

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

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

Question 1

- (a) *For the year ended 31st March, 2016, the audit report of Avinash Ltd., contained a qualification regarding non-provision for diminution in the value of investments to the extent of ₹ 50 lacs. As an Auditor of the Company for the year 2016-17, how would you report, if:*
- (i) *The Company does not makes provision for diminution in the value of investments in the year 2016-2017.*
 - (ii) *The Company makes adequate provision for diminution in the year 2016-2017.*
- (b) *Crush Ltd. is a dealer in fast moving consumer goods. The Company has warehouses throughout the country where the stocks are stored. The Auditor of the Company normally conduct physical verification of stocks along with the Management at the end of the financial year. However, the Auditor could not be physically present during stock- taking at two places on account of certain disturbances in the region.*
- In the light of the above facts :*
- (i) *How sufficient appropriate audit evidence regarding the condition and existence of inventory may be obtained?*
 - (ii) *How an Auditor is supposed to deal when attendance at physical inventory counting is impracticable?*
- (c) *Durafone Mobile Co. Ltd. have pan India presence and market leader in mobile operation. It has outsourced all its revenue operation including accounting functions to Set Solutions (P) Ltd. As an Auditor of the mobile company, enumerate the factors to be taken into consideration related to its financial reporting.*
- (d) *Gap Ltd. possesses some investment for which there is no ready market and to assess its fair market value it hires an expert, the result of which it can use in preparing its financial statement. Being an Auditor of the Company, state the matters which may affect the nature, timing and extent of audit procedure to be adopted by you in the instant case.*

(5 x 4 = 20 Marks)

Answer

- (a) **Auditor's responsibilities in cases where audit report for an earlier year is qualified** is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements". As per SA 710, when the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable

financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

- (i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- (ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant case, if Avinash Ltd. does not make provision for diminution in the value of investment to the extent of ₹ 50 lacs, the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

- (b) (i) **Special Consideration with Regard to Inventory:** As per SA 501 "Audit Evidence-Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:
 - (I) Attendance at physical inventory counting, unless impracticable, to:
 - (1) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
 - (2) Observe the performance of management's count procedures;
 - (3) Inspect the inventory; and
 - (4) Perform test counts; and
 - (II) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
- (ii) **Attendance at Physical Inventory Counting Not Practicable:** In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved

is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

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

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

- (c) **Factors to be considered by Auditor related to Financial reporting of Service organisation:** As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", services provided by a service organisation are relevant to the audit of a user entity's financial statements when those services, and the controls over them, are part of the user entity's information system, including related business processes, relevant to financial reporting.

Although most controls at the service organisation are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organisation's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services affect any of the following:

- (i) The classes of transactions in the user entity's operations that are significant to the user entity's financial statements;
- (ii) The procedures, within both information technology (IT) and manual systems, by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (iii) The related accounting records, either in electronic or manual form, supporting information and specific accounts in the user entity's financial statements that are used to initiate, record, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;
- (iv) How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;
- (v) The financial reporting process used to prepare the user entity's financial statements, including significant accounting estimates and disclosures; and
- (vi) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

- (d) **Nature, Timing and Extent of Audit Procedures:** As per SA 500 "Audit Evidence", the nature, timing and extent of audit procedures to be adopted by an auditor in case of management's expert, may be affected by such matters as:
- (i) The nature and complexity of the matter to which the management's expert relates.
 - (ii) The risks of material misstatement in the matter.
 - (iii) The availability of alternative sources of audit evidence.
 - (iv) The nature, scope and objectives of the management's expert's work.
 - (v) Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
 - (vi) The extent to which management can exercise control or influence over the work of the management's expert.
 - (vii) Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
 - (viii) The nature and extent of any controls within the entity over the management's expert's work.
 - (ix) The auditor's knowledge and experience of the management's expert's field of expertise.
 - (x) The auditor's previous experience of the work of that expert.

