## PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

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

*Answer any **five** from the rest*

**Question 1**

*(a) M/s. ABC & Co. is an audit firm having partners Mr. A, Mr. B and Mr. C, whose tenure as statutory auditor in R Ltd. a listed entity, has expired as per the Companies Act, 2013. M/s. XY is another audit firm which is appointed as the statutory auditor of R Ltd. for the subsequent year. Mr. A joins M/s XY as partner, 3 months after it was appointed the statutory auditor of R Ltd. Comment.* *(5 Marks)*

*(b) C Ltd. is holding 55% shares of D Ltd. M/s AB & Associates are statutory auditors of C Ltd. whereas for D Ltd. there is another firm appointed as statutory auditors. What are the reporting responsibilities of M/s. AB & Associates for audit of consolidated financial statements?* *(5 Marks)*

*(c) Moon Ltd. acquired 65% shares of Sun Ltd. on 28th October 2016. On 25th April 2017 they sold 25% shares of Sun Ltd. While preparing consolidated financial statements for the year ended 31st March, 2017, accountant of Moon Ltd. did not consider financial statements of Sun Ltd. for consolidation. Comment.* *(5 Marks)*

*(d) While commencing the statutory audit of ABC Company Ltd., the auditor undertook the risk assessment and found that the detection risk relating to certain class of transactions cannot be reduced to acceptance level. Explain.* *(5 Marks)*

**Answer**

**(a) Audit Firm having Common Partner: Section 139(2) of the Companies Act, 2013 provides that as on the date of appointment**, no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

In the given case, R Ltd. is a listed entity, thus, rotational provisions are applicable. Mr. A is a partner in M/s. ABC & Co., whose tenure as statutory auditor in R Ltd. has expired. He joined M/s. XY as partner, 3 months after it was appointed as statutory auditor of R Ltd.

It may be noted that that there should not be a common partner in the firms as on the date of appointment, however, in the given case, Mr. A has joined M/s. XY after 3 months of its appointment as statutory auditor of R Ltd.

Thus, M/s. XY may continue as statutory auditor of R Ltd. for the subsequent term.

**Note:** An alternative view is possible as 'Auditor Rotation' provisions are intended to maintain the auditor's independence. Though as per the Companies Act, 2013, there should not be common partner in the firms on the date of appointment but to maintain the integrity and independence it is important to apply this auditor rotation rule for whole term. Therefore, if there are common partners in previous firm and newly appointed audit firm the purpose of law for the auditor's rotation will be defeated.

In view of above provisions, if, after the date of appointment of new firm (M/s. XY), old partner Mr. A (of M/s. ABC & Co.-old audit firm) joins the new audit firm, it would defeat the objective and intention of lawmakers. Thus M/s. XY should vacate the office as an auditor.

(b) **When the Parent's Auditor is not the Auditor of all its Components:** In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of **SA 600 "Using the Work of Another Auditor".**

**As per SA 706**, When the parent's auditor decides that he will make reference to the audit of the other auditors, the auditor's report on consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). This may be done by stating aggregate rupee amounts or percentages of total assets and total revenues and cash flows of subsidiary(s) included in consolidated financial statements not audited by the parent's auditor. Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidated adjustments.

However, reference in the report of the auditor of consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its subsidiaries.

(c) **Consolidation of Financial Statement of a Subsidiary: Accounting Standard 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when control is intended to be temporary** because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future. Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are acquired & held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".

In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary is temporary, the auditor should verify that the intention of the parent, to dispose the subsidiary, in the near future, existed at the time of acquisition of the subsidiary. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements. However, **as per section 129(3) of the Companies Act, 2013** where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in **Schedule III to the Act.**

In the given case, Moon Ltd. acquired 65% shares of Sun Ltd. on 28th October 2016 and sold 25% shares on 25th April 2017 i.e. during year 2017-18. Moon Ltd. did not consolidate the financial statements of Sun Ltd. for the year ending 31.03.2017.

