PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

*Question No. **1** is compulsory*

*Answer any **four** from the rest*

Question 1

(a) *You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was ₹ 12,000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for ₹ 850 crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with Ind AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises.*

Analyse this issue in finalizing the Audit Report.

(b) *Amudhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2018. The Audit Report for that year was signed by the Auditors on 04/05/2018. The Annual General Meeting was decided to be held during the month of August 2018. On 06/05/2018, the Company had received a communication from the Central Government that an amount of ₹ 5800 crore kept pending on account of incentives pertaining to Financial Year 2017-18 had been approved and the amount would be paid to the Company before the end of May 2018. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2018. On 08/05/2018, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2018. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.*

(c) *M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2018 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the* *issue involves uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the "Going Concern" would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter.*

(d) *There are certain circumstances in which Emphasis of Matter in Auditor's Report is mandated to be included. Explain this statement in the light of mandatory requirements of matters that are to be emphasised in Auditor's Report when the Audit Report is on Financial Statements prepared in accordance with Special Purpose Framework.* ***(5 x 4 = 20 Marks)***

Answer

(a) Related Party Disclosures : As per Ind AS 24, "Related Party Disclosures", a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with (i) a government that has control or joint control of, or significant influence over, the reporting entity; and (ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:

(1) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);

(2) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:

  (i) the nature and amount of each individually significant transaction; and

  (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Further, as per SA 550 Related Parties, in forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In the instant case, Power Supply Corporation Limited, a Government Company has procured spares for transmitters for rupees 850 crore from abroad through a corporation namely Procurement and Supply India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Power Supply Corporation Limited has to disclose the matters specified above (i.e.name of Government, natures of its relationship with reporting entity, the nature and amount of transaction etc.). Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise in not tenable.

(b) Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

(i) Discuss the matter with management and, where appropriate, those charged with governance.

(ii) Determine whether the financial statements need amendment and, if so,

(iii) Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, XYZ Company Ltd. received an amount of rupees 5800 crore on account of incentives pertaining to year 2017-18 in the month of May 2018 i.e. after finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Amudhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2018.

After applying the conditions given in SA 560, Amudhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

(c) Reporting requirements in case of Uncertainty clamping on the Going Concern: As per SA 570 "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements : (i)adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and (ii) disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

(i) Draw attention to the note in the financial statements that discloses the matters set out above; and

(ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

In the instant case, M/s Aircraft Ltd. is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of its ability to continue in near future. Therefore, a committee has been constituted to study this aspect and till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts. Therefore, the auditor should disclose about the material uncertainty and express an unmodified opinion and in his audit report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to draw attention to the note in the financial statements that discloses the matters set out above; and state that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

(d) Circumstances in which Emphasis of Matter Paragraph in Auditor's Report is mandated in case of Financial Statements prepared in accordance with a Special Purpose Framework: As per SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" and/or SA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks", the auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose frame work and that, as a result, the financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading.

The special purpose financial statements may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose financial statements on public record. To avoid misunderstandings, the auditor alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose frame work and, therefore, may not be suitable for another purpose.

Restriction on Distribution or Use: In addition to the alert required above, the auditor may consider it appropriate to indicate that he auditor's report is intended solely for the specific users. Depending on the law or regulation of the particular jurisdiction, this may be achieved by restricting the distribution or use of the auditor's report. In these circumstances, the emphasis of matter paragraph given above maybe expanded to include these other matters, and the heading may be modified accordingly.

Question 2

(a) Mr. X, a Chartered Accountant in Practice filed his income tax return for the Assessment Year 2018-19 under section 44ADA of the Income Tax Act, 1961, declaring his income on presumptive basis. In a disciplinary proceeding against him for an alleged misuse of funds of his clients, it was asked that he should submit his books of accounts for the financial year ended on 31/03/2018. Mr. X refused to submit books of accounts on the ground that he had not maintained any books and even for income tax purposes, he submitted his Return of Income on a presumptive basis. Is he right in putting such a defence? Analyse the issues in the light of Professional Code, if any.

