 315 and SA 330 “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment” and “The Auditor’s Responses to Assessed Risks” states that in performing an audit of financial statements, the auditor should have or

obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditor's judgement, may have a significant effect on the financial statements or on the examination or audit report. Knowledge of the business is a frame of reference within which the auditor exercises professional judgement. Understanding the business and using this information appropriately assists the auditor in assessing risks and identifying problems, planning and performing the audit effectively and efficiently. It also ensures that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to enable them to carry out the audit work delegated to them. This would also ensure that the audit staff understands the need to be alert for additional information and the need to share that information with the auditor and the other audit staff.

- (ii) **Performing Analytical Procedures:** The purpose of analytical procedures at the planning stage is attention-directing; corroboration is not normally necessary at this stage. The use of the analytical procedures during the planning stage requires the extensive use of accounting and business knowledge and experience to assess the potential for material misstatement in the financial statements as a whole, because the key aspect of the task is to identify the relevant risk indicators and to interpret them properly. Furthermore, analytical techniques applied during the planning stage are not generally as precise as the analytical techniques at the substantive stage.
- (iii) **Evaluating Inherent Risk:** To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors such as quality of accounting system, unusual pressure on management, etc. having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which, might have taken place since his last assessment.
- (iv) **Evaluating Internal Control:** The auditor's assessment of the control environment is crucial to the decision on whether to make an extended assessment of controls. This is because a good control environment is conducive to the maintenance of a reliable system of accounting and control procedures. For strategy purposes, the auditor should obtain a sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the audit strategy will involve an extended assessment of internal accounting controls. This is done by:
  - (1) considering the results of gathering or updating information about the client; and
  - (2) making preliminary judgements about materiality, inherent risk and control effectiveness. These will include identification of the system(s) the auditor

proposes to subject to an extended assessment of controls.

Thus, the audit strategy is evolved after considering the engagement objectives, the results of the business review, preliminary judgements as to materiality and identified inherent risks. Audit strategy also considers main points relating to planning and controlling the audit or comments on adequacy of the existing arrangements. Thus, the overall audit plan involving determination of timing, manpower, coordination and the directions in which the audit work has to proceed is dependent upon the audit strategy formulated by the audit firm.

4. (a) **Important Points to be kept in Mind While Drafting Letter of Weakness:** As per SA 265, “Communicating Deficiencies in Internal Control to Those 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.

- (b) **Control System over Selling and Collection of Tickets:** In order to achieve proper internal control over the sale of tickets and its collection by the Y Co. Ltd., following system should be adopted -

- (i) **Printing of tickets:** Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.

- (ii) **Ticket sales:** The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.
  - (iii) **Daily cash reconciliation:** Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.
  - (iv) **Daily banking:** Each day's collection should be deposited in the bank on next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.
  - (v) **Entrance ticket:** Entrance tickets should be cancelled at the entrance gate when public enters the centre.
  - (vi) **Advance booking:** If advance booking of facility is made available, the system should ensure that all advance booked tickets are paid for.
  - (vii) **Discounts and free pass:** The discount policy of the Y Co. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.
  - (viii) **Surprise checks:** Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.
5. Auditor must provide a competent, independent opinion as to whether the financial statements records and report a true and fair view of the state of affairs of an entity. However, computer systems have affected how auditors need to collect and evaluate evidence. These aspects are discussed below:
- (i) **Changes to Evidence Collection** - Collecting evidence on the reliability of a computer system is often more complex than collecting evidence on the reliability of a manual system. Auditors have to face a diverse and complex range of internal control technology that did not exist in manual system, like:
    - (1) accurate and complete operations of a disk drive may require a set of hardware controls not required in manual system,
    - (2) system development control include procedures for testing programs that again are not necessary in manual control.

Since, Hardware and Software develop quite rapidly, understanding the control technology is not easy. With increasing use of data communication for data transfer, research is focused on cryptographic controls to protect the privacy of data. Unless auditor's keep up with these developments, it will become difficult to evaluate the reliability of communication network competently.

The continuing and rapid development of control technology also makes it more difficult for auditors to collect evidence on the reliability of controls. Even collection of audit evidence through manual means is not possible. Hence, auditors have to run through computer system themselves if they are to collect the necessary evidence. Though generalized audit softwares are available the development of these tools cannot be relied upon due to lack of information. Often auditors are forced to compromise in some way when performing the evidence collection

- (ii) **Changes to Evidence Evaluation** - With increasing complexity of computer systems and control technology, it is becoming more and more difficult for the auditors to evaluate the consequences of strength and weaknesses of control mechanism for placing overall reliability on the system.