The intention of Moon Ltd. is quite clear that the control in Sun Ltd. is temporary as the former company disposed off the acquired shares in the next year of its purchase. However, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013, **Moon Ltd. is required to consolidate the financial statements as per the provisions on consolidated financial statements provided in Schedule III to the said Act.**

**(d) Assessment of Risk and Acceptable Level: SA 315 and SA 330 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" and "The Auditor's Responses to Assessed Risks"** establishes standards on the procedures to be followed to obtain an understanding of the accounting and internal control systems and on audit risk and its components: inherent risk, control risk and detection risk. SA 315 and SA 330 require that the auditor should use professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level.

**"Detection risk"** is the risk that an auditor's substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material. The higher the assessment of inherent and control risks, the more audit evidence the auditor should obtain from the performance of substantive procedures. When both inherent and control risks are assessed as high, the auditor needs to consider whether substantive procedures can provide sufficient appropriate audit evidence to reduce detection risk, and therefore audit risk, to an acceptably low level.

The auditor should use his professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. If it cannot be reduced to an acceptable level, the auditor should express a qualified opinion or a disclaimer of opinion as may be appropriate.

**Question 2**

*(a) ABC Co. Ltd. a company having trans-national operations, conducts its entire operations in a Computerised Information Systems (CIS) environment. As the audit partner of M/s. XYZ & Co., draw out the audit plan for evaluating the reliability of controls. (6 Marks)*

*(b) Secure Bank Ltd. is working as a depository along with their normal banking activities. The Securities and Exchange Board of India (SEBI) wants to appoint Mr. 'W' as an inspector to inspect books of accounts and records of the depository. Explain the purpose for which SEBI can appoint a person to inspect these books of accounts and records. (5 Marks)*

*(c) The auditor should select sample items in such a way that the sample can be expected to be representative of the population. Comment. (5 Marks)*

**Answer**

**(a) Audit Plan for Evaluating the Reliability of Controls in CIS Environment:** In evaluating the effects of a control, the auditor needs to assess the reliability by considering the various attributes of a control. Some of the attributes for example are that the control is in place and is functioning as desired, generality versus specificity of the control with respect to the various types of errors and irregularities that might occur. General control inhibit the effect of a wide variety of errors and irregularities as they are more robust to change controls in the application sub-system which tend to be specific control because component in these sub-system execute activities having less variety, that whether the control acts to prevent, detect or correct errors etc.

The auditor focuses here on-

(i) **Preventive controls:** Controls which stop errors or irregularities from occurring.

(ii) **Detective controls:** Controls which identify errors and irregularities after they occur.

(iii) **Corrective controls:** Controls which remove the effects of errors and irregularities after they have been identified.

The auditors are expected to see a higher density of preventive controls at the early stages of processing or conversely, they expect to see more detective and corrective controls later in system processing.

Further, while evaluating the reliability of controls, the auditor should:

(i) Ensure that authorized, correct and complete data is made available for processing;

(ii) Provide for timely detection and correction of errors;

(iii) Ensure that in the case of interruption in the work of the CIS environment due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records;

(iv) Ensure the accuracy and completeness of output;

(v) Provide adequate data security against fire and other calamities, wrong processing, frauds etc.;

(vi) Prevent unauthorized amendments to the program;

(vii) Provide for safe custody of source code of application software and data files.

**(b) SEBI appoints inspecting officers to investigate or inspect the affairs of a depository for any of the following purposes:**

(i) To ensure that the books of accounts are maintained in the manner specified in the regulations.

(ii) To look into the complaints received from depositors' participant, beneficial owners or other persons.

(iii) To ascertain whether the provisions of the Act, bye-laws, agreements and the regulations are being complied.

(iv) To ascertain whether the systems, procedures and safeguards being followed are adequate.

(v) To *suo motu* ensure that the affairs are being conducted in a manner which are in the interest of the Investors / Securities markets.