(b) While doing Tax Audit, under section 44AB of the. Income Tax Act, 1961, of the accounts of Glue Private Limited for the Assessment Year 2018-19, it was found that during the Financial Year 2017-18, Glue Private Limited had received 9,000 shares, the market value of which was ₹ 90,000 on the date of transfer, at a price of ₹ 45,000 from Stick Private Limited. The Management of Glue Private Limited maintained that the transaction was as per the terms of negotiations and there would be no cause for the Auditor to bring this matter in his Tax Audit Report - Comment.

(c) During the financial year ended on 31/03/2018, LM Private Limited had borrowed from a Nationalized Bank, a term loan of ₹ 120 lakhs consisting of ₹ 100 lakhs for purchase of a machinery for the new plant and ₹ 20 lakhs for erection expenses. As on the date of 31st March, 2018, the total of capital and free reserves of the Company was ₹ 50 lakhs and turnover for the year 2017-18 was ₹ 750 lakhs. The Bank paid ₹ 100 lakhs to the vendor of the Company for the supply of machinery on 31/12/2017. The machinery had reached the yard of the Company. On 28/02/2018, the Company had drawn the balance of loan viz. ₹ 20 lakhs to the credit of its current account maintained with the Bank and utilized the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction. Comment as to reporting issues, if any, that the Auditor should be concerned with for the financial year ended on 31/03/2018, in this respect.

(d) State what may be the evaluative or review procedures that the Statutory Auditor may do before concluding as to relevance and reasonableness of Auditor's Expert work for using it for his audit purposes. ***(5 x 4 = 20 Marks)***

Answer

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

Accordingly, it does not matter that as per section 44ADA of the Income Tax Act Mr. X declared his income on presumptive basis. Here, it may be noted that though 44ADA of the Income Tax Act exempt the requirement of books and accounts but as per Council

General Guidelines a chartered accountant in practice is required to maintain and keep proper books of accounts including cash book and ledger. Hence, Mr. X is guilty of professional misconduct.

(b) Reporting for Receipt of Shares, the Aggregate Fair Market Value of Which Exceeds ₹ 50,000: In this case, Glue Private Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2017-18, the company received property, being shares, for rupees 45000 as consideration, the fair market value of which is ₹ 90,000.

A tax auditor has to furnish the details of shares received during the previous year, under clause 28 of Form 3CD, in case, the assessee has received any property, being share of a company not being a company in which public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2) of the Income Tax Act, 1961.

Section 56(2) provides that where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year any property being shares of a company not being a company in which the public is substantially interested,

(i) without consideration, the aggregate fair market value of which exceeds ₹ 50,000, the whole of the aggregate fair market value of such property;

(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding ₹ 50,000, the aggregate fair market value of such property as exceeds such consideration,

shall be chargeable to income-tax under the head "Income from other sources".

As per the facts of the case, provisions and explanations given above, the income generated by Glue Private Ltd., is rupees 45,000 i.e. in excess of fair market value of shares received (i.e. ₹ 90,000), is lesser than rupees 50,000 as per section 56(2) of the Income Tax Act, 1961. Therefore, the tax auditor of Glue Private Ltd. is not required to furnish the details of such shares received under clause 28 of Form 3CD. The contention of the management of the company, for not reporting such receipt of shares, is in order.

(c) Applicability of CARO , 2016 and Utilisation of Term Loan: CARO ,2016 specifically exempts a private limited company, not being a subsidiary company of a public company, having a paid up capital , reserves & surplus not more than rupees one crore as on balance sheet date and which does not have total borrowing exceeding rupees one crore from any bank or financial institution at any point of time during the year and which does not have a total revenue as disclosed in Schedule III to the companies Act 2013 exceeding Rd 10 crore during the financial year as per financial statements.

In the case of LM Pvt. Ltd, it has paid up capital of rupees 50 lacs which is below the specified limit of rupees 1 crore and turnover is rupees 7.5 crore which is also less than specified rupees 10 crore. However, there is total borrowing of rupees 1.20 crore which is more than rupees 1 crore and exceeding the specified limits of rupees 1 crore. Hence CARO, 2016 will be applicable to LM Pvt. Ltd.