Auditors need to understand:

- (a) whether a control is functioning reliably or multi functioning,
- (b) traceability of control strength and weakness through the system. In a shared data environment a single input transaction may update multiple data item used by diverse, physically disparate user, which may be difficult to understand.

Consequences of errors in a computer system are a serious matter as errors in computer system tend to be deterministic, i.e., an erroneous program will always execute data incorrectly. Moreover, the errors are generated at high speed and the cost and effort to correct and rerun program may be high. Errors in computer program can involve extensive redesign and reprogramming. Thus, internal controls that ensure high quality computer systems should be designed implemented and operated upon. The auditors must ensure that these control are sufficient to maintain assets safeguarding, data integrity, system effectiveness and system efficiency and that they are in position and functioning.

6. (a) **Treatment of Employee Benefits Expenses:** The present case falls under the category of defined benefit scheme under AS 15 “Employee Benefits”. The said scheme encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company’s obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company’s control. Thus,
- (i) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.

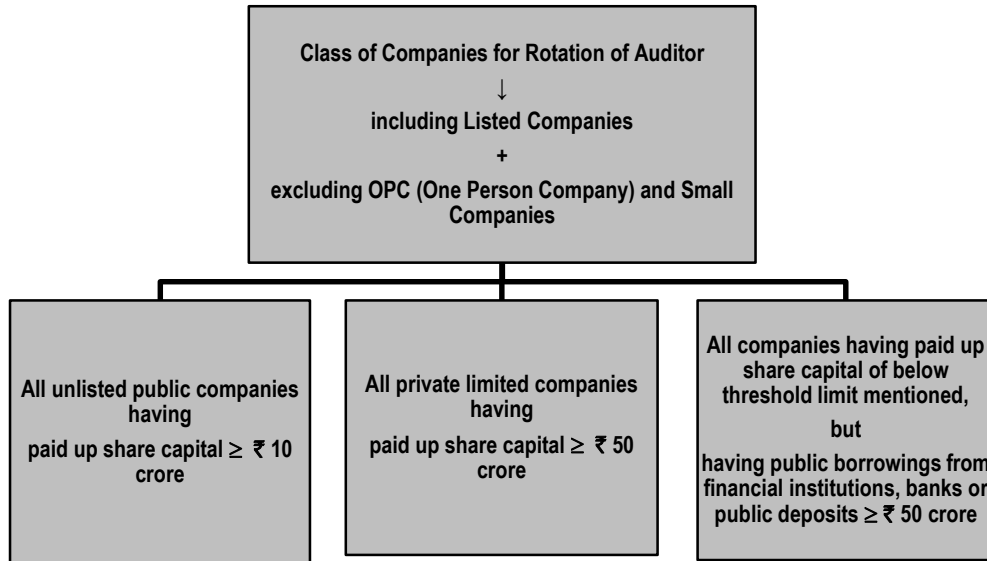
- (ii) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.
  - (iii) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.
- (b) **Services not to be Rendered by the Auditor:** Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:
- (i) accounting and book keeping services;
  - (ii) internal audit;
  - (iii) design and implementation of any financial information system;
  - (iv) actuarial services;
  - (v) investment advisory services;
  - (vi) investment banking services;
  - (vii) rendering of outsourced financial services;
  - (viii) management services; and
  - (ix) any other kind of services as may be prescribed.

Further section 141(3)(i) of the Companies Act, 2013 also disqualify a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

In the given case, CA Innocent was appointed as an auditor of Contravene Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

- (c) **Rotation of Auditor & Cooling Off Period Provisions:** The provision related to Rotation of Auditor & Cooling Off Period is newly inserted by section 139(2) of the Companies Act, 2013 read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014, which is discussed as under:

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies excluding one person companies and small companies, namely:-



- (i) all unlisted public companies having paid up share capital of ₹ 10 crore or more;
- (ii) all private limited companies having paid up share capital of ₹ 50 crore or more;
- (iii) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ₹ 50 crores or more.

As per Section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

- (a) an individual as auditor for more than one term of 5 consecutive years; and
- (b) an audit firm as auditor for more than two terms of 5 consecutive years.