**(c) Sample Selection:** As per **SA 530, "Audit Sampling**", the auditor should select sample items in such a way that the sample can be expected to be representative of the population. **The principal methods are – Random selection, Systematic selection, Monetary unit, Haphazard selection, Block selection.** This requires that all items in the population have an opportunity of being selected.

There are two major methods in which the size of the sample and the selection of individual items of the sample are determined. These methods are statistical and non-statistical sampling.

**(i) Statistical sampling:** This is a method of audit testing which is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. With statistical sampling, sample items are selected in a way that each sampling unit has a known probability of being selected.

**(ii) Non-statistical sampling:** With non-statistical sampling, judgment is used to select sample items. Because the purpose of sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected, it is important that the auditor selects a representative sample, so that bias is avoided, by choosing sample items which have characteristics typical of the population.

**Question 3**

*(a) Describe the principal method of design of the samples and its evaluation. (4 Marks)*

*(b) Mr. Ram, a Chartered Accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivers to the Income Tax Authorities a false declaration. What are the liabilities of Mr. Ram under Income Tax Act, 1961?*

*(4 Marks)*

*(c) How does an auditor report on the description, design and operating effectiveness of controls at a service organization? (4 Marks)*

*(d) What are the specific matters to be included in auditor's report in an audit of Non-Banking Financial Company (NBFC) not accepting public deposits? (4 Marks)*

**Answer**

**(a) Principal Method of Design of Samples:** As per SA 530 "Audit Sampling", when designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.

**In designing an audit sample, the auditor has to consider the following:**

**(i) Audit objectives –** Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn.

**(ii) Population –** The population is the entire set of data from which the auditor wishes to sample in order to reach a conclusion. The auditor determines that the population from which he draws the sample is appropriate for the specific audit objective. Population must be sufficiently large. The system which produces the records to be tested must be sufficiently reliable. All items within a particular population must be homogeneous and must be identifiable and accessible.

**(iii) Confidence level –** The reliability referred to is unusually termed the confidence level. More precisely, in an auditing context, it is the mathematical probability that the misstatement rate in the sample will not differ from the error rate in the population by more than a stated amount.

**(iv) Precision –** The precision may be defined with which we can describe the attributes of a given population.

**(v) Evaluating Results of Audit Sampling:** The auditor shall evaluate-

(a) The results of the sample; and

(b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

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

- Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
- Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance.

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

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable **under section 278** of the Income Tax Act 1961. Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

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

**(c) Report on the Description, Design and Operating Effectiveness of Controls at a Service Organization:** As per **SA 402 "Audit Considerations Relating to an Entity using a Service Organisation"**, a report on the description, design and operating effectiveness of controls at a service organization shall comprise-

(i) A description, prepared by management of the service organisation, of the service organisation's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and

(ii) A report by the service auditor with the objective of conveying reasonable assurance that includes:

a. The service auditor's opinion on the description of the service organisation's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and

b. A description of the service auditor's tests of the controls and the results thereof.

**(d) Specific matters included in an auditor's report in the case of a non-banking financial company:** The auditor shall include a statement on the following matters, namely:

In the case of a non-banking financial company not accepting public deposits:

(i) Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;

(ii) Whether the company has accepted any public deposits during the relevant period/year;

(iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it.

(iv) In respect of Systemically Important Non-deposit taking NBFCs:

(a) whether the capital adequacy ratio as disclosed in the return submitted to the Bank in prescribed form, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the Bank;

(b) whether the company has furnished to the Bank the annual statement of capital funds, risk assets/exposures and risk asset ratio within the stipulated period.

**Question 4**

*(a) Explain briefly the duties and responsibilities of an auditor in case of material misstatement resulting from management fraud.* *(6 Marks)*

*(b) What is included in an Auditors' Responsibility paragraph?* *(5 Marks)*

*(c) What are the main phases in the conduct of Risk Based Audit.* *(5 Marks)*

**Answer**

**(a) Duties & Responsibilities of an Auditor in case of Material Misstatement resulting from Management Fraud:** Misstatement in the financial statements can arise from fraud or error. The term fraud refers to an 'Intentional Act' by one or more individuals among management, those charged with governance. The auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements.