As per clause (ix) of Para 3 of CARO, 2016, an auditor need to state in his report that whether the term loans were applied for the purpose for which the loans were obtained. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

The auditor should examine the terms and conditions subject to which the company has obtained the term loans. The auditor may also examine the proposal for grant of loan made to the bank. As mentioned above, normally, the end use of the funds raised by term loans is mentioned in the sanction letter or documents containing the terms and conditions of the loan. The auditor should ascertain the purpose for which term loans were sanctioned. The auditor should also compare the purpose for which term loans were sanctioned with the actual utilization of the loans. The auditor should obtain sufficient appropriate audit evidence regarding the utilization of the amounts raised. If the auditor finds that the funds have not been utilized for the purpose for which they were obtained, the auditor's report should state the fact.

In the present case, the term loan obtained by LM Private Ltd. amounting rupees 20 lakh have not been utilized for erection expenses instead its utilized for renovating its administrative office building. Further, assuming that erection work has not been done and machinery is not being installed, disclosure of the same as Capital Stock under construction is in order.

Here, the auditor should report the fact in his report that pending utilization of the term loan for erection expenses, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (ix) of Para 3 of CARO, 2016.

(d) Evaluating the Adequacy of the Auditor's Expert's Work: As per SA 620 Using the work of an Auditor's Expert, the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence, etc.

Specific procedure to evaluate the adequacy of the auditor's expert's work are –

- Enquiries of the auditor's expert.
- Reviewing the auditor's expert's working papers and reports
- Corroborative procedure such as-
    - (a) Observing the auditor's expert's work
    - (b) Examining the published data, such as statistical reports from reputed source
    - (c) Confirming the relevant matters with third parties
    - (d) Performing detailed analytical procedure to see whether principles of materiality aspects considered
    - (e) Re performing calculations

- Discussions with another expert with relevant expertise when, for example, the findings or the conclusion of the auditor's expert are not consistent with other audit evidence.
- Discussing the expert's report with the management.

Question 3

(a) *During the opening ceremony of a new branch office of CA. Young, his friend CA. Old introduced to CA. Young, his friend and client Mr. Rich, the owner of an Export House whose accounts had been audited by CA. Old for more than 15 Years. After few days, Mr. Rich approached CA. Young and offered a certification work which hitherto had been done by CA. Old. CA. Young undertook the work for a fee which was not less than fee charged by CA. Old in earlier period. Comment whether CA. Young had done any professional misconduct.*

(b) *The Board of Directors of XYZ Ltd. is concerned with decreasing operating efficiency in material consumption. As an Auditor entrusted with investigating the causes for this poor state, what may be the areas of your focus in this respect.*

(c) *ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. The Financial year 2017-18 was so very bad for the Company that it was not possible for the Company to maintain the payment of consistent dividend as above. The Management, being hopeful of recovery of its performance in next year, felt that the depreciation of the year to the extent of 75% alone be charged to the Statement of Profit and Loss and the remaining 25% be kept in a separate account code in the Balance Sheet- 'Debit Balances Adjustable against Revenue account'. The Management was of the view that it would be in fair practice of accounting if the depreciation for asset is charged before the expiry of the lifes of assets and the amount parked in asset code as above would unfailingly be adjusted to Revenue before the close of next financial year anyway. Analyse the issues involved and state how the Auditor should decide on this matter.*

(d) *H Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your views.* ***(4 x 5 = 20 Marks)***

Answer

(a) Acceptance of original professional work by a member emanating from the client Introduced to him by another member: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.

Further, some forms of the soliciting work which the Council has prohibited include that a member should not accept the original professional work emanating from a client introduced to him by another member. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.

In the given case, CA Old introduced his friend CA. Young to his friend and client Mr. Rich, the owner of an Export House whose accounts has been audited by CA. Old for more than 15 years. After a few day Mr. Rich approached CA. Young and offered a certification work which hitherto had been done by CA. Old. Fees charged by CA. Young is also not less than fee charged by CA. Old.

In view of above decision CA Young should ask the client to come through CA Old. However, CA Young undertook the work without informing CA. Old. Thus, CA. Young is held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act,1949.

(b) **Decreasing Operating Efficiency in Material Consumption:** It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximized at the minimum of inputs, or input is minimized for any given quantity and quality of output.