In the given case, Ram Ltd. is a private company having paid up share capital of ₹ 5 crore and public borrowing of ₹ 100 crore. The company has appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2017 for 11 years.

The provisions relating to rotation of auditor will be applicable as the public borrowings exceeds ₹ 50 crore. Therefore, Ram (P) Ltd. can appoint M/s Shyam & Co. as an auditor of the company for not more than one term of five consecutive years twice i.e. M/s Shyam & Co. shall hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2022 and thereafter can be re-appointed as auditor for one more term of five years i.e. upto year 2027. The appointment shall be subject to ratification by members at every annual general meeting of the company. As a result, the appointment of M/s Shyam & Co. made by Ram Ltd. for 11 years is void.

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

| REPORT  |   |
|---|---|
| Reporting to Shareholders   | Reporting to those Charged with Governance  |
| <ul style="list-style-type: none"> <li>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.</li> </ul> | <ul style="list-style-type: none"> <li>Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.</li> </ul>                  |
| <ul style="list-style-type: none"> <li>Statutory Audit Report is on true and fair view and as per prescribed Format.</li> </ul>   | <ul style="list-style-type: none"> <li>It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.</li> </ul> |
| <ul style="list-style-type: none"> <li>Statutory Audit Reports are in public domain.</li> </ul>   | <ul style="list-style-type: none"> <li>Reporting to those Charged with Governance is an internal document i.e. private report.</li> </ul>                                     |

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

| REPORT  |  |
|---|--|
| Audit Qualification   | Emphasis of Matter   |
| <ul style="list-style-type: none"> <li>Standard on Auditing 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with the provisions relating to Audit Qualification.</li> </ul> | <ul style="list-style-type: none"> <li>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.</li> </ul> |

|   |   |
|---|---|
| <ul style="list-style-type: none"> <li>• Audit Qualifications are also known as “subject to report” or “except that report”.</li> </ul>   | <ul style="list-style-type: none"> <li>• 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.</li> </ul>  |
| <ul style="list-style-type: none"> <li>• 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.</li> </ul> | <ul style="list-style-type: none"> <li>• 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.</li> </ul> |

- (b) **Reporting for Default in Repayment of Dues:** As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, terms of repayment of term loans and other loans is required to be disclosed in the notes to accounts. It also requires specifying the period and amount of continuing default as on the balance sheet date in repayment of loans and interest, separately in each case.

Further, as per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to state in his report whether the Company has defaulted in repayment of dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

In the given case, C Ltd. has defaulted in repayments of dues to a financial institution during the financial year 2016-17 which remain outstanding as at March 31, 2017. However, the company has settled the total outstanding dues including interest in April, 2017 but, the dues were outstanding as at March 31, 2017. Therefore, it needs to be reported in the notes to accounts.

**The draft report for above matter is as under:**

*“The company has taken a loan during the year, from a financial institution amounting to ₹ XXXX @ X% p.a. which is repayable by monthly installment of ₹ XXXX for XX months.*

*The company has defaulted in repayment of dues including interest to a financial institution during the financial year 2015-16 amounting to ₹ XXXX which remained outstanding as at March 31, 2017. The period of default is XXX days. However, the outstanding sum was settled by the company in April, 2017.”*

**(c) Emphasis of Matters Para:**

- We draw attention to Note XX, regarding certain income-tax demands of ₹ 100 crores pending in various stages of assessments/ appeals. The management based upon expert's advice believes that no demand or liability including interest and penalty on account of settlement of assessment/ appeals of the pending matters by the Income tax authorities is likely to devolve on the Company, in addition to those already provided for in these financial statements. Pending the final outcome of the aforesaid matters, no further adjustments have been made in these financial statements in this regard.
- Note XX of the financial statements that as at March 31, 2017, the Company has accumulated losses of ₹ 150 crores against equity of ₹ 100 crores and also net current liabilities of ₹ 35 crores. These conditions indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern, which is dependent on establishing profitable operations and obtaining continuing financial support from its key shareholders. These mitigating factors have been more fully discussed in Note XX of the accompanying financial statements, in view of which the accompanying financial statements have been prepared under the going concern assumption, and consequently, no further adjustments have been made in these financial statements.

Our opinion is not modified in respect of the above matters.