Question 2

- (a) *AP & Co., a firm of Chartered Accountants, was appointed by D Ltd., to evaluate the cost of a new product manufactured by it for their information system and fixation of fair market price. Partner 'P' of the CA firm is a non-executive director of the Company. Comment with reference to Chartered Accountants Act, 1949 and Regulations there to.*
- (b) *The growth and development in the field of Information Technology is a fast paced one with regular updation and the auditors are required to be alert and equip their knowledge to the recent changes. Discuss few instances of recent changes, which you, as an auditor, may need to be aware of and addressed in discharging your responsibility of audit assignment.*
- (c) *You have been appointed as auditor of Bahubali Ltd. for the first time. Enumerate the factors to be considered while establishing an overall audit strategy and its benefits.*
- (d) *In the course of your audit assignment of Indraprastha Ltd., you want to guide your audit assistants in selecting sample items in such a way that sample can be expected to be representative of the population and all items have an opportunity of being selected. Guide your assistants with principal methods of collecting samples. (4x 4 = 16 Marks)*

Answer

- (a) **Evaluation of Cost of Products:** Clause (4) of Part I of the Second Schedule to Chartered Accountants Act, 1949, states that expressing an opinion on financial statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest would constitute misconduct.

Also, the Council of the Institute of Chartered Accountants of India has stated that in cases where a member of the Institute is a director of a company, or the firm in which the said member is a partner, should not express any opinion on its financial statements.

As per facts of the case, the firm has been retained to evaluate the cost of products manufactured by it for its information system. It is a part of management consultancy service of the firm and moreover its partner was on the Board.

Hence, the firm can perform this assignment and it will not constitute misconduct. However, the firm while accepting the position as auditor in future would have to consider whether it would be possible to act in independent manner and express opinion on financial statements.

- (b) The growth and development in the field of information technology is a fast paced one and unless the auditors are alert to such developments and take pre-emptive action in upgrading their knowledge, they may find difficulty in coping with such advancement.

Following are a few instance of the recent changes which may need to be addressed in discharging their responsibilities in such environment:

- (1) Mainframes are substituted by mini/micro users.
- (2) There is a shift from proprietary operating system to more universal ones like UNIX, LINUX, Programming in 'C' etc.
- (3) Relational Data Base Management (RDBMS) are increasingly being used.
- (4) The methodology adopted for systems development is becoming crucial and CASE (Computer Aided Software Engineering) tools are being used by many organisation.
- (5) End user computing is on the increase resulting in decentralized data processing.
- (6) The need for data communication and networking is increasing.
- (7) Common business documents are getting replaced by paperless electronic data interface (EDI).
- (8) Conventional data entry giving way to scanner, digitized image processes, voice recognition system etc.

- (c) **Factors while establishing Overall Audit Strategy: Overall audit strategy would involve-**

- (i) **Determination of Characteristics of Audit:** Identify the characteristics of the engagement that define its scope.

- (ii) **Reporting Objectives:** Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.
- (iii) **Team's Efforts:** Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts.
- (iv) **Preliminary Work:** Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant.
- (v) **Nature, timing and Resources:** Ascertain the nature, timing and extent of resources necessary to perform the engagement.

Benefits of Overall Audit Strategy: The process of establishing the overall audit strategy assists the auditor to determine such matters as-

- (i) **Employment of Qualitative Resources:** The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters.
 - (ii) **Allocation of Quantity of Resources:** The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas.
 - (iii) **Timing of Deployment of Resources:** When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates.
 - (iv) **Management of Resources:** How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.
- (d) **Principal Methods of Collecting Samples:** As per SA 530 "Audit Sampling", the principal methods of selecting samples are the use of random selection, systematic selection and haphazard selection.

There are many methods of selecting samples. The principal methods are as follows:

- (i) Random selection (applied through random number generators, for example, random number tables).
- (ii) Systematic selection, in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerised random number generator or random number tables. When using systematic selection, the

auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.