- The auditor should make an analytical procedure to compare the material consumption with output for the current year as well as previous years.
- The internal control system should be studied.
- The auditor should have discussions/ inquiry with different personnel of the company including production personnel.
- The production process, scheduling, machine usage, material mix should be studied.
- A reconciliation of variation as to various causes – Price, quantity efficiency are to be analyzed.
- The budget, standard coasting and other MIS reports should be called for and studied.
- Internal audit report should be thoroughly studied and whether any pilferage, fraud etc. were noticed. These are to be looked into.
- The key material should be picked up for detailed study of their ordering, receipts, issue, normal loss yield percentage etc.

(c) **Provision of Depreciation :** Section 123(1) of the Companies Act, 2013 provides that dividend cannot be declared or paid by a company for any financial year except out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Section 123(2), or out of the profits or the company for any previous financial year or years arrived at after providing for depreciation in the manner aforementioned and remaining undistributed, or out of both. Further, it is the duty of auditor to check whether the depreciation was provided according to provision of AS 10 / IND AS 16/Schedule II to the Act.

In the instant case, ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. Due to bad financial condition, company has not provided for dividend for the year 2017-18. In addition to this management has also taken decision to charge 75% of the depreciation in the statement of Profit and Loss whereas 25% of the depreciation amount kept in a separate account code in the Balance Sheet – 'Debit Balances Adjustable against Revenue Account'.

Contention of management that it would be in fair practice of accounting where the depreciation of asset is charged before the expiry of the life of assets and the amount parked in asset code would unfailingly be adjusted to revenue before the close of next financial year is not tenable.

The practice of the company in not charging the depreciation and accumulating 25% of it in a debit balance for being written of in the next year is not an acceptable accounting treatment. If dividend is declared in such situation, it would mean payment out of capital.

Therefore, the auditor of the company should ensure the compliance of provisions of section 123 and Schedule II. In case the management does not comply with the provisions and does not charge the 100% depreciation the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

(d) **Consolidated Financial Statements:** According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

However, an investment entity need not present consolidated financial statements if it is required, in accordance with Ind AS 110'Consolidated Financial Statements', to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

(An investment entity is an entity that(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.)

In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in SI Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated then list should be disclosed in notes to accounts with reason.

Question 4

(a) D, a Chartered Accountant in practice was appointed by Realty Limited to represent its cases before GST Authorities under a duly executed power of representation. In the course of proceedings he submitted certain statements-written as well as oral-which later found to be false and materially misleading. Comment this in the light of Professional Code.

(b) In audit of DEF Limited, the Auditor had made use of certain analytical procedures with regard to certain key data in the Statement of Profit and Loss. The results obtained showed inconsistencies with other relevant information. State the course of action that the Auditor should take to ensure that the risk of material misstatement would be contained to a low level fixed as per materiality level.

(c) You have been appointed to carry out the audit of Sky Insurance Company Ltd. for the year 2017-18. In the course of your audit, you observed that the commission paid to agents constituted a major expense in operating expenses of the Company. Enumerate the audit concerns that address to the assertions required for the Auditor to ensure the continued existence of internal control as well as fairness of the amounts in accounting of commission paid to agents.

(d) "The audit cycle consists of Planning, Execution and Completion. The automation in processing of business transactions has considerations to be weighed by Auditor at every phase of this cycle." Enumerate the focal points of such considerations when auditing in automated environment.

(e) Sunlight Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Goa with a new technology for a cost of ₹ 5,750 crore. The project had seen delay in commencement and cost overrun. State the matters that a Comprehensive Audit by C&AG may cover in reporting on the performance and efficiency of this project. ***(4 x 5 = 20 Marks)***

Answer

(a) Submitting Information as Authorized Representative: As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, if a member in practice fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional capacity, he will be held guilty under Clause (5). As per Clause (6) of Part I of Second Schedule if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity, he will be held guilty under Clause (6).

In given case, the Chartered Accountant had submitted the statements before the GST authorities. These statements are based on the data provided by the management of the company. Although the statements prepared were based on incorrect facts and misleading, the Chartered Accountant had only submitted them acting on the instructions of his client as his authorized representative.

Hence Mr. D would not be held liable for professional misconduct.

