

## PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

### PART – I

#### ACADEMIC UPDATE

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

#### Chapter 5 : The Company Audit

**(i) Submission of Cost Audit Report to the Central Government-** The company shall within 30 days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein in Form CRA-4 in Extensible Business Reporting Language (XBRL) format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

***Provided that the companies which have got extension of time of holding Annual General Meeting under section 96 (1) of the Companies Act, 2013, may file form CRA-4 within resultant extended period of filing financial statements under section 137 of the Companies Act, 2013.***

{Note: As per MCA notification dated 3 December 2018 vide Companies (cost records and audit) Amendment Rules, 2018, a Proviso has been inserted above in Bold and italic Relevant page no 5.40 of the Company Audit Chapter under the heading no 12 sub heading namely Submission of Cost Audit Report}

**(ii) Constitution of National Financial Reporting Authority:** According to Section 132 of the Act, the Central Government may, by notification, constitute a National Financial Reporting Authority (NFRA) to provide for matters relating to accounting and auditing standards for adoption by companies or class of companies under the Act.

**As per Section 132 (2) of the Companies Act 2013, notwithstanding anything contained in any other law for the time being in force, the NFRA shall—**

- (a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;
- (b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;
- (c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and

(d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

**In exercise of the powers conferred under sub-sections (2) and (4) of section 132, the Central Government made the National Financial Reporting Authority Rules, 2018 (NFRA Rules) (MCA Notification dated 13 November 2018).**

As per NFRA rules, NFRA shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate:

- (a) companies whose securities are listed on any stock exchange in India or outside India;
- (b) unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year;
- (c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of section 1 (4) of the Companies Act, 2013;
- (d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the NFRA by the Central Government in public interest; and
- (e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d) above, if the income or net-worth of such subsidiary or associate company exceeds 20% of the consolidated income or consolidated net-worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d) above.

Every existing body corporate other than a company governed by these rules, shall inform the NFRA within 30 days of the commencement of NFRA rules, in Form NFRA-1, the particulars of the auditor as on the date of commencement of these rules.

Every body corporate, other than a company as defined in clause (20) of section 2 of the Act, formed in India and governed under NFRA Rules shall, within 15 days of appointment of an auditor under sub-section (1) of section 139, inform the NFRA in Form NFRA-1, the particulars of the auditor appointed by such body corporate. Provided that a body corporate governed under

clause (e) of sub-rule (1) of NFRA Rules shall provide details of appointment of its auditor in Form NFRA-1.

A company or a body corporate other than a company governed under NFRA Rules shall continue to be governed by the NFRA for a period of 3 years after it ceases to be listed or its paid-up capital or turnover or aggregate of loans, debentures and deposits falls below the limit stated therein (i.e. mentioned in points (a) to (e) above).

Every auditor referred to in Rule 3 shall file a return with the NFRA on or before 30th April every year in such form as may be specified by the Central Government.

**Recommending accounting standards (AS) and auditing standards (SA)** - For the purpose of recommending AS or SA for approval by the Central Government, the NFRA -

- (a) shall receive recommendations from the ICAI on proposals for new AS or SA or for amendments to existing AS or SA;
- (b) may seek additional information from the ICAI on the recommendations received under clause (a), if required.

The NFRA shall consider the recommendations and additional information in such manner as it deems fit before making recommendations to the Central Government.

**Monitoring and Enforcing Compliance with Auditing Standards -**

- (1) For the purpose of monitoring and enforcing compliance with auditing standards under the Act by a company or a body corporate governed under rule 3, the NFRA may:
  - (a) review working papers (including audit plan and other audit documents) and communications related to the audit;
  - (b) evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and
  - (c) perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.
- (2) The NFRA may require an auditor to report on its governance practices and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk of failure of the auditor and may take such action on the report as may be necessary.
- (3) The NFRA may seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

- (4) The NFRA shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.
- (5) The NFRA shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.
- (6) The NFRA shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing.
- (7) The NFRA may send a separate report containing proprietary or confidential information to the Central Government for its information.
- (8) Where the NFRA finds or has reason to believe that any law or professional or other standard has or may have been violated by an auditor, it may decide on the further course of investigation or enforcement action through its concerned Division.

**Overseeing the quality of service and suggesting measures for improvement**

- (1) On the basis of its review, the NFRA may direct an auditor to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.
- (2) It shall be the duty of the auditor to make the required improvements and send a report to the NFRA explaining how it has complied with the directions made by the NFRA.
- (3) The NFRA shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor.
- (4) The NFRA may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 (38 of 1949) or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.
- (5) The NFRA may take the assistance of experts for its oversight and monitoring activities.

**Punishment in case of non-compliance** - If a company or any officer of a company or an auditor or any other person contravenes any of the provisions of NFRA Rules, the company and every officer of the company who is in default or the auditor or such other person shall be punishable as per the provisions of section 450 of the Act.

**Financial reporting advocacy and education** - The NFRA shall take suitable measures for the promotion of awareness and significance of AS, SA, auditors' responsibilities, audit quality and such other matters through education, training, seminars, workshops, conferences and publicity.

(Insertion of role of NFRA, punishment for non-compliance and financial reporting advocacy and education as per **MCA Notification dated 13 November 2018** under heading no 14 Constitution of National Financial Reporting Authority)

### Chapter 8: Audit Committee and Corporate Governance

**8.6 The statutory auditor of a listed entity shall undertake a limited review of the audit of all the entities/companies whose accounts are to be consolidated with the listed entity as per Ind AS in accordance with guidelines issued by SEBI on this matter". Consequently,**

- ☛ all listed entities whose equity shares and convertible securities are listed on a recognised stock exchange,
- ☛ the statutory auditors of such entities,
- ☛ all entities whose accounts are to be consolidated with the listed entity and
- ☛ the statutory auditors of entities whose accounts are to be consolidated with the listed entity.

shall comply with the prescribed procedure.

(Insertion of sub heading on page no. 8.11 under heading no 8 i.e. Role of Auditor in Audit Committee and Certification of Compliance of Conditions of Corporate Governance)

**13. Subsidiary of Listed Entity [Regulations 16(c), 24 and 46 and Part C of Schedule V]:** As per Regulation 16(c), "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds ten percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year. [Explanation- The listed entity shall formulate a policy for determining 'material' subsidiary.]

Regulation 24(1) provides that at least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not. [For the purposes of this provision, notwithstanding anything to the contrary contained in regulation 16, the term "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.]