- (iii) Monetary Unit Sampling is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.
- (iv) Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.
- (v) Block selection involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

Question 3

- (a) *You were the statutory auditor of Speed Ltd., a PSU, for the year 2016-17. In the course of your audit, you did not observe any fraud having been committed during that year. However, the C & AG audit staffs during their routine inspection found that chief cashier of the Company has committed a fraud in Debtor's ledger and absconded with the amount. Investigation made in the fraud revealed that the Auditor did not exercise proper skill and care and performed his work in an Improper way.*
Director of the Company, intends to file disciplinary proceedings against the Auditor with the ICAI. Discuss the position of the auditor with regard to the disciplinary proceedings under Chartered Accountants Act, 1949 and Regulations there to.
- (b) *Director (Finance) of Beta Ltd. is of the opinion that total trade payables mentioned in the financial statement is sufficient disclosure in the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013. They did not mention details regarding Micro, Small and Medium Enterprises (MSME). Give your view as statutory auditor of the Company and state the details required to be disclosed in notes regarding MSME.*
- (c) *Discuss any eight (8) adverse or qualified statement or disclosure, which you would like to make in respect of non-compliance with requirements of Corporate Governance of a company.*

- (d) *Deluxe Ltd. holds the ownership of 51% of voting power and control over Executive Ltd. Holding company have prepared the consolidated financial statement as required by Sec. 129 of the Companies Act, 2013. What will be your objective, as an Auditor, in the audit of such Consolidated Financial Statement?* **(4x 4 = 16 Marks)**

Answer

- (a) **Failure to Exercise Reasonable Care and Skill:** Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Apparently, as it appears from the facts of the case that the auditor did not exercise proper skill and care and that he performed his work in aim proper manner. In this matter, the test for auditor's liability lies in whether he has applied reasonable care, skill and caution called for in the circumstances of the case and whether he reasonably used all the information that he came across in the course of audit.

Cash is a very significant item in any situation and the fact that the cashier had left during the year without notice should have placed the auditor on alert as regards the cash book. In fact, the very fact that the cashier was chief, i.e., left without any notice constituted sufficient circumstances to excite suspicion of the auditor to probe to the bottom.

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

As it appears from the facts of the case, the auditor has been grossly negligent in performing his duties which constitutes professional misconduct. Thus, such instances require reference to Disciplinary Committee of the Council of the Institute.

- (b) **Details required to be disclosed in Notes regarding MSME:** Opinion of Director (Finance) of Beta Ltd. that total trade payables mentioned in the financial statement is sufficient disclosure in the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013, is not correct. The following details relating to Micro, Small and Medium Enterprises shall be disclosed by Beta Ltd. in the notes:
- (i) **the principal amount and the interest due** thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;
 - (ii) **the amount of interest paid by the buyer** as per Micro, Small and Medium Enterprises Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;
 - (iii) **the amount of interest due and payable** for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without

adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;

- (iv) **the amount of interest accrued** and remaining unpaid at the end of each accounting year; and
 - (v) **the amount of further interest remaining due** and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure as per Micro, Small and Medium Enterprises Development Act, 2006.
- (c) **Adverse or Qualified Statement or Disclosure in respect of Non-Compliance with requirements of Corporate Governance:** Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for e.g.,
- (i) The number of non-executive directors is less than 50% of the strength of Board of directors.
 - (ii) A qualified and independent audit committee is not set up.
 - (iii) The Chairman of the audit committee is not an independent director.
 - (iv) The Audit Committee does not meet four times a year.
 - (v) The necessary powers in terms of Part C of Schedule II have not been vested by the Board in the Audit Committee.
 - (vi) The time gap between two Board meetings is more than one hundred and twenty days.
 - (vii) A director is a member of more than ten committees or acts as Chairman of more than five committees across all companies in which he is a director.
 - (viii) The information of quarterly results is neither put on the listed entity's website nor sent in a form so as to enable the stock exchange on which the entity's securities are listed to enable such stock exchange to put it on its own website.
 - (ix) The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer agents.
- (d) **Objective of the Auditor in the audit of Consolidated Financial Statements as required by section 129 :** As per section 129 (4) of the Companies Act, 2013 the auditor's objectives in an audit of consolidated financial statements are:
- (i) to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of applicable financial reporting framework;
 - (ii) to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements.