(b) Investigating Results of Analytical Procedures: As per SA 520, "Analytical Procedures", if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and

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

Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

(c) Commission: The commission is the consideration payable for getting the insurance business. The term 'commission' is used for the payment of consideration to get Direct business. Commission received on amount of premium paid to a re-insurer is termed 'Commission on reinsurance accepted' and is reduced from the amount of commission expenditure. The internal control with regard to commission is aimed at ensuring that commission is paid in accordance with the rules and regulations of the company and in accordance with the agreement with the agent, commission is paid to the agent who brought the business and the legal compliances, for example, tax deduction at sources, GST on reverse charge mechanism and provisions of the Insurance Act, 1938 have been complied with.

Role of Auditor: The auditor should, *inter alia*, do the following for verification of commission:

- Ensure that commission is not paid in excess of the limits specified by IRDAI
- Ensure that commission is paid as per rates with the agent and rates filed with IRDAI
- Ensure that commission is paid to the agent/broker who has solicited the business
- Ensure that the agent is not blacklisted by IRDAI and is not terminated for fraud etc.
- Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.
- Check whether the vouchers are authorized by the officers-in–charge as per rules in force and income tax is deducted at source, as applicable.
- Test check correctness of amounts of commission allowed.
- Scrutinize agents' ledger and the balances, examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.
- Check whether commission outgo for the period under audit been duly accounted.

(d) Consideration of Automated Environment at Each Phase of Audit Cycle: In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

- during risk assessment, the auditor should consider risk arising from the use of IT systems at the company;
- when obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered;
- while assessing the entity level controls the aspects related to IT governance need to be understood and reviewed;
- pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed;
- during testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
- when testing of reports and information produced by the entity (IPE) generated through IT systems and applications;
- at completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

(e) Matters covered in Reporting in case of Comprehensive Audit are: To facilitate a proper consideration, the reports of the C&AG on the audit of PSUs are presented to the Parliament in several parts consisting of results of comprehensive appraisals of selected undertakings conducted by the Audit Board etc. Some of the issues examined in comprehensive audit are:

(i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?

(ii) Have the accepted production or operational outputs been achieved? Has there been under-utilization of installed capacity or shortfall in performance and, if so, what has caused it?

(iii) Has the planned rate of return been achieved?

(iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?

(v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?

(vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?

(vii) Does the enterprise have research and development programmes ? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?

(viii) If the enterprise has an adequate system of repairs and maintenance?

(xi) Are procedures effective and economical?

(x) Is there any poor or insufficient or inefficient project planning?

Question 5

(a) XYZ Associates, a Chartered Accountants Firm is having a relationship with a multi-national accounting firm in India. The ICAI required that all firms having networking relationship with any other entity need to furnish information online within the stipulated time. XYZ Associates failed to respond. Comment on this with reference to Professional misconduct, if any.

(b) Internal auditor makes an appraisal of organization structure to ensure that it is in harmony with the objectives of the entity, besides checking of financial transactions and operational activities of the entity- Elaborate.

(c) Give a check list of audit for checking the transactions of dematerialized securities in the conduct of audit of Financial Statements of a Member of a Stock Exchange.

(d) List few documents that require mandatory review by Audit Committee.

(e) *In the use of standardized Internal Control Questionnaire (ICQ), certain basic assumptions about elements of a good internal control system are taken into account. List down few such assumptions.* ***(4 x 5 = 20 Marks)***

Answer

(a) Failed to Supply Information Called For: As per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Thus, in the given case, Mr. XYZ Associates, a chartered accountant firm is failed to furnish the information of its relationship with multi-national accounting firm in India. The ICAI required this information to be submitted online within the stipulated time. XYZ Associates failed to respond and submit the required information. Therefore, XYZ Associates is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

(b) Review of the Organisation Structure - The internal auditor should conduct an appraisal of the organisation structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith. For this purpose:

- He should review the manner in which the activities of the enterprise are grouped for managerial control. It is also important to review whether responsibility and authority are in harmony with the grouping pattern.
- The internal auditor should examine the organization chart to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others.
- He should particularly see that the responsibilities of managerial staff at headquarters do not overlap with those of chief executives at operating units. He should examine whether there is a satisfactory balance between authority and responsibility of important executives.
- The internal auditor should examine the reasonableness of the span of control of each executive (the number of sub-ordinates that an executive controls). He should examine whether there is a unity of command i.e., whether each person reports only to one superior.
- Where dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed. This must be made known to all concerned.
- Finally, he should evaluate the process of managerial development in the enterprise. This is a vital aspect in a fast growing enterprise.