- 8. Liability of Auditor:** “It is the auditor's responsibility to audit the statement of accounts and prepare tax returns on the basis of books of accounts produced before him. Also if he is satisfied with the books and documents produced to him, he can give his opinion on the basis of those documents only by exercising requisite skill and care and observing the laid down audit procedure.

In the instant case, Income tax Officer observed some irregularities during the assessment proceeding of M/s Cloud Ltd. Therefore, he started investigation of books of accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through the books, he found that M/s Cloud Ltd. Used to maintain two sets of Books of Accounts,

one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the ICAI saying Mr. Old had negligently performed his duties.

Mr. Old, the auditor was not under a duty to prepare books of accounts of assessee and he should, of course, neither suggest nor assist in the preparations of false accounts. He is responsible for the books produced before him for audit. He completed his audit work with official set of books only.

In this situation, as Mr. Old, performed the auditing with due skill and diligence; and, therefore, no question of negligence arises. It is the duty of the Department to himself investigate the truth and correctness of the accounts of the assessee.

- 9. Current Period Consolidation Adjustments:** Current period adjustments are those adjustments that are made in the accounting period for which the consolidation of financial statements is done. Current period consolidation adjustments primarily relate to elimination of intra-group transactions and account balances. While doing the audit of consolidated Financial Statements, current period consolidation adjustments should be taken into account. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements. This would also help the auditor in ascertaining whether there is any difference in the elimination. Following are the current period consolidation adjustments while making consolidation of financial statements:

- (a) intra-group interest paid and received, or management fees, etc.;
- (b) unrealised intra-group profits on assets acquired/ transferred from/ to other subsidiaries;
- (c) intra-group indebtedness;
- (d) adjustments related to harmonising the different accounting policies being followed by the parent and its components;
- (e) adjustments to the financial statements (of the parent and the components being consolidated) for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the consolidated financial statements of the group.

There are two types of subsequent events:

- The first type of subsequent events consists of events or transactions that provide additional evidence about conditions that existed at the date of the financial statements, including the estimates inherent in the process of preparing financial statements (i.e. adjusting events).
- The second type of subsequent events consists of events that provide evidence about conditions that did not exist at the date of the financial statements but arose subsequent to that date (i.e. non-adjusting events).

Events occurring after balance sheet date which do not require adjustments would not normally require disclosure, although they may be of such significance that they may require a disclosure in the report of approving authority in the case of accounting standards and in the financial statements in case of Ind AS. For such events, the following shall be disclosed:

- (i) The nature of the event; and
  - (ii) An estimate of its financial effect or a statement that such an estimate cannot be made.
- (f) adjustments for the effects of significant transactions or other events that occur between the date of the components balance sheet and not already recognised in its financial statements and the date of the auditor's report on the group's consolidated financial statements when the financial statements of the component to be used for consolidation are not drawn upto the same balance sheet date as that of the parent;
- (g) In case of a foreign component, adjustments to convert a component's audited financial statements prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared.
- (h) determination of movement in equity attributable to the minorities interest/non-controlling interest since the date of acquisition of the subsidiary.
- (i) adjustments of deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intragroup transactions and undistributed profits of the component in case of consolidated financial statements prepared under Ind AS.
10. (a) The following points require special attention in the examination of **Inter Branch transactions**.
- (i) While verifying the closing balance, special attention should be paid to the origin and validity of old outstanding unmatched entries, particularly debit entries. The auditor may also seek confirmation of transactions relating to outstanding in appropriate cases.
  - (ii) Whether there are any reversal entries indicating the possibility of irregular payments or frauds.
  - (iii) Whether the balances include any items in the nature of cash in transit included in this head which remain pending for more than a reasonable period. This is because such items are not expected to remain outstanding beyond a very small period during which they are in transit.
  - (iv) Whether transactions other than those relating to inter branch transactions have been included in inter branch accounts. Any unusual items put through inter branch accounts as well as old or large entries outstanding in Inter branch accounts should be carefully looked into. The auditor should also seek

explanations from the Management in this regard in appropriate cases.

- (b) 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).

- (c) **Verification of advances in the Long Form Audit Report (LFAR):** The auditor has to comment on various specific issues as mentioned in the Long Form Audit Report of the bank. While evaluating the efficacy of internal controls over advances, the auditor should particularly examine those aspects on which he is required to comment in his long form audit report.