- (iii) to enquire into the matters as specified in section 143(1) of the Companies Act, 2013; and.
- (iv) to report on the matters given in the clauses (a) to (i) of section 143(3) of the Companies Act, 2013; for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014, to comment on the matters specified in sub-rule (a), (b) and (c), on the basis of auditors' report of the respective component to the extent applicable.

Question 4

- (a) *Efficient Ltd. is running into losses and in order to optimize resource utilization and cost reduction, approaches you to carryout the assignment and offers a fee of 5% of benefits derived from the suggestions made by you.* **(4 Marks)**

Comment with respect to Chartered Accountants Act, 1949 and Regulations there to.

- (b) *Give examples of Emphasis of Matters which may have an adverse effect on the functioning of the company as well as those which may not affect the functioning of the company.* **(6 Marks)**

- (c) *M/s ABC and Co., a firm of Chartered Accountants, comprising of three partners A, B, and C, is Statutory Auditors of 50 Companies as per details given below:*

- (i) *Small Companies - 10*
- (ii) *Private Companies having paid up share capital of less than ₹ 100 Crores - 20*
- (iii) *Private Companies having paid up share capital of more than ₹ 100 Crores - 15*
- (iv) *Public Companies - 5*

Mr. A signs the Balance Sheet of 10 Small Companies and 10 Private Companies having paid up share capital of less than ₹ 100 Crores. Mr. B signs the Balance Sheet of 10 Private Companies having paid up share capital of less than ₹ 100 Crores and 5 Private Companies having paid up share capital of more than ₹ 100 Crores. Mr. C signs the Balance Sheet of 10 Private Companies having paid up share capital of more than ₹ 100 crores and 5 Public Companies.

What is the maximum number of audits that the firm as a whole can accept and what is the maximum number of audits each individual partner can accept ? **(6 Marks)**

Answer

- (a) **Charging of Fees based on Percentage:** Clause (10) of Part I to First Schedule to the Chartered Accountants Act prohibits a Chartered Accountant in practice to charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

The Council of the Institute has however framed Regulation 192 which exempts members from the operation of this clause in certain professional services which includes the services related to cost optimisation, the fees may be based on a percentage of the benefit derived.

In the instant case, Efficient Ltd. is running into losses. Efficient Ltd. offered fee of 5% benefits derived from the suggestions made with respect to optimization of resource utilization and cost reduction. This service is covered under the said exemption.

Thus, the fees offered on a percentage basis of the benefit derived by services rendered related to cost optimization are not liable for professional misconduct.

(b) Examples of Emphasis of Matters which may have an Adverse Effect on the Functioning of the Company: Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- (i) An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- (ii) A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- (iii) Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- (iv) A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- (v) The going concern assumption is appropriate but there are several factors leading to a material uncertainty that may cast a significant doubt about the Company's ability to continue as a going concern; or
- (vi) a material uncertainty regarding the outcome of a litigation wherein an unfavourable decision could result in a significant outflow of resources for the company, etc.

Examples of Emphasis of Matters which may not affect the Functioning of the Company are:

- (i) When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- (ii) To alert users that the financial statements are prepared in accordance with a special purpose framework.
- (iii) When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).
- (iv) on managerial remuneration which is subject to the approval of the Central Government;
- (v) relating to accrual of a contractually receivable claim based on management estimate where the ultimate realisation could be different from the amount accrued;
- (vi) on frauds that have been dealt with in the financial statements of the company and would not have any accounting effect on the financial statements.

- (c) **Ceiling on Number of Audit:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Therefore, maximum number of audits that the firm M/s ABC & Co. as a whole can accept is 60 and maximum number of audits each individual partner can accept is 20 i.e. other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore

In the given case, CA A is holding appointment in 20 companies i.e. 10 small companies and 10 private companies having paid up share capital of less than ₹ 100 crore, whereas CA B is having appointment in 15 Companies i.e. 10 private companies having paid up share capital of less than ₹ 100 crore and 5 private companies having paid up share capital of more than ₹ 100 crore and CA C is having appointment in 5 public companies and 10 private companies having paid up share capital of more than ₹ 100 crore. In aggregate all three partners are having 50 audits.