(c) Dematerialized Securities:

(i) On account of compulsory dematerialization of most of the securities listed on the Exchange, all stock brokers are required to maintain two accounts with their Depository Participants (DP) for handling the receipt and delivery of securities in demat. One account is 'Beneficiary Account' wherein the demat securities belonging to the members' for their own account are held and the other is 'Pool Account' wherein the demat securities of the clients are temporarily lodged for transfer to/from the Clients / Clearing House in the Pay-in/Pay-out.

(ii) In case of sale of securities by clients, the clients transfer the same in the demat form to the member's Pool Account to the Clearing House on the Pay-in day. In case of purchase of securities by the Client, the Clearing House transfers the securities to the Pool Accounts of the members and the members then transfer the same to the accounts of individual clients.

(iii) The members are required to maintain a proper record of all shares received and delivered from their Pool Account as well as preserve acknowledged copy of the delivery instructions given to their DP's for transferring the securities from the Pool Account to the Clients' account after the Pay-out.

(iv) The auditor should verify whether the securities received by the member in the Pool Account are regularly transferred to the buying clients' Demat Accounts within 24 hours of declaration of Pay-out of the relevant settlement of the Exchange. It may be noted that Sometimes, the clients instruct the brokers to retain the shares in the Pool Account either because they have not opened a demat account or because they intend to sell the shares they have bought earlier, in the subsequent settlement and thereby avoid transaction charges.

(v) The auditor should check that the shares lying in the Pool Account have not been utilized by the member to meet his own pay-in obligations or used for meeting auction obligations. If the auditor discovers something like this then, he should further enquire into the matter. Such instances might indicate the breach of fiduciary trust by the member of the stock exchange.

(vi) Depending upon the nature of the business carried on by the member, the auditor may apply such procedural tests as he considers necessary on major items of income and expense such as, commission, sub-brokerage, underwriting income, interest and dividends, advisory fees, interest, amounts payable towards transactions charges and other charges to the Exchange or Clearing House and other income and expenses.

(vii) The auditor should apply analytical procedures on the financial statements of the member. The auditor should compare current operating results with those of the prior period to ascertain that the variations are logical in the circumstances such as volume of business at the stock-exchanges, the brokerage concern's share of the market, changed business conditions such as volume of new securities issued, changes in the character of the business of the brokerage concern, and trend prices of securities. A discussion of this comparative data with the officials of the member may highlight areas where added audit emphasis may be directed.

(d) The Audit Committee shall mandatorily review the following information as per LODR Regulations:

(i) Management discussion and analysis of financial condition and results of operations;

(ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;

(iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;

(iv) Internal audit reports relating to internal control weaknesses;

(v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee; and

(vi) Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

(e) Basic Assumption about Elements of Good Control in Standardized Internal Control Questionnaire: In the use of standardized internal control questionnaire, certain basic assumptions about elements of good control are taken into account. These are -

(i) Certain procedures in general used by most business concerns are essential in achieving reliable internal control. This is a time-tested assumption. Deposit into bank of the entire receipts of a day or daily balancing of the cash book and ledgers or periodic reconciliation with the control accounts are examples of widely used practices which are considered good internal control practices. Besides, basic operations giving rise to these practices exist in all businesses irrespective of their nature.

(ii) Organisations are such that permit an extensive division of duties and responsibilities. The larger the organisation, the greater is the scope of such division.

(iii) Employees concerned with accounting function are not assigned any custodial function.

(iv) No single person is thrust with the responsibility of completing a transaction all by himself.

(v) There should always be evidence to identify the person who has done the work whether involving authorisation, implementation or checking.

(vi) The work performed by each one is expected to come under review of another in the usual course of routine.

(vii) There is proper documentation and recording of the transactions.

Question 6

(a) The identified risks are assessed by Auditor as to its significance on account of its likely impact, by way of material misstatement appearing in financial statements or by affecting internal control system. What may be the points of indication that may direct the Auditor to judge that the risks identified may be significant?

(b) What are the liabilities of a Chartered Accountant under Income Tax Act, 1961 for furnishing an incorrect statement in any report or certificate required to be submitted by him under the Act?