Thus, he should examine:

- (i) Whether the loan applications are complete and in prescribed form;
- (ii) Procedural instructions regarding grant/ renewal/ enhancement of facilities have been complied with;
- (iii) Sanctions are within delegated authority and disbursements are as per terms of the sanction;
- (iv) Documentation is complete; and supervision is timely, effective and as per prescribed guidelines.

The auditor can gather the requisite evidence by examining relevant documents (such as loan application forms, supporting documentation, sanctions, security documents, etc.) and by obtaining information and explanations from the branch management in appropriate cases.

The auditors must familiarise themselves with those issues and guidance relating to the same and should cover the same during the regular course of audit of advances.

11. (a) **General Insurance Company – Verification of Agents' Balances:** The following are the audit procedures for verification of outstanding agents' balances -
- (i) Scrutiny and review of control accounts debit balances and their nature should be enquired into.
  - (ii) Examination of inoperative balances and treatment given for old balances shall be looked into.

- (iii) Enquiring into the reasons for retaining the old balance.
  - (iv) Verification of old debit balances which may require provision or adjustment. Explanation shall be obtained from the management in this regard.
- (b) Verification of Re-insurance Outward:** The following steps may be taken by the auditor in the verification of re-insurance outward-
- (i) The auditor should verify that re-insurance underwriting returns received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims.
  - (ii) The auditor should check whether the pattern of re-insurance underwriting for outward cessions fits within the parameters and guidelines applicable to the relevant year.
  - (iii) The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk.
  - (iv) The auditor should verify whether the cessions have been made as per the agreements entered into with various companies.
  - (v) It should also be seen whether the outward remittances to foreign re-insurers have been done as per the foreign exchange regulations.
  - (vi) It should also be seen whether the commission on cession has been calculated as per the terms of the agreement with the re-insurers.
  - (vii) The auditor should verify the computation of profit commission for various automatic treaty arrangements in the light of the periodical accounts rendered and in relation to outstanding loss pertaining to the treaty.
  - (viii) The auditor should examine whether the cash loss recoveries have been claimed and accounted on a regular basis.
  - (ix) The auditor should also verify whether the Claims Paid item appears in Outstanding Claims list by error. This can be verified at least in respect of major claims.
  - (x) He should see whether provisioning for outstanding losses recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified.
  - (xi) Accounting aspects of the re-insurance cession premium, commission receivable, paid claims recovered, and outstanding losses recoverable on cessions have to be checked.
  - (xii) The auditor should check percentage pattern of gross to net premium, claims paid and outstanding claims to ensure comparative justification.
  - (xiii) The auditor should also check that the re-insurers balance on cessions and

whether the sub ledger balances tallies with the general ledger balances.

- (xiv) The auditor should review the individual accounts to find out whether any balance requires provisioning / write off or write back.
- (xv) He should verify whether the balances with re-insurers are supported by necessary confirmation obtained from them.
- (xvi) He should verify whether opening outstanding claims not paid during the year find place in the closing outstanding claims vis-a-vis the reinsurance inwards outstanding losses recoverable on cessions appears in both opening and closing list. If not, the reason for the same should be analysed.
- (xvii) Any major event after the Balance Sheet date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re-insurance balances will need to be brought out suitably.

- 12. Reporting under CARO, 2016 for Registration under RBI Act, 1934:** As per Clause (xvi) of paragraph 3 of the CARO, 2016, the auditor is required to report whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934. If so, whether the registration has been obtained.

Audit Procedures and Reporting-

- (i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
  - (ii) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
  - (iii) Whether the company has net owned funds as required for the registration as NBFC.
  - (iv) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.
- 13. (a)** The provisions relating to tax audit under section 44AB of the Income Tax Act, 1961 applies to every person carrying on business, if his total sales, turnover or gross receipts in business exceed the prescribed limit of ₹ 1 crore and to a person carrying on a profession, if his gross receipts from profession exceed the prescribed limit of ₹ 50 lakhs (w.e.f. A.Y. 2017-18) in any previous year. However, the term "sales", "turnover" or "gross receipts" are not defined in the Act, and therefore the meaning of the aforesaid terms has to be considered for the applicability of the section.