### Chapter 12: Audit of Non-Banking Financial Companies

**Merging three categories of NBFCs viz. Asset Finance Companies (AFC), Loan Companies (LCs) and Investment Companies (ICs) into a new category called Investment and Credit Company (NBFC-ICC):** As per circular RBI/2018-19/130 DNBR (PD) CC.No.097/03.10.001/2018-19 dated February 22, 2019, in order to provide NBFCs with greater operational flexibility, it has been decided that harmonisation of different categories of NBFCs into fewer ones shall be carried out based on the principle of regulation by activity rather than regulation by entity. Accordingly, it has been decided to merge the three categories of NBFCs viz. Asset Finance Companies (AFC), Loan Companies (LCs) and Investment Companies (ICs)

into a new category called NBFC - Investment and Credit Company (NBFC-ICC). Investment and Credit Company (NBFC-ICC) means any company which is a financial institution carrying on as its principal business - asset finance, the providing of finance whether by making loans or advances or otherwise for any activity other than its own and the acquisition of securities; and is not any other category of NBFC as defined by the RBI in any of its Master Directions. (Circular DBR.BP.BC.No.25/21.06.001/2018-19 dated 22 February 2019)

Differential regulations relating to bank's exposure to the three categories of NBFCs viz., AFCs, LCs and ICs stand harmonised vide Bank's circular DBR.BP.BC.No.25/21.06.001/2018-19 dated, February 22, 2019. Further, a deposit taking NBFC-ICC shall invest in unquoted shares of another company which is not a subsidiary company or a company in the same group of the NBFC, an amount not exceeding twenty per cent of its owned fund. All related Master Directions (Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016, Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, Standalone Primary Dealers (Reserve Bank) Directions, 2016 and Residuary Non-Banking Companies (Reserve Bank) Directions, 2016) have also been updated accordingly. These directions can be accessed at <https://www.rbi.org.in/>.

**Some points that may be covered in the audit of NBFC - Investment and Credit Company (NBFC-ICC) are given below:**

- i. Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- ii. Verify whether the NBFC has not advanced any loans against the security of its own shares.
- iii. Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.
- iv. Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.

- v. Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.
- vi. Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
- vii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- viii. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- ix. An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- x. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- xi. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).
- xii. Verify charges received or paid in respect of securities lend/borrowed.
- xiii. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
- xiv. An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.
- xv. An auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which an advance could be considered realisable.
- xvi. Obtain balance confirmations from the concerned parties.
- xvii. As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscouted by the NBFC. Test check some transactions with

reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.

- xviii. Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.
- xix. An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.
- xx. Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

**(Note:** The above checklist is not exhaustive. It is only illustrative. There could be various other audit procedures which may be performed for audit of an NBFC.)

#### **Chapter 13: Audit under Fiscal Laws**

**Reporting under Clause 30C and 44 of Form 3CD has been deferred till 31 March 2020 (Circular No. 9/2019 of the Central Board of Direct Taxes dated 14 May 2019).**

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

## **PART – II : QUESTIONS AND ANSWERS**

### **QUESTIONS**

#### **PART A: MULTIPLE CHOICE QUESTIONS**

1. RBJ Ltd. is a listed company engaged in the business of software and is one of the largest company operating in this sector in India. The company's annual turnover is ₹ 40,000 crores with profits of ₹ 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India. Outside India, the company is focusing more on US and European markets and the company has been able to establish its good reputation in these markets as well. During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion. The audit team for this engagement is generally very big i.e. a team of approx. 70-80 members. The company's contracts with its various customers are quite complicated and different. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner.



After completion of audit for the year ended 31 March 2019, the audit partner was discussing significant matters with the management wherein he also communicated to the management that he plans to include revenue recognition as key audit matter in his audit report. The management was quite surprised to understand this from the auditor and did not agree with revenue recognition to be shown as key audit matter in the audit report. As per the management, the auditors didn't have any modification and such a matter getting reported as key audit matter would not go down well with various stakeholders and would significantly impact the financial positions of the company in the market. The auditors were not able to convince the management in respect of this point and there was a difference of opinion.

You are requested to give your view in respect of this matter.

- (a) The concern of the management is valid. For such a large sized company, such type of matter getting reported as key audit matter is not appropriate.
  - (b) The assessment of the auditor is valid. Such a matter qualifies to be a key audit matter and hence should be reported accordingly by the auditor in his audit report.
  - (c) Reporting revenue as key audit matter when the auditor does not have observation in that area leading to any modification in his report, would not be appropriate.
  - (d) This being the first year of reporting of key audit matters, the auditor should take a soft stand and should avoid reporting such controversial matters in his report.
2. BDJ Ltd. is engaged in the business of providing management consultancy services and have been in operation for the last 15 years. The company's financial reporting process is very good and its statutory auditors always issued clean report on the audit of the financial statements of the company. The auditors were required to be rotated due to mandatory audit rotation requirement of the Companies Act 2013.

RNJ & Associates, a firm of Chartered Accountants, was appointed as the new auditor of the company for a term of 5 years and have to start their first audit for the financial year ended 31 March 2019.

The auditors had a detailed and clear discussion with the management that they will perform their audit procedures in respect of opening balances along with the audit procedures for the financial year ended 31 March 2019.

Management agreed with that and the audit was completed as per the plan.

The auditors did not have any significant observations and hence they communicated to the management that their report will be clean. Management was quite happy with this and also requested the auditors to share draft report before issuing the final report.

In the draft audit report, all the particulars were fine except 'other matters paragraph' wherein the auditors gave a reference that the financial statements for the comparative year ended 31 March 2018 was audited by another auditor. Management asked the audit team to remove this paragraph as the auditors had performed all the audit procedures on

opening balances also. But the auditors did not agree with the management.

Please advise the auditor or the management whoever is incorrect with the right guidance.

- (a) The contention of the management is valid. After performing all the audit procedures, an auditor should not pass on the responsibility to another auditor by including such references in his audit report.
  - (b) Any auditor has two options, either to perform audit procedures on opening balances or given such reference of another auditor in his report. An auditor can not mix up the things like this auditor has done. It is completely unprofessional.
  - (c) In the given situation even if the auditor wants to give such reference, the management and the auditor should have taken approval from the previous auditor at the time of appointment of new auditor. In this case, it cannot be done.
  - (d) The report of the auditor is absolutely correct and is in line with the auditing standards. An auditor is required to include such reference in his report as per the requirements of the auditing standard.
3. KJ Private Ltd. is engaged in the business of e-commerce wherein most of the operations are automated. The company has SAP at its ERP package and is planning to upgrade the SAP version.

Currently, the version of SAP being used is fine but the higher version would lead to increased efficiencies and hence the company is considering this plan which will also involve a huge outlay.

KPP & Associates, were appointed as the statutory auditors of this company for the year ended 31 March 2019 and the statutory audit firm has been working in this industry for long but most of the work which the firm did was more of risk advisory or internal audit.