As per section 141 (3)(g), applying the above provisions, an auditor can accept more appointments as auditor = ceiling limit as per section 141(3)(g) - already holding appointments as an auditor.

Hence (1) CA A can accept: 20 more audits. (2) CA B can accept $20-5 = 15$ more audits and (3) CA C can accept $20-15 = 5$ more audits.

As per facts of the case, M/s ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition, they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹100 crores.

As per section 141(3)(g) of the Companies Act, 2013, M/s ABC & Co. can accept appointment as an auditor of 40 more companies as under:

Total Number of Audits available to the Firm	= 20×3	=	60
Number of Audits already taken by all the partners			
in their individual capacity	= $0+5+15$	=	<u>20</u>
Remaining number of Audits available to the Firm		=	<u>40</u>

Question 5

- (a) *In the course of his audit assignment in M/s Bailey Ltd., CA Soft came to know that the company, due to financial crunch and unable to meet employees salary, has taken a loan of ₹ 50 lacs from Employees Gratuity Fund. The said loan was not reflected in the books of account of the company and the auditor ignored this transaction in his report.*

Comment with reference to the Chartered Accountants Act, 1949 and Regulations there to.

- (b) *Your audit assistant seeks your help in checking the claim liability of Bharat Insurance Co. Ltd. and wants to know the registers and records which they should obtain and review in this regard.*
- (c) *Your firm has been appointed as branch auditor of East West Bank Ltd. In carrying out verification of advances, what are the primary evidences you will look into?*
- (d) *Tiger Ltd., is a company engaged in the production of wool. Along with its production business, it is also engaged in buying and selling of securities with the expectation of a favourable price change. During the year, its speculation loss on account of purchase and sale of securities was to the tune of ₹ 12 lacs.*

As a tax auditor, what is the reporting requirement in Form 3 CD under Section 44 AB of the Income Tax Act, 1961 ?

(4x 4 = 16 Marks)

Answer

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

In this case, CA. Soft has come across information that a loan of ₹50 lakhs has been taken by the company from Gratuity Fund. This is contravention of Rules and the said loan has not been reflected in the books of account.

Further, this material fact has also to be disclosed in the financial statements. The very fact that CA. Soft has failed to disclose this fact in his report, he would be guilty for professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

- (b) **Register and Records for checking the Claim Liability:** The components of the cost of claims to an insurer comprise the claims under policies and claim settlement costs. Claims under policies comprise the claims paid for losses incurred, and those estimated or anticipated claims pending settlements under the policies. Settlement cost of claims includes surveyor fee, legal expenses, etc. A liability for outstanding claims should be brought to account on the following:

- (i) Direct Business;
- (ii) Inward Reinsurance Business; and
- (iii) Co-Insurance business.

The liability includes future payments in relation to unpaid reported claims and claims incurred but not reported including inadequate reserves which would result in future cash or asset outgo for settling liabilities against those claims. Change in estimated liability represents the difference between the estimated liabilities for outstanding claims in respect of claims under policies, whether due or intimated at the beginning and at the end of the financial period. The accounting estimate also includes claims cost adjusted for salvage value if there is sufficient degree of certainty of its realisation.

Registers and Records -The following register and records are generally prepared in respect of claims:

- (i) Claims Intimation Register;
- (ii) Claims Paid Register;
- (iii) Claims Disbursement Bank Book;
- (iv) Claims Dockets, normally containing the following records:
 Claim intimation, claim form, particulars of policy, survey report, Photograph showing damage, repairer's bills, letter of subrogation, police report, fire service report, claim settlement note, claim satisfaction note, salvage report, salvage disposal note, claims discharge voucher, etc.;
- (v) Report of quality assurance team; and
- (vi) Salvage register.