Some of the points for merit consideration in this regard as discussed in the Guidance Note issued by the Institute are given below-

- (i) Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted from the turnover.
- (ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. Therefore, should not be deducted from the turnover.
- (iii) Turnover discount is normally allowed to a customer if the sales made to him exceed a particular quantity. As per trade practice, it is in the nature of trade discount and should be deducted from the figure.
- (iv) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount. If it is in the nature of commission on sales, the same cannot be deducted from the figure of turnover.
- (v) Price of goods returned should be deducted from the turnover even if the returns are from the sales made in the earlier year/s.
- (vi) Sale proceeds of any shares, securities, debentures, etc., held as investment will not form part of turnover. However, if the shares, securities, debentures etc., are held as stock-in-trade, the sale proceeds thereof will form part of turnover.

In the given case, Concession Ltd. is engaged in manufacturing business. Therefore, the tax audit would be applicable if the turnover exceeds ₹ 1 crore during the financial year 2017-18. The calculation of effective turnover for the prescribed limit purpose, in accordance with abovementioned conditions, is given below:

|  |                      |
|--|----------------------|
| Recorded turnover during the year                      | ₹ 1,13,00,000        |
| <b>Less:</b> (i) Discount allowed in the Sales Invoice | (₹ 8,20,000)         |
| (ii) Trade discount                                    | (₹ 2,90,000)         |
| (iii) Sales Return                                     | (₹ 1,60,000)         |
| <b>Effective turnover</b>                              | <b>₹ 1,00,30,000</b> |

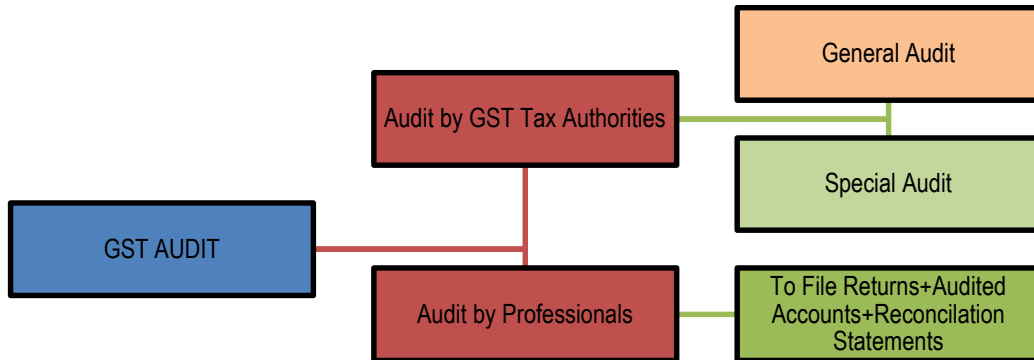
**Conclusion:** The effective turnover of Concession Ltd. is rupees one crore and thirty thousand only which is over and above the prescribed limit for tax audit under section 44AB of the Income Tax Act, 1961. Thus, the provisions related to tax audit are applicable to the company and is therefore liable for tax audit

**(b) Types of Audit under GST Law:**

GST envisages three types of Audit.

- (1) Audit of accounts [Section 35(5) read alongwith section 44(2) and rule 80]
- (2) Audit by Tax Authorities wherein the Commissioner or any officer authorised by him, can undertake audit of any registered person for such period, at such frequency and in such manner as may be prescribed. [Section 65 and rule 101]
- (3) Special Audit wherein the registered person can be directed to get his records

including books of account examined and audited by a chartered accountant or a cost accountant during any stage of scrutiny, inquiry, investigation or any other proceedings; depending upon the complexity of the case. [Section 66 and rule 102]



**1. Audit of Accounts [Section 35(5) read alongwith section 44(2) and rule 80]**

As per sub-section 5 of section 35 read alongwith section 44(2) and rule 80 of the CGST Rules, 2017 stipulates as follows:

|   |   |
|---|---|
| <p>Every registered person must get his accounts audited by a Chartered Accountant or a Cost Accountant if his aggregate turnover during a FY exceeds ₹ 2 crores.</p> | <p>Such registered person is required to furnish electronically through the common portal alongwith Annual Return a copy of:</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Audited annual accounts</li> <li><input type="checkbox"/> A Reconciliation Statement, duly certified, in prescribed FORM GSTR-9C.</li> </ul> |
|---|---|

**Reconciliation Statement** will reconcile the value of supplies declared in the return furnished for the financial year with the audited annual financial statement and such other particulars, as may be prescribed.