For the first time, this audit will be conducted and that's why the audit team started obtaining understanding of the operations of the company which included understanding of the SAP system of the company.

However, the management of the company was not comfortable with this approach of the audit team particularly because audit team was spending good time on understanding of the IT systems of the company.

The management suggested that the auditors should limit their understanding and should perform audit procedures rather than getting into business/ operations.

But the auditors have a different view on this matter and because of which work has got stuck.

In the given situation, please suggest what should be the course of action.

- (a) The approach of audit team to obtain detailed understanding of the company before starting with the audit procedures is absolutely fine. If the auditors don't understand the systems properly the audit procedures may not be appropriate.

- (b) The management's concern regarding the approach of the auditors seems reasonable. The auditors are spending time on understanding of the systems/ business and not performing their audit procedures.
  - (c) This being a private company and that too into the business of e-commerce, the auditors should have knowledge about the operations of the company through their understanding of the industry and hence should not get into this process of obtaining detailed understanding at the client place.
  - (d) The audit team could have planned their work differently. They should involve IT experts who would have knowledge of the systems of the company and hence lot of time can be saved. Further in case of such type of industry, involvement of IT experts is anyways required mandatorily as per the legal requirements.
4. Yuvraj Ltd. is a non-banking financial company other than Nidhi company and is covered under "Master Direction - Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016". The NBFC has been in existence for the last 11 years and its operations are considerable in size having a net worth of ₹ 299 crores.
- The NBFC has new statutory auditors for the financial year ended 31 March 2019. The audit report (including CARO) of the NBFC was clean for the financial year ended 31 March 2018. The company had a planning discussion with the auditors of the company for the financial year ended 31 March 2019 who raised a point regarding the applicability of new set of accounting standards, Indian Accounting Standards (Ind AS), on the NBFC for the financial year ended 31 March 2019 and have asked the management to ensure that its financial statements should be according to that. This comes as a big surprise to the management who had assessed that Ind AS would not be applicable to this NBFC because of the fact that CARO is applicable on this NBFC. There is a big disconnect on this matter between the auditor and the management. Please help by resolving this matter.
- (a) Both the management and statutory auditors are not correct because Ind AS is not applicable to any NBFC covered under "Master Direction - Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016".
  - (b) Management is correct because Ind AS is only applicable to NBFC which are also a Nidhi company. In this case, CARO being applicable Ind AS cannot apply to this NBFC.
  - (c) If the management does not agree with the view of statutory auditors then they should give adverse opinion in their report and also report this to RBI.
  - (d) Ind AS would not be applicable for financial year ended 31 March 2019 and hence the view of statutory auditors is not correct.
5. Kshitij and a group of persons subscribed to the shares of JNN Ltd. JNN Ltd. had issued a prospectus for issuance of shares against which these persons had subscribed the shares.

It was later on found that some information as included in the prospectus was misleading. These persons filed a case against the company covering all the parties who were responsible for the prospectus on the ground that the information contained in the prospectus was misleading and they suffered losses by relying on that information.

The company consulted this matter with its legal consultants in respect of the course of action to be taken and also consulted that if the outcome of the case goes against the company then which all parties may be held liable and what could be the other consequences.

The prospectus included auditor's report who had also given his clearance. Some of the experts were also involved in respect of the information on which the litigation was filed.

Subsequently, it was proved that the contention of Kshitij and those persons was correct. It was held that the directors, promoters of the company and the experts involved would be liable to pay compensation to all these persons who had sustained losses or any damage.

The auditors of the company were also asked to make good the losses but they refused with an argument that it is limited to directors, promoters and experts.

In this context, please suggest which of the following statement is correct.

- (a) The argument of the auditors is valid. As per the final outcome of the litigation the auditors were not held liable. However, on moral grounds the auditors should contribute towards the losses suffered by any person.
  - (b) The argument of the auditors is valid. Since the final outcome of the litigation did not held them liable, they cannot be asked to contribute towards the losses suffered by any person.
  - (c) The argument of the auditors is not valid. The final outcome of the litigation covers the experts and hence the auditors also get covered to contribute towards the losses suffered by the persons.
  - (d) The outcome of the litigation seems to be completely wrong. The directors and experts were held liable but along with that the statutory auditors, internal auditors, tax auditors, Company Secretary, tax consultants and the legal advisors should also have been held liable. Further the promoters cannot be held liable in such matters.
6. The audit of Selby & Co is at the last stage, where your team member is looking at the presentation of items in the financial statements. You have instructed the team member to follow the general instructions given under Schedule III of the Companies Act, 2013 for the preparation and presentation of financial statements. The team member has shown you the following list where the company has not adhered to the general instructions given in Schedule III. Which of the following from the list is not as per Schedule III.

- (a) The company had ₹ 32,500 in deferred tax liability and ₹ 12,500 in deferred tax asset. The financial statements include both the above figures at non-current liabilities and non-current assets respectively.
  - (b) The company had a loss in the current year, this debit balance of statement of profit and loss was shown as a negative figure under the head "Surplus" in the notes to the financial statements.
  - (c) In the current year the company had issued a performance guarantee and counter guarantees, but these were not disclosed as contingent liability in the notes in the financial statements.
  - (d) The company has clubbed all other expenses under the head 'Other expenses on the basis of one percent of the revenue from operations or ₹ 1,00,000 whichever is higher to be disclosed separately.
7. VKPL & Associates, a firm of Chartered Accountants, have been operating for the last 5 years having its office in Gurgaon. The firm has staff of around 25 persons with 3 Partners. The firm has been offering statutory audit, risk advisory and tax services to its various clients. The major work of the firm is for taxation services. The audit partners also discussed that the firm needs to work significantly to improve the quality of the services they offer and that would also help the firm to grow its business. Considering this objective, the firm started training programmes for the staff which were made mandatory to be attended.
- During one of the training programmes on quality, a topic was discussed regarding the information that should be obtained by the firm before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. It was explained that the following points may assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate (as per SA 220):
- (i) The integrity of the principal owners, key management and those charged with governance of the entity;
  - (ii) The qualification of all the employees of the entity;
  - (iii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
  - (iv) The remuneration offered by the entity to its various consultants;
  - (v) Whether the firm and the engagement team can comply with relevant ethical requirements; and
  - (vi) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

We would like to understand from you which of the above mentioned points are relevant for the topic under discussion or not?

- (a) i, ii, iv and v.
- (b) ii, iv, v and vi.
- (c) iii, iv, v and vi.
- (d) i, iii, v and vi.

8. AOP Pvt. Ltd. is currently engaged in closing its books of accounts for the financial year ended 31 March 2019. The company has always been a compliance-savvy and has also engaged consultants for the same. The business of the company has been stable over the years and profitability has been good over the last 3 years.