**As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements",** fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

Fraud involving one or more members of management or those charged with the governance is referred to as "management fraud". The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity.

Further, an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees

Auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance, hence in an audit, the auditor does not guarantee that material misstatements will be detected.

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

The auditor is also required **to report as per Clause (x) of Paragraph 3 of CARO, 2016,** whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

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

(i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and

(iii) If the auditor withdraws:

  (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

  (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

**(b) Auditor's Responsibility Paragraph in Audit Report: As per SA 700 "Forming an opinion and reporting on financial statements",** the auditor's report shall include a section with the heading "Auditor's Responsibility".

The auditor's report shall state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.

The auditor's report shall state that the audit was conducted in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. The auditor's report shall also explain that those Standards require that the auditor comply with ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

The auditor's report shall describe an audit by stating that:

(i) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements;

(ii) The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of internal control; and

(iii) An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements.

Where the financial statements are prepared in accordance with a fair presentation framework, the description of the audit in the auditor's report shall refer to "the entity's preparation and fair presentation of the financial statements" or "the entity's preparation of financial statements that give a true and fair view", as appropriate in the circumstances.

The auditor's report shall state whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

**(c) Main Phases in the Conduct of Risk Based Audit:** Risk Based Audit is an approach to audit that analyses audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high risk areas.

These are achieved through the following:

- **Understand auditee operations to identify and prioritize risks:** Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

- **Assess auditee management strategies and controls to determine residual audit risk:** Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.
- **Manage residual risk to reduce it to acceptable level:** Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.
- **Inform auditee of audit results through appropriate report:** The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of internal controls that affect the organization's ability to record, process, summarize and report financial data.

**Question 5**

(a) *You have been appointed as an energy auditor of Sunlight Energy Ltd. What are the key functions you would carry out?* *(4 Marks)*

(b) *What is tolerable misstatement and tolerable rate of deviation?* *(4 Marks)*

(c) *M/s. SB & Co. has been appointed as tax auditor under section 44 AB of Income Tax Act, 1961 by Woodcraft Interior Consultants, a professional partnership firm, having turnover 1.25 Crores. M/s. RS & Co. are the statutory auditors of the firm but they are unable to give their report on the financial statements of the firm. M/s. SB & Co., have, however, completed their tax audit and want to issue their reports. Comment.* *(4 Marks)* *(d) ABC Ltd. owns a piece of Land and Building situated at IP road, Mumbai which was purchased before 30 years. The title deeds for the same are deposited with State Bank of India for obtaining credit facilities by the company.*

*As the statutory auditor of the company for the year ended 31st March, 2017, what are the audit procedures to be followed and what is the reporting under CARO 2016? (4 Marks)*

**Answer**

**(a) Key Function of Energy Auditor:** The following are some of the key functions of the energy auditor:

(i) Quantify energy costs and quantities.

(ii) Correlate trends of production or activity to energy costs.

(iii) Devise energy database formats to ensure they depict the correct picture – by product, department, consumer, etc.

(iv) Advise and check the compliance of the organisation for policy and regulation aspects.

(v) Highlight areas that need attention for detailed investigations.

(vi) Conduct preliminary and detailed energy audits which should include the following:

(a) Data collection and analysis.

(b) Measurements, mass and energy balances.

(c) Reviewing energy procurement practices.

(d) Identification of energy efficiency projects and techno-economic evaluation.

(e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.

(f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.

**(b) Tolerable Misstatement & Tolerable Rate of Deviation:** SA 530 Audit Sampling define tolerable misstatement and tolerable rate of deviation.