**2. Audit under section 65:**

| Section    | Description              | Remarks   |
|------------|--------------------------|---|
| Section 65 | Audit by tax authorities | The audit under Section 66 is a special audit to be conducted by a Chartered Accountant or Cost Accountant nominated by the Commissioner whereas the audit under Section 65 is a routine audit by the tax office. |

**3. Special Audit under section 66:** Availing the services of experts is an age old practice of due process of law. These experts have done yeoman service to the

process of delivering justice. One such facility extended by the Act is in Section 66 where an officer not below the rank of Assistant Commissioner, duly approved, may avail the services of a Chartered Accountant or Cost Accountant to conduct a detailed examination of specific areas of operations of a registered person. Availing the services of the expert be it a Chartered Accountant or Cost Accountant is permitted by this section only when the officer considering the nature & complexity of the business and in the interest of revenue is of the opinion that:

- ☞ Value has not been correctly declared; or
- ☞ Credit availed is not within the normal limits.

It would be interesting to know how these 'subjective' conclusions will be drawn and how the proper officers determines what is the normal limit of input credit availed.

- 14. Certificate from Cost Auditor:** The Companies (Cost Records and Audit) Rules, 2014 requires that, before appointment of cost auditor is made, the written consent of the cost auditor to such appointment and a certificate from him shall be obtained.

The certificate to be obtained from the cost auditor shall certify that the-

- (i) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Companies Act, 2013, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;
  - (ii) 141 of the Companies Act, 2013 so far as may be applicable;
  - (iii) the proposed appointment is within the limits laid down by or under the authority of the Companies Act, 2013; and
  - (iv) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.
- 15. (a) Key Functions of Energy Auditor:** Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use efficiency. The function of an energy auditor could be compared with that of a financial auditor. The energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor:
- (i) Quantify energy costs and quantities.

- (ii) Correlate trends of production or activity to energy costs.
  - (iii) Devise energy database formats to ensure they depict the correct picture – by product, department, consumer, etc.
  - (iv) Advise and check the compliance of the organisation for policy and regulation aspects.
  - (v) Highlight areas that need attention for detailed investigations.
  - (vi) Conduct preliminary and detailed energy audits which should include the following:
    - (a) Data collection and analysis.
    - (b) Measurements, mass and energy balances.
    - (c) Reviewing energy procurement practices.
    - (d) Identification of energy efficiency projects and techno-economic evaluation.
    - (e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.
    - (f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.
- (b) **Special Audit Report:** A lending bank may, in special cases, require the non-corporate entity to obtain a special report from the auditor. Such a report can be called by a lending bank if it finds that it is necessary to have more information about the working of the entity. In such a case the report will have to be given by the auditor on a quarterly basis. The special audit report which is to be given on a quarterly basis in the specified form is in addition to the normal audit report which is to be given by the auditor on a yearly basis.

**Special Report in respect of Operating Data:** In the quarterly special audit report, the auditor will have to give information relating to the operating data for each quarter. This information will have to be classified in the following manner:

- (i) Actual production;
- (ii) Actual production as a percentage of rated capacity;
- (iii) Sales;
- (iv) Cost of goods sold/cost of production;
- (v) Gross margin;
- (vi) Interest on bank borrowing; and

(vii) Interest on others

**Special Report in respect of Inventory:** The age-wise classification of raw materials and finished goods is to be given. For this purpose age-wise classification is to be made in the following manner in respect of raw materials and finished goods separately;

- (i) Inventory for more than one year;
- (ii) Between 6 months and one year;
- (iii) Between three months and 6 months; and
- (iv) Below 3 months.

Similar information about the work-in-progress i.e. the number of days of production which remains in progress should also be given.

The basis of valuation of raw material and finished goods should be given. For this purpose the following information is to be given:

- (i) The manner of determination of cost (i.e. components of cost)
- (ii) The method of valuing stock i.e. FIFO, weighted average cost, etc.

It is also necessary to state if there is any discrepancy between the quantity and value of the stock as furnished to the bank and as appearing in the books. The reasons for such discrepancy should be given in the audit report.

**Special Report in respect of Other Items:** Age-wise classification of bills receivable and other receivables with reference to the, bills due from domestic parties and bills in respect of exports should be given. The age-wise classification is to be done on the same basis as the classification for raw materials and finished goods as stated above.