The company got registered for GST on time. Since registration the company has been filing statement of returns in GSTR 3B. However, Annual Return in GSTR 9 has not been filed by the company.

Proper Officer issued a notice for failure to file Annual Return within 15 days. Even then, no Annual Return was filed by the company within the time permitted. Please advise.

- (a) In such a case, the company becomes a 'non-filer'.
  - (b) In such a case, the company would remain fully compliant.
  - (c) The Proper Officer would be required to discuss this matter with the GST auditors of the company.
  - (d) GST auditor may resign in this situation.
9. NIC Pvt. Ltd. is a large private company engaged in the business of insurance for the last 9 years. The company has expanded its business considerably over the years and have set up various divisions across India.

The accounting and the operational systems of the company are centralized wherein the accounts of all the divisions, trial balances and their balance sheets are prepared by the Head Office. AJ & Co, a firm of Chartered Accountants, are the statutory auditors of this company and audit all the divisions and the head office. The auditors have completed the audit of the financial statements of the company for the year ended 31 March 2019 and the company's financial statements are approved.

Before the annual general meeting of the company, the company received a notice from the Insurance Regulatory and Development Authority of India (IRDAI) which has asked the company to respond within 7 days as to why this company breached the requirement of IRDAI guidelines by having a single auditor for all the divisions and head office.

The management of the company has been doing this over the years and were never aware of this requirement. To respond to this, the management has consulted many legal experts and also the auditors. They would also like to understand your views as to how to respond

to IRDAI in this critical situation. Please advise carefully.

- (a) There has been no breach of IRDAI guidelines and accordingly the management should respond.
  - (b) The management should request IRDAI to consider relaxation in respect of this provision for the company for the current year as the audit is completed and it would be practically very difficult to complete the entire process within the required timelines.
  - (c) The management should respond to IRDAI that this provision is applicable to a company only after 15 years of its existence and hence there is no breach of IRDAI guidelines.
  - (d) The management should respond to IRDAI that this provision should have been ensured by the auditors and hence they should be held liable for this breach of provision of the IRDAI guidelines.
10. Shivam & Co LLP is a large firm of Chartered Accountants based out of Delhi-NCR. During the financial year ended 31 March 2019, the firm Shivam & Co LLP got an intimation for the peer review on 1 July 2018. The process of peer review got started and completed on 15 September 2018 which included the on-site review from 1 August 2018 to 16 August 2018.
- Shivam & Co LLP objected to the time taken by the Peer Reviewer on-site, however, as per Peer Reviewer, the entire review process got completed within 90 days from the date of notifying the firm about its selection for review.
- (a) The time for complete review should be completed within 120 days.
  - (b) The time for on-site review should not have extended beyond 10 working days.
  - (c) The time for complete review should be completed within 60 days.
  - (d) The time for on-site review should not have extended beyond 7 working days.

## **PART B : DESCRIPTIVE QUESTIONS**

### **Standards on Auditing, Statements and Guidance Notes**

11. (a) MNO Limited is one of the prominent players in the chemicals industry. The company is a public company domiciled in India and listed on BSE and NSE. The Company was facing extreme liquidity constraints and there were multiple indicators that casted doubt over the company's ability to continue as a going concern.
- The Company was led into insolvency proceedings by consortium of banks led by PNB and the NCLT ordered the commencement of corporate insolvency process against the Company on 31 August 2018. The company invited prospective lenders, investors and others to submit their resolution plans to the Resolution Professional (RP) latest by 1 January 2019. The RP reviewed the resolution plans and ensured

conformity with Insolvency and Bankruptcy Code 2016. The compliant plans were presented to Committee on Creditors (CoC) on 2 February 2019 and the resolution plan submitted by PQR Ltd. was evaluated as highest evaluated Compliant Resolution Plan. CoC of MNO Ltd. approved the Resolution Plan submitted by PQR Ltd. on 2 March 2019. The approval of NCLT was finally obtained on 4 May 2019.

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

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

#### **Audit Planning Strategy and Execution**

12. Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram.

What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement?

#### **Risk Assessment and Internal Control**

13. BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2018-19. In order to review internal controls of the sales department of the company, you visited the department and noticed the work division as follows:
- (1) An officer was handling the sales ledger and cash receipts.
  - (2) Another official was handling dispatch of goods and issuance of Delivery challans.
  - (3) One more officer was there to handle customer/ debtor accounts and issue of receipts.
- (a) As an internal auditor you are required to briefly discuss the general condition pertaining to the internal check system.
- (b) Do you think that there was proper division of work? If not, why?



**Special Aspects of Auditing in an Automated Environment**

14. "Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics and the data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs." You are required to give a suggested approach to get the benefit from the use of CAATs.

**The Company Audit**

15. (a) "ABC & Co." is an Audit Firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.
- (i) Provide the maximum number of Audits remaining in the name of "ABC & Co."
  - (ii) Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.
  - (iii) Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ₹ 100 crore which has not committed default in filing its financial statements under section 137 or annual return under section 92 of the Companies Act with the Registrar, 2 small companies and 1 dormant company?
  - (iv) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ₹ 110 crore each?
- (b) Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts for the year 2018-19. The decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company, held in April 2018, subject to shareholders' approval in AGM of the company scheduled to be held in June 2018. Meanwhile, the Principal Auditor of the company raised an objection that the branch auditor cannot be appointed without his consent. Advise, whether the objection raised by company auditor is valid.

**Audit Report**

16. (a) Under CARO, 2016, as a statutory auditor, how would you report?
- (i) RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director, which is an arrangement by which the RPS Ltd. is in process to acquire assets for consideration other than cash.
  - (ii) NSP Limited has its factory building, appearing as fixed assets in its financial statements in the name of one of its director who was overlooking the manufacturing activities.
- (b) KPI Ltd. is a company on which International Standards on Auditing are applicable along with Standard on Auditing issued by the ICAI. The company appointed new auditors for

the audit of the financial statements year ended 31 March 2019 after doing all appointment formalities. Therefore, the auditor's report referred the International Standard on Auditing in addition to the Standard on Auditing issued by the ICAI.

As an expert, you are required to advise the auditor regarding auditor's report for audits conducted in accordance with both the Standards.

#### **Liabilities of Auditor**

17. Anvisha Ltd. is a company engaged in the business of software development. It is one of the largest companies in this sector with a turnover of ₹ 25,000 crores. The operations of the company are increasing constantly, however, the focus of the management is more on cost cutting in the coming years to improve its profitability. In respect of the financial statements of the company which are used by various stakeholders, some fraud was observed in respect of assets reported therein due to which those stakeholders suffered damages. As a result, those stakeholders applied to Tribunal for change of auditor on the basis that auditor is colluded in the fraud.