**Tolerable misstatement:** A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements.

**Tolerable rate of deviation:** It is a rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

**(c) Tax Audit Report: Section 44AB** requires the tax auditor to submit the audit report:

(i) in the case of a person who carries on business or profession and who is required by or under any other law to get his accounts audited, in **Form No. 3CA;**

(ii) in the case of a person who carries on business or profession, but not being a person referred to in clause (i), in **Form No. 3CB.**

Further, the statement of particulars should be given in **Form No. 3CD.**

Form No. 3CA requires the Tax auditor to enclose a copy of the audit report conducted by the statutory auditor or the auditor of the financial statements as the case may be. Where a statutory auditor has not been appointed under the statute or where the report of the statutory auditor is not available for whatever reasons, it will be possible for the Tax auditor to give his report in Form No. 3CB and to certify the relevant particulars in Form No. 3CD.

It may however, be noted that the Tax auditor in such cases will have to conduct the financial audit as well in order to enable him to certify whether or not the accounts reported upon by him give a true and fair view of the state of affairs of the assesse whose accounts are audited by him under Sec 44AB.

In the instant case, M/s SB & Co. has been appointed as tax auditor under section 44AB of Income Tax Act, 1961 by Woodcraft Interior Consultants, a professional partnership firm. Here it may be noted that there is no statutory audit requirement for a professional partnership firm, therefore M/s SB & Co. may issue their report in Form No. 3CB.

**(d) Title deeds of Immovable Property in the name of Bank:** 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, company is required to provide the details thereof. This clause shall cover the immovable properties which are covered under the Fixed Assets, as reporting under Clause (i) (a) and (i) (b) of Para 3 of CARO, 2016.

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. Accordingly, the auditor should carry out a detailed examination of the Registered sale deed and related documents of Land and Building.

Where the title deeds of the immovable property have been mortgaged with the Banks/ Financial Institutions, etc., for securing the borrowings and loan raised by the company, a confirmation about the same should be sought from the respective institution to this effect. The auditor may also consider verifying this information from the online records, if available, of the relevant State.

In the given case, ABC Ltd. owns a piece of land and building situated at IP road Mumbai and title deeds for the same are deposited with State Bank of India for obtaining credit facilities by the company. **Thus, the auditor needs to follow the audit procedure as mentioned above and 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.*

**Question 6**

*(a) Mr. M, a Chartered Accountant in practice, has printed visiting cards which besides other details also carries a Quick Response (QR) code. The visiting card as well the QR code contains his name, office and residential address, contact details, e-mail id and name of the firm's website. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. (4 Marks)*

*(b) L, a chartered accountant prepares and certifies projected financial statements of his client Abacus Ltd. Abacus Ltd. forwarded the same to their banks to secure some loans and bank, on that basis sanctioned a loan. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. (4 Marks)*

*(c) X, a chartered accountant in practice, in spite of several reminders from the Secretary of the Institute of Chartered Accountants of India fails to submit Form 18. Is he liable for misconduct ? (4 Marks)*

*(d) P, a Chartered Accountant holding Certificate of Practice, is a leading Income Tax Practitioner in Gurugram. He is also trading in derivatives. Comment with reference to the Chartered Accountant Act, 1949 and schedules thereto. (4 Marks)*

**Answer**

**(a) Printing of QR Code on Visiting Cards: As per Clause (7) of Part I of First Schedule** to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he advertises his professional attainments or services.

**Ethical Standards Board** has also clarified that a member in practice is allowed to print Quick Response Code (QR Code) on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card.

In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice.

Thus, Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

**(b) Certification of Projected Financial Forecast**: **Under Clause (3) of Part I of Second Schedule** to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.

In the instant case, Mr. L, a chartered accountant, has **prepared** and certified a projected financial forecast of his client Abacus Ltd. which was forwarded to the client's bank to secure some loans and based on which the bank sanctioned a loan to the client is not in order.

Thus, Mr. L will be held guilty of misconduct in view of above.

**(c) Failure to Submit the Information: Clause (2) of Part III of the First Schedule** requires a member to supply the information called for by the Council or any of its Committees and **Clause (1) of Part II of the Second Schedule** requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulation made thereunder.