**Information in respect of the following items is also to be given:**

- (i) Balances at the end of each month of the quarter for major categories of stock, receivables and bills receivables;
- (ii) Tax assessments and payments made during the quarter;
- (iii) Actual disbursement of capital expenditure during the quarter;
- (iv) Outstanding contracts on capital account at the end of the quarter giving the details about the names of parties and amounts outstanding;
- (v) The contingent liability which may or may not materialize during the financial year succeeding the relevant quarter;
- (vi) Investment made during the quarter and the income from such investments including profit on sale of investments;
- (vii) Loans given during the quarter;

- (viii) Loans raised during the quarter from banks and from others. Separate figures to be given;
- (ix) Overdue statutory liability at the end of the quarter;
- (x) Amounts due but not paid at the end of the quarter in respect of (a) loans from banks, (b) public deposits, and (c) other loans; and
- (xi) Figures of cash losses during the last 2 years to be stated on the basis of the annual accounts. If such accounts were not audited this fact should be stated.

The funds obtained from the lending banks have to be utilised for the purpose for which they are given by the bank. If the auditor finds that these funds have been diverted for the purposes other than those for which they were given by the bank the auditor will have to give the details of the diversion for such other purposes.

In order that the lending bank may be able to ascertain the correct financial position and financial health of the entity it is necessary for the auditor to give the details of the diversion for such other purposes.

In order that the lending bank may be able to ascertain the correct financial position and financial health of the entity it is necessary for the auditor to give information about the following ratios:

- (a) Current ratio
- (b) Acid test ratio
- (c) Raw materials-turnover ratio
- (d) Finished goods-turnover ratio
- (e) Receivables-turnover ratio
- (f) Return on investment
- (g) Interest cover ratio
- (h) Net margin ratio
- (i) Capital turnover ratio
- (j) Debt equity ratio
- (k) Operating cash flow.

#### **16. 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.

17. (a) **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 involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

**Significant judgments include the following:**

- ◆ Assessing the risks of material misstatement;
- ◆ Evaluating the sufficiency of tests performed;
- ◆ Evaluating the appropriateness of management's use of the going concern assumption;
- ◆ Evaluating significant accounting estimates; and
- ◆ Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

- (b) While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

The Participative Approach comes to the help of the auditor. In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor do not have to force any change on the auditee.

Hence, Operational Auditor of DLF manufacturing unit should adopt above mentioned participative approach to tackle the hostile management of DLF.

18. **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?

19. (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
- (ii) 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.

20. (a) **Technical, Ethical and Professional Standards as per Statement on Peer Review:** As per the Statement, Technical, Professional and Ethical Standards means-
1. Accounting Standards issued by ICAI and /or prescribed and notified by the Central Government of India;
  2. Standards issued by the Institute of Chartered Accountants of India including -
    - (i) Engagement standards
    - (ii) Statements
    - (iii) Guidance notes
    - (iv) Standards on Internal Audit
    - (v) Statements on Quality Control
    - (vi) Notifications / Directions / Announcements / Guidelines / Pronouncements/ Professional standards issued from time to time by the Council or any of its committees.

3. Framework for the Preparation and presentation of financial statements, framework of statements and Standard on Auditing, Standard on Assurance Engagements, Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the Institute of Chartered Accountants of India and framework for assurance engagements;
  4. Provisions of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.
- (b) **Special Report by Auditor to Registrar of Co-operative Societies:** Under the following circumstances, an auditor has to issue special report to the Registrar of Co-operative Societies (This report should be in addition to the regular report) -
- (i) (a) Any member of the managing committee is involved in personal profit making by using the properties or assets of the society, resulting into the loss to the society.  
(b) Frauds are detected from the society's transactions.
  - (ii) There is mismanagement in the society and the principles of co-operative are not maintained by the management.
  - (iii) In the respect of audit of Urban Co-operative Banks, disproportionate advances to vested interest groups. Such as relative of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.
- (c) **The main features of a qualified and independent audit committee to be set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are as follows:**
1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors;
  2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise;
- Explanation (i): The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.
- Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief

financial officer or other senior officer with financial oversight responsibilities.

3. The Chairperson of the Audit Committee shall be an independent director;
  4. The Chairperson of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
  5. The Audit Committee at its discretion shall invite the finance director or the head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee; provided that occasionally, the Audit Committee may meet without the presence of any executives of the listed entity.;
  6. The Company Secretary shall act as the secretary to the committee.
- (d) **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.