Elucidate the power of tribunal to change the auditor of a company if found acted in a fraudulent manner as provided under sub-section (5) of section 140 of the Companies Act, 2013.

#### **Audit Committee and Corporate Governance**

18. Comment on the following in the light of certificate of compliance of conditions of Corporate Governance to be issued for a listed company where the Board consists of 10 directors including a non-executive director as its chairman:
- (i) There were 5 audit committee meetings held during the year as follows 01/04/2018, 01/06/2018, 01/09/2018, 03/01/2019, 25/03/2019.
  - (ii) There are 4 independent directors. One of them resigned on 25/05/2018. A new independent director was appointed on 01/09/2018.
  - (iii) The Chairman of Audit Committee did not attend the Annual General meeting held on 14/09/2018.
  - (iv) The internal audit reports were obtained by Audit Committee on quarterly basis. Quarter 1 internal audit report commented on certain serious irregularities as regards electronic online auction of scrap. The agenda of Audit Committee did not deliberate or take note of the issue.
  - (v) There is no woman director.

#### **Audit of Bank**

19. (a) In course of audit of TruePrinci Bank as at 31<sup>st</sup> March, 2019, you observed that in a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not

invoked the guarantee. Comment. Would your answer be different if the advance is guaranteed by a State Government?

- (b) While auditing FAIR Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks.

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

20. Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC).

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

21. You are doing Tax Audit of Private Limited Company for the financial year ending 31<sup>st</sup> March, 2019. During audit, you notice that the company is not regular in deposit of VAT/GST and there remains pendency every year. The details of VAT/GST payable are:
- (i) GST payable as on 31/03/2018 of FY 2017-18 was ₹ 200 Lakh and out of which ₹ 100 Lakh was paid on 15/09/2018 and ₹ 50 Lakh on 30/03/2019 and balance of ₹ 50 Lakh paid on 16/09/2019.
  - (ii) GST payable of current financial year 2018-19 was ₹ 100 lakh and out of this, ₹ 40 Lakh was paid on 25/05/2018 and balance of ₹ 60 Lakh remained unpaid till the due date of return.

The date of Tax Audit report and due date of return was 30<sup>th</sup> September.

Now as a Tax Auditor, how/where the said transaction will be reflected in Tax Audit Report under Section 43B(a)?

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

22. (a) Perfect Steel Ltd. has reported a higher turnover of ₹ 560 crores in the year 2018-19 as compared to earlier years but its sales return has also increased to 10% from only 4% upto the last year. The management is concerned about the high sales returns and feels a need to get the operational audit done for sales and production department of the company. The company is also having an internal audit system in the company. Elaborate the possible reason/s, why management is getting operational audit done when internal audit has already been done for both the departments by stating the shortcomings of conventional information sources.
- (b) You are also required to discuss the difference in the approach of both of these audits.

**Due Diligence, Investigation and Forensic Audit**

23. (a) General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose.

In view of the above, you are required to brief out the difference between Audit and Investigation.

- (b) Beta Ltd. is anticipating taking over a manufacturing concern and appoints you for due diligence review. While reviewing, it requests you to look specifically for any hidden liabilities and overvalued assets. State in brief the major areas you would examine for hidden liabilities and overvalued assets.

**Professional Ethics**

24. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) Mr. 'A' is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee, for taking care of routine matters of his office. During his absence, Mr. 'Y' has conducted the under mentioned jobs in the name of M/s A & Co.:

- (i) He issued the audit queries to client which were raised during the course of audit.
- (ii) He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.

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

- (b) M/s Amudhan & Co., a firm of Chartered Accountants, received ₹ 2.8 lakhs in January, 2019 on behalf of one of their clients, who has gone abroad and deposited the amount in their Bank account, so that they can return the money to the client in July, 2019, when he is due to return to India.
- (c) CA Raman who is contesting Regional Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period.
- (d) Mr. Anil, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.
25. Write a short note on the following:
- (a) Auditor's objectives in an audit of consolidated financial statements.

- (b) Areas of propriety audit under Section 143(1) of the Companies Act, 2013.
- (c) Auditor's considerations while reviewing of Investment Department of Life Insurance Company.
- (d) State whether a Tax audit report can be revised and if so state those circumstances.
- (e) Scope of the Quality review.

### SUGGESTED ANSWERS/HINTS

#### PART A : ANSWERS TO MULTIPLE QUESTIONS

1	b	The assessment of the auditor is valid. Such a matter qualifies to be a key audit matter and hence should be reported accordingly by the auditor in his audit report.
2	d	The report of the auditor is absolutely correct and is in line with the auditing standards. An auditor is required to include such reference in his report as per the requirements of the auditing standard.
3	a	The approach of audit team to obtain detailed understanding of the company before starting with the audit procedures is absolutely fine. If the auditors don't understand the systems properly the audit procedures may not be appropriate.
4	d	Ind AS would not be applicable for financial year ended 31 March 2019 and hence the view of statutory auditors is not correct.
5	c	The argument of the auditors is not valid. The final outcome of the litigation covers the experts and hence the auditors also get covered to contribute towards the losses suffered by the persons.
6	a	The company had ₹ 32,500 in deferred tax liability and ₹ 12,500 in deferred tax asset. The financial statements include both the above figures at non-current liabilities and non-current assets respectively.
7	d	i, iii, v and vi.
8	a	In such a case, the company becomes a 'non-filer'.
9	a	There has been no breach of IRDAI guidelines and accordingly the management should respond.
10	d	The time for on-site review should not have extended beyond 7 working days.

#### PART B

11. (a) **As per SA 570 Going Concern**, if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant

doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty") through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

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

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

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

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

- (b) **Inventory under the Custody and Control of a Third Party:** As per SA 501, "Audit Evidence—Specific Considerations for Selected Items" when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:
- (i) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
  - (ii) Perform inspection or other audit procedures appropriate in the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include:
    - Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
    - Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
    - Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
    - Requesting confirmation from other parties when inventory has been pledged as collateral.
12. As per **SA 210 "Agreeing the Terms of Audit Engagements"**, in order to establish whether the preconditions for an audit are present, the auditor shall:
- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
  - (b) Obtain the agreement of management that it acknowledges and understands its responsibility
    - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
    - (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
    - (iii) To provide the auditor with:
      - a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
      - b. Additional information that the auditor may request from management for

the purpose of the audit; and

- c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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

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

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

13. (a) **Internal Check System:** The general condition pertaining to the internal check system may be summarized as under:

- (i) no single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iii) Every member of the staff should be encouraged to go on leave at least once a year.
- (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
- (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
- (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
- (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
- (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.