(c) A Review Report of an Auditor is negative in form in expression of conclusion- Explain.

(d) You are the Concurrent Auditor of a Branch of Nationalized Bank which deals in foreign exchange transactions. Give focus areas of your checking in this respect.

(e) What are the objectives of Peer Review?

OR

What are the inherent limitations of Peer Review? ***(4 x 5 = 20 Marks)***

Answer

(a) Points of Indication that may direct the Auditor to Judge that the Risks Identified may be Significant: As per SA 315"Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment", as part of the risk assessment the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

(i) Whether the risk is a risk of fraud;

(ii) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;

(iii) The complexity of transactions;

(iv) Whether the risk involves significant transactions with related parties;

(v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

(vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.

(b) Liability of an Auditor under Income Tax Act: Liabilities of a Chartered Accountant under the Income Tax Act of 1961 for furnishing an incorrect statement in any report or certificate required to be submitted by him under the Act are as below:

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

Section 278 of the Income Tax Act, 1961:

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

(ii) in any other case, with rigorous imprisonment for a term which shall not be less than three months but which may extend to [two] yeas and with fine

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

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

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

(c) Negative Review Report in expression of conclusion: According to Standards on Review Engagement (SREs) review report is a limited assurance engagement. The practitioner provides a written report containing a conclusion that conveys the assurance obtained about the subject matter information. SAs, SREs and SAEs establish basic elements for assurance reports. In addition, the practitioner considers other reporting responsibilities, including communicating with those charged with.

In a reasonable assurance engagement, the practitioner expresses the conclusion in the positive form, this form of expression conveys "reasonable assurance". However, in a limited assurance engagement, the practitioner expresses the conclusion in the negative form, for example, "based on our work described in this report, nothing has come to our attention that causes us to believe that internal control is not effective, in all material respects, based on XYZ criteria". This form of expression conveys a level of "limited assurance" that is proportional to the level of the practitioner's evidence-gathering procedures given the characteristics of the subject matter and other engagement circumstances described in the assurance report.

The format of Review report in SRE in conclusion caption of the report provides as follows- "nothing has come to our attention that causes to believe that these financial statements do not give a true and fair view of (Or presents fairly in all material respects) the financial position of the company and of its financial performance and cash flows for the period then ended in accordance with the Accounting standards referred to in Companies Act 2013 and other accounting principles generally accepted in India" .

Thus, in view of above it is clear that in a review report instead of positive form, the negative form of expression is being used. Also it is to be noted that the Review report contains caption -conclusion and not opinion.

(d) Focus Areas in case of Foreign Exchange Transactions:

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

(e) Objectives of Peer Review: The main objective of Peer Review is to ensure that in carrying out the assurance service assignments, the members of the Institute-

(1) comply with Technical, Professional and Ethical Standards as applicable including other regulatory requirements thereto and

(2) have in place proper systems including documentation thereof, to amply demonstrate the quality of the assurance services.

Thus, the primary objective of peer review is not to find out deficiencies but to improve the quality of services rendered by members of the profession. The Statement of Peer Review also makes it clear that the peer review, "does not seek to redefine the scope and authority of the Technical Standards specified by the Council but seeks to enforce them within the parameters prescribed by the Technical Standards".

The peer review is directed towards maintenance as well as enhancement of quality of assurance services and to provide guidance to members to improve their performance and adherence to various statutory and other regulatory requirements. Such an objective of the peer review process makes it amply clear that the reviewer is not going to sit on the judgment of the practice unit while rendering assurance services but to evaluate the procedure followed by the practice unit in rendering such a service. Accordingly, where a practice unit is not following technical standards, the reviewers are expected to recommend measures to improve the procedures. To elaborate further, the key objective of peer review exercise is not to identify isolated cases of engagement failure, but to identify weaknesses that are pervasive and chronic in nature. The conclusion, therefore, is that the peer review seeks to identify and address patterns of non-compliance with quality control standards.

OR

Inherent Limitations of Peer Review: The reviewer conducts the review in accordance with the Statement on Peer Review. The review would not necessarily disclose all weaknesses in compliance of technical standards and maintenance of quality of assurance services since it would be based on selective tests. As there are inherent limitations in the effectiveness of any system of quality control which happens to be subject-matter of review, departure from the system may occur and may not be detected.