Under the former clause, it is misconduct for chartered accountants generally, if they do not supply the information called for by the Council. The Secretary acts for the Council; hence, request from the Secretary amounts to a request from the Council. **Besides, it is also a contravention of Regulation of the Chartered Accountants Regulations, 1988.**

**Thus, failure to submit Form 18 constitutes professional misconduct.**

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

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, CA. P is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

**Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty** of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.

**Question 7**

*Write short notes on any **four** of the following:*

*(a) Auditor's right to Lien as per Companies Act, 2013.*

*(b) Proper books of accounts as per Companies Act, 2013.*

*(c) Differentiate between audit report and audit certificate.*

*(d) 'Inquiry' as one of the methods of collecting audit evidence.*

*(e) Verification of payment of remuneration to an insurance agent.* *(4 x 4 = 16 Marks)*

**Answer**

**(a) Auditor's Right to Lien as per the Companies Act, 2013:** Auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fee for work done on the following conditions:

(i) Documents retained must belong to the client who owes the money;

(ii) Documents must have come into possession of the auditor on the authority of the client;

(iii) The auditor can retain the documents only if he has done work on the documents assigned to him;

(iv) Such documents can be retained which are connected with the work on which fees have not been paid.

**Under section 128 of the Act, books of account of a company must be kept at the registered office.** These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act.

Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

**(b) Proper Books of Account as per the Companies Act, 2013:** Section 128(1) of the Companies Act, 2013 requires that every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

The provisions mentioned above are required to be followed by the company to maintain proper books of accounts. The Auditor is required to check that the company has complied with all the provisions related to maintenance of books of accounts etc. Further, **the books have to be maintained under accrual system** and if the statutory auditor finds the books are not maintained accordingly, he will have to modify his report.

**According to Section 143(3)(b),** the auditor's report shall also state whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him.

If answer is in negative or with qualification, the report shall state the reasons therefor.

**(c) Differentiate between Audit Report and Audit Certificate**: A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. The term 'certificate' is, therefore, used where the auditor verifies the accuracy of facts. An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain figures and is in a position to vouch safe their accuracy as per his examination of documents and books of account.

A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill. The 'report' involves expression of opinion which may differ from one professional to another. There is no question of exactitude in case of a report since the information contained therein is based on estimates and involves judgement element.

For instance, as per Section 66 of the Companies Act, 2013, an auditor is required to file a certificate in the tribunal where company is proposing for the reduction of capital. However, the report under Section 143 of the Companies Act, 2013, is an opinion based report and is not a certificate.

**(d) Inquiry: "SA 500 Audit Evidence**" mentions inquiry as one of the methods of collecting evidence by seeking appropriate information from knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiries may range from formal written inquires addressed to third parties to informal oral inquiries addressed to persons inside the entity. Responses to inquiries may provide the auditor with information, which he did not possess earlier or may not provide him with corroborative evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

The need for inquiry may arise at every stage of auditing. Evaluating responses to inquiries is an integral part of the inquiry process.

Auditor has to make a statement in his report whether he has obtained all information and explanation that he considered necessary for audit. This is possible through inquiry, as one of the methods of obtaining information.

Section 143(1) of the Companies Act, 2013 also casts upon the auditor a specific duty to inquire into certain specified transactions.

**(e) Verification of Payment of Remuneration to an Insurance Agents:** It is a well-known fact that insurance business is solicited by insurance agents. The remuneration of an insurance agent is paid by way of commission which is calculated by applying a percentage to the premium collected by him.

The auditor should, inter alia, do the following for verification of commission-

(i) Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.

(ii) Check whether the vouchers are authorised by the officers-in–charge as per rules in force and income tax is deducted at source, as applicable.

(iii) Test check correctness of amounts of commission allowed.

(iv) Scrutinise 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.

(v) Check whether commission outgo for the period under audit duly accounted.