- (x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.
- (b) **Division of Work:** Company has not done proper division of work as:
- (i) the receipts of cash should not be handled by the official handling sales ledger.
  - (ii) delivery challans should be verified by an authorised official other than the officer handling despatch of goods.
14. There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is given below:
- Understand Business Environment including IT ;
  - Define the Objectives and Criteria;
  - Identify Source and Format of Data;
  - Extract Data;
  - Verify the Completeness and Accuracy of Extracted Data;
  - Apply Criteria on Data Obtained;
  - Validate and Confirm Results.
15. (a) **Fact of the Case:** In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.
- Provisions and Explanations:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).
- As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be  $3 \times 20 = 60$  company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.
- Conclusion:**
- (i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more

companies:

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

Number of Audits already taken by all the partners

In their individual capacity =  $4+6+10$  = 20

Remaining number of Audits available to the Firm = 40

- (ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor. Hence (1) Mr. A can hold:  $20 - 4 = 16$  more audits. (2) Mr. B can hold  $20 - 6 = 14$  more audits and (3) Mr. C can hold  $20 - 10 = 10$  more audits.
- (iii) In view of above discussed provisions, ABC & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than ₹ 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar), 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.
- (iv) As per fact of the case, ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹ 100 crores (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar). In the given case, out of the 60 private companies ABC & Co. is offered, 45 companies having paid-up share capital of ₹ 110 crore each. Therefore, ABC & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than ₹ 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.) and 40 private companies having paid-up share capital of ₹ 110 crore each in addition to above 20 company audits already holding.
- (b) **Appointment of Branch Auditor:** Section 143 (8) of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.

In case of subsequent appointment of auditor, section 139(1) of the Act provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting.

In the instant case, Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts and the decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company subject to shareholders' approval in AGM of the company.

Thus, objection raised by company auditor is not valid as per section 143(8) of the companies Act, 2013 and the Board has authority to appoint branch auditor but should be approved by shareholders in General Meeting.

16. (a) (i) **Non-cash Transactions with Relative of Director:** As per Clause (xv) of paragraph 3 of CARO, 2016, the auditor is required to report "whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with".

Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

In the instant case, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is an arrangement by which RPS Ltd. is in process to acquire assets for consideration other than cash. In the above situation the provisions of section 192 of Companies Act, 2013 have been complied with.

However, the reporting requirements under this clause are given in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

In the given situation, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is affirmative answer to the first part of the Clause (xv) of Paragraph 3 of CARO, 2016, thus, reporting is required for the same. Draft report is given below.

*According to the information and explanations given to us, the Company has entered into non-cash transactions with Mr. Rahul, son of one of the directors*

*during the year, for the acquisition of assets, which in our opinion is covered under the provisions of Section 192 of the Companies Act, 2013.*

- (ii) **Title deeds of Immovable Property in the name of Director:** As per Clause (i)(c) of Paragraph 3 of the CARO, 2016, the auditor is required to report on whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.

The auditor should verify the title deeds available and reconcile the same with the fixed assets register. The scrutiny of the title deeds of the immovable property may reveal a number of discrepancies between the details in the fixed assets register and the details available in the title deeds. This may be due to various reasons which needs to be examined.

In the given case, NSP Limited has its factory building, appearing as fixed assets in its financial statements in the name of director. Thus, the auditor shall report on the same under Clause (i)(c) of Paragraph 3 of the CARO, 2016.

The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise:

**A In case of land:-**

- total number of cases,
- whether leasehold / freehold,
- gross block and net block, (as at Balance Sheet date), and
- remarks, if any.

**B In case of Buildings:-**

- total number of cases,
- gross block & net block, (as at Balance Sheet date) and
- remarks, if any.

- (b) **Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing or Auditing Standards of Any Other Jurisdiction:** As per SA 700, "Forming an Opinion and Reporting on Financial Statements", an auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

- (a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:
- (i) to form a different opinion, or

- (ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that,

in the particular circumstances, is required by SAs; **and**

- (b) The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

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

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

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

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

- 18. Compliance of conditions of Corporate Governance in case of Listed Company:** As per Listing Obligation and Disclosure Requirements Regulations 2015, depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for example:

- (i) The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings. The number of days between the meetings held on 1.9.2018 and 3.01.2019 is more than 120 days. Hence

it is a non-compliance and would require qualification in certificate of corporate governance

- (ii) Since the Chairman is the non-executive director, there should be  $\frac{1}{3}$ <sup>rd</sup> of directors (rounded to next integer) to be independent. In this case, 4 directors need to be independent. Any vacancy during shortfall of independent directorship should be filled within next 3 months or before the start of next meeting, whichever is later. In the instant case, since the independent director was appointed after lapse of 3 months (i.e. on 1.9.2018) and after next first meeting 1/6/2018, there is default which would require qualification in certificate on corporate governance.
  - (iii) Chairman shall be present at Annual General Meeting to answer shareholder queries. In the given scenario, Chairman of Audit Committee did not attend the Annual General Meeting held on 14/09/2018 which is not in order/compliance.
  - (iv) The Audit Committee shall mandatorily review the Internal audit reports relating to internal control weaknesses as per Part C (B) of Schedule II and the auditor should ascertain from the minutes book of the Audit Committee and other sources like agenda papers, etc. whether the Audit Committee has reviewed the above-mentioned information. In the given situation, the agenda of Audit Committee did not deliberate or take note of serious irregularity mention in Internal Audit Report which is again not in compliance of conditions of Corporate Governance and warrant audit qualification in certificate on corporate governance.
  - (v) The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one-woman director. Therefore, there should be at least one-woman director. In the given situation, there is no woman director which is again not in compliance.
19. (a) **Government Guaranteed Advance:** If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

**(b) Contingent Liabilities for Banks:** The Third Schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet-

*(A) Contingent liabilities*

- (i) Claims against the bank not acknowledged as debts.
- (ii) Liability for partly paid investments.
- (iii) Liability on account of outstanding forward exchange contracts.
- (iv) Guarantees given on behalf of constituents-
  - (1) In India.
  - (2) Outside India.
- (v) Acceptances, endorsements and other obligations.
- (vi) Other items for which the bank is contingently liable.

*(B) Bills for collection.*

**20 Some points that may be covered in the audit of NBFC - Investment and Credit Company (NBFC-ICC):**

- i. Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- ii. Verify whether the NBFC has not advanced any loans against the security of its own shares.
- iii. Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.
- iv. Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
- v. Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.

- vi. Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
- vii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- viii. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- ix. An auditor will have to ascertain whether the requirements of AS 13 “Accounting for Investments” or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- x. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- xi. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).
- xii. Verify charges received or paid in respect of securities lend/borrowed.
- xiii. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
- xiv. An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.
- xv. An auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which an advance could be considered realisable.
- xvi. Obtain balance confirmations from the concerned parties.
- xvii. As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscouted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.
- xviii. Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.



- xix. An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.
- xx. Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

(Note: The above checklist is not exhaustive. It is only illustrative. There could be various other audit procedures which may be performed for audit of an NBFC.)

- 21. Reporting in Tax Audit Report:** Any amount of GST/Tax payable on the last day of previous year (opening balance) as well as on the last day of current year has to be reported in Tax Audit Report under clause 26(A) and 26(B) in reference of section 43 B.

Clause 26 (A) dealt GST/VAT payable on the pre-existed of the first day of the previous year but was not allowed in the assessment of any preceding previous year and was either paid {clause 26(A) (a)} or/ and/ not paid during the previous year {clause 26(A)(b)}

The details will be as under in regard to opening balances:

**Liability Pre-existed on the previous year.**

Sr. No.	Section	Nature of Liability	Outstanding Opening balance not allowed in previous year	Amount paid/set-off during the year	Amount written back to P&L Account	Amount unpaid at the end of the year
01	43B(a)	VAT/GST	100 lakh	50 lakh	0	50 lakh

It has been assumed that 50 lakh was allowed in last year as it was paid before the due date of return.

**Liability incurred during the previous year**

Sr. No.	Section	Nature of Liability	Amount incurred in previous year but remaining outstanding on last day	Amount paid/set-off before the due date of filing return/date upto which reported in the tax audit	Amount unpaid on the due of filing of return/date upto which reported in the tax audit report,

			of previous year.	report, whichever is earlier	whichever is earlier
01	43B(a)	VAT/GST	100 lakh	40 lakh	60 lakh

22. (a) **Why Operational Audit?:** The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company where the management is at a distance from actual operations due to layers of delegation of responsibility, separating it from actualities in the organisation.

Operational audit is considered as a specialised management information tool to fill the void that conventional information sources fail to fill. Conventional sources of management information are departmental managers, routine performance report, internal audit reports, and periodic special investigation and survey. These conventional sources fail to provide information for the best direction of the departments all of whose activities do not come under direct observation of managers. The shortcomings of these sources can be stated as under:

- (i) Executives and managers are too preoccupied with implementation of plans and achieving of targets. They are left with very little time to collect information and locate problems. They may come across problems that have come to surface but they are hardly aware of problems that are brewing and potential.
- (ii) Managers or their aides are generally relied upon for transmitting information than for booking for information or for analysing situations.
- (iii) The information that is transmitted by managers is not necessarily objective - often it may be biased for various reasons.
- (iv) Conventional internal audit reports are often routine and mechanical in character and have a definite leaning towards accounting and financial information. They are also historical in nature.
- (v) Other performance reports contained in the annual audited accounts and the routine reports prepared by the operating departments have their own limitations. The annual audited accounts are good as far as an overall evaluation is concerned in monetary terms.



Sales may be shown at a higher monetary value compared to the previous year and this may apparently suggest that the functioning of the sales department is satisfactory. But this may have been caused by a number of factors in spite of a really bad performance on the sales front. This fact may not be readily known unless one cares to analyse the sales data by reference to notes and explanations to the accounts and other related accounting data. Even a study of this nature may not fully reveal the weakness. It is

quite possible that the established market for sales has been lost partly while some fortuitous sales have compensated the loss



The routine weekly production report may include production 'that is subsequently rejected by the quality control staff, or to avoid showing a bad production performance; even the partly produced goods may also be included. Remember, all this can happen in spite of specific management instructions about the basis on which the production report is to be made out.

Another important point may be noticed in the matter of routine departmental reports. The busy management people, who can afford time only to glance over the performance reports, cannot be expected to make an integrated reading of several reports or to undertake an analysis of such reports. What they need is reliable, unmanipulated and objective report which they would like to look into to understand the situation.

- (vi) Operations of controls in a satisfactory manner cannot be relied upon to bring to light the environmental conditions. Controls are specific and their satisfactory operation is related to the specific situation under control. Also monitoring of the breakdown or non-operation of controls is a periodic phenomenon.
- (vii) Surveys and special investigations, no doubt, are very useful but these are at the best occasional in character. Also, they are costly, time consuming and keep the departmental key personnel busy during the period they are on. These are basically an attempt to carry out a post-mortem rather than to enlighten the management about the ways on improvement or for better performance or to give a signal for dangers and disasters to come.

**(b) The difference in the approach of both of these audits is illustrated below:**

1. **Perception** - Traditionally, internal auditors have been engaged in a sort of protective function, deriving their authority from the management. They view and examine internal controls in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are not there; they check the accounting books and records to see, whether the internal checks are properly working and the resulting accounting data are reliable.

**For example** - when the auditor looks into the vouchers to see whether they corroborate the entries in the cash book or physically examines the cash in hand he is doing his traditional protective function. The moment he concerns himself to see whether customers' complaints are duly attended to or whether cash balance is excessive to the need, he comes to the operational field.

Also, he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would be interested in such matters as reorder policy, obsolescence

policy and the overall inventory management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

2. **Issues** - The basic difference that exists in conceptualisation of the technique of operational auditing is in the auditor's role in recommending corrections or in installing systems and controls. According to Lindberg and Cohn, such a situation would be in conflict with the role of operational auditor. In this connection, the views of the Institute of Internal Auditors, in the context of internal audit are relevant. According to that Institute, "the internal auditor should be free to review and appraise policies, plans, procedures and records; but his review and appraisal does not in any way relieve other persons in the organisation of the responsibilities assigned to them.

However, a further distinction should be observed between traditional internal auditing and operational auditing - this lies in the attitude and approach to the whole auditing proposition. Every aspect of operational auditing programme should be geared to management policies, management objectives and management goals.

3. **Objectives** - The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems and prospects and its environment.

Above all, his mind should be open and active so as to be able to perceive problems and prospects and grasp technical matters. In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues. The norms and standards should be such as are generally acceptable or developed by the company itself.

Performance yardsticks can be found in the management objectives, goals and plans, budgets, records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments.

**For example** - The standards relating to objectives for a government company are quite different from those of a private sector company. Similarly, standards of performance of a well equipped company which also adequately looks after the well-being of employees may be significantly different from a company which offers scanty welfare facilities or is ill-equipped.

Today, however, the concept of modern internal auditing suggests that there is no difference in internal and operational auditing. In fact, the scope of internal auditing is broad enough to embrace the areas covered by operational auditing as well. The modern internal auditing performs both protective as well as constructive functions.

23. (a) Etymologically, **auditing and investigation** are largely overlapping concepts because auditing is nothing but an investigation used in a broad sense. Both auditing and investigation are fact finding techniques but their basic nature and objectives differ as regards scope, frequency, basis, thrust, depth and conclusiveness. Audit and investigation differ in objectives and in their nature. Auditing is general while investigation is specific.

Basis of Difference	Investigation	Audit
(i) Objective	An investigation aims at establishing a fact or a happening or at assessing a particular situation.	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.
(ii) Scope	The scope of investigation may be governed by statute or it may be non- statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.
(iii) Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either quarterly, half-yearly or yearly.
(iv) Nature	Requires a detailed study and examination of facts and figures.	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion.
(v) Inherent Limitations	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent limitation.
(vi) Evidence	It seeks conclusive evidence.	Audit is mainly concerned with prima-facie evidence.

(vii) Observance of Accounting Principles	It is analytical in nature and requires a thorough mind capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements.
(viii) Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

- (b) **Major areas to examine in course of Due Diligence Review:** 'Due Diligence' is a term that is often heard in the corporate world these days in relation to corporate restructuring. The purpose of due diligence is to assist the purchaser or the investor in finding out all he can, reasonably about the business he is acquiring or investing in prior to completion of the transaction including its critical success factors as well as its strength and weaknesses.

Due diligence is an all pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review of Financial Statements. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does not involve examination from the view point of extraordinary items, analysis of significant deviations, etc.

However, in order to investigate **hidden liabilities**, the auditor should pay his attention to the following areas:

- ◆ The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
- ◆ The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- ◆ The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- ◆ Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
- ◆ Tax liabilities under direct and indirect taxes.
- ◆ Long pending sales tax assessments.

- ◆ Pending final assessments of customs duty where provisional assessment only has been completed.
- ◆ Agreement to buy back shares sold at a stated price.
- ◆ Future lease liabilities.
- ◆ Environmental problems/claims/third party claims.
- ◆ Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
- ◆ Huge labour claims under negotiation when the labour wage agreement has already expired.
- ◆ Contingent liabilities not shown in books.

**Regularly Overvalued Assets:**

The auditor shall have to specifically examine the following areas:

- ◆ Uncollected/uncollectable receivables.
- ◆ Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- ◆ Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- ◆ Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- ◆ Litigated assets and property.
- ◆ Investments carried at cost though realizable value is much lower.
- ◆ Investments carrying a very low rate of income / return.
- ◆ Infructuous project expenditure/deferred revenue expenditure etc.
- ◆ Group Company balances under reconciliation etc.
- ◆ Intangibles of no value.

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

In this case CA 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of

routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- (i) In the given case, Mr. 'Y', a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here "Y" is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
  - (ii) In this instance, Mr. "Y", CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
- (b) **Money of Clients to be Deposited in Separate Bank Account:** Clause (10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended".

In the given case, M/s Amudhan & Co. received the money in January, 2019 which is to be paid only in July 2019, hence, it should be deposited in a separate bank account. Since in this case M/s Amudhan & Co. has failed to keep the sum of ₹ 2.8 lakhs received on behalf of their client in a separate Bank Account, it amounts to professional misconduct under Clause (10) of Part I of Second Schedule.

- (c) **Other Misconduct:** CA Raman has engaged his Articled Assistant for his own election campaigning for the Regional Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work. This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.



Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'.

Hence, CA Raman is guilty of 'Other Misconduct'.

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

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

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard, he was guilty of professional misconduct under Clause (7).

Since, Mr. Anil has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

**25. (a) The auditor's objectives in an audit of consolidated financial statements are:**

- (i) to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of applicable financial reporting framework;
- (ii) to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements;
- (iii) to enquire into the matters as specified in section 143(1) of the Companies Act, 2013; and.
- (iv) to report on the matters given in the clauses (a) to (i) of section 143(3) of the Companies Act, 2013, for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014, to comment on the matters specified in sub-rule (a), (b) and (c)<sup>1</sup> to the extent applicable;
- (v) The auditor should also validate the requirement of preparation of CFS for the company as per applicable financial reporting framework.

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<sup>1</sup> The auditor of the consolidated financial statements generally report on the matters pertaining to the component, on the basis of auditors' report of the respective component.

(b) **Areas of propriety audit under Section 143(1):** Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to -

- (i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
- (ii) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made;
- (iii) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- (iv) whether loans and advances made by the company have been shown as deposits;
- (v) whether personal expenses have been charged to revenue account;
- (vi) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.

(c) **Role of Auditor:** The Auditor during his review of Investment Department of Life Insurance Company should mainly consider the following:

-  Review the Investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office.
-  Review of insurer's Standard Operating Procedures which are prescribed by the IRDA Regulations and are required to cover the entire gamut of investment related processes and policies.
-  Review of insurer's Investment policy.
-  Review of functioning and scope and minutes of Investment Committee.
-  Compliance of all Investment regulations, various other circulars specified by IRDA and other regulations specified in the Insurance Act, 1938.
-  Review of insurer's Disaster Recovery, Backup and Contingency Plan.

- ✎ Review of access Controls, authorization process for Orders and Deal execution, etc.
  - ✎ Review of insurer's Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer's system should be able to determine the amount of Investible surplus.
  - ✎ Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments.
  - ✎ Review of fund wise reconciliation with Investment Accounts, Bank, and Custodian records.
  - ✎ Ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life (Participating & Non-Participating), Pension & Group (Participating & Non-Participating) and Unit Linked Fund.
  - ✎ Review the arrangements and reconciliations of holdings with the insurer's custodian.
  - ✎ Review and check insurer's Investment Accounting and valuation policy and the controls around this process.
  - ✎ insurer's risk management policies and processes to manage investment risk such as Market risk, Liquidity risk, Settlement risks, etc.
  - ✎ Determine the extent of activities outsourced and the controls over such activities.
  - ✎ Controls over NAV computation and declaration.
  - ✎ Controls over various system interfaces such as Seamless integration of data, between front office and back office, in the Investments accounting system.
  - ✎ Flow of data from PMS to the Investment Accounting system.
  - ✎ Controls around personal dealings, insider trading and front running.
- (d) Revision of Tax Audit Report:**
- (1) Normally, the report of the tax auditor cannot be revised later.
  - (2) However, when the accounts are revised in the following circumstances, the tax Auditor may have to revise his Tax audit report also.
    - (i) Revision of accounts of a company after its adoption in the annual general meeting.

- (ii) Change in law with retrospective effect.
- (iii) Change in interpretation of law (e.g.) CBDT Circular, Notifications, Judgments, etc.

The Tax Auditor should state it is a revised Report, clearly specifying the reasons for such revision with a reference to the earlier report.

**(e) The scope of the quality review includes:**

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