The Claim Account is debited with all the payments including repair charges, fire fighting expenses, police report fees, survey fees, amount decreed by the Courts, travel expenses, photograph charges, etc. The provision for claims incurred but not reported is not made at Branch/Divisional Office level but at the Head Office level.

- (c) **Verification of Advances** : Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

- (i) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- (ii) Advances represent amount due to the bank.
- (iii) Amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances.

- (iv) The stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation.
 - (v) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
 - (vi) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.
 - (vii) There are no unrecorded advances.
- (d) **Reporting Requirement Under Clause (32)(e) of Form 3CD:** Tiger Ltd. is engaged in production business of wool and side by side dealing in buying and selling of securities with the intention of speculation. During the current financial year, the company has made Speculation Loss of ₹ 12 lakhs.

A tax auditor has to furnish the details of speculation loss incurred during the previous year, under Clause 32(e) of Form 3CD, regarding whether the company is deemed to be carrying on a speculation business as per explanation to section 73.

The Explanation to section 73 provides that where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Income from house property", "Capital gains" and "Income from other sources" or a company the principal business of which is the business of trading in shares or banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

Therefore, the tax auditor of Tiger Ltd. is required to furnish the details under Clause 32(e) of Form 3CD with respect to the speculation loss of ₹12 lakhs made during the year.

Question 6

- (a) *In carrying out efficiency audit of a Public Sector Undertaking (PSU), what important aspects are required to be looked into, to assess the efficiency?* **(4 Marks)**
- (b) *M/s ISBN Bank Ltd. appoints you to investigate on behalf of them for advancing loan to M/s Dust Ltd. As an investigating accountant, what information and factors you will enquire into?* **(4 Marks)**
- (c) *In evaluating the organizational structure of a company, what aspects may be considered by the operational auditor to achieve his objectives?* **(3 Marks)**
- (d) *While doing the audit of a Nationalised bank branch, your audit assistant informed you that he suspects some irregularities in Guarantees issued by the Bank. What should be your guidance in the matter to check the same?* **(5 Marks)**

Answer 6

- (a) **Aspects to be looked into, to assess the efficiency-** It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

Auditing efficiency embraces aspects such as whether:

- (i) sound procurement practices are followed;
 - (ii) resources are properly protected and maintained;
 - (iii) human, financial and other resources are efficiently used;
 - (iv) optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;
 - (v) public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
 - (vi) efficient operating procedures are used; and
 - (vii) the objectives of public sector programmes are met cost-effectively.
- (b) **Investigation on behalf of a bank proposing to advance loan to a company:** A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under-mentioned points:
- (i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.
 - (ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.
 - (iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.
 - (iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
 - (v) The history of growth and development of the company and its performance during the past 5 years.
 - (vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

- (c) **Aspects to be considered by Operational Auditor in evaluating Organisational Structure:** Organisational structure provides the line of relationships and delegation of authority and tasks. This is an important element of the internal control design. Therefore, this is also another important area for appraisal by the operational auditor.

In evaluating organisational structure, the aspects that may be considered by the operational auditor may be as follows:

- (i) Is the organisational structure in conformity with management objectives?
- (ii) Whether the organisational structure is drawn up on the basis of matching of responsibility and authority?
- (iii) Whether the line of responsibility from the top to the bottom is clearly discernible from the structure?
- (iv) Whether the delegation of responsibility and authority at each stage is clear and overlapping are avoided?

- (d) **Guarantees Given on Behalf of Constituents:**

1. The auditor should ascertain whether there are adequate internal controls over issuance of guarantees, e.g., whether guarantees are issued under proper sanctions, whether adherence to limits sanctioned for guarantees is ensured, whether margins are taken from customers before issuance of guarantees as per the prescribed procedures, etc.
2. The auditor should ascertain whether there are adequate controls over unused guarantee forms, e.g., whether these are kept under the custody of a responsible official, whether a proper record is kept of forms issued, whether stock of forms are periodically verified and reconciled with the book records, etc.
3. The auditor should examine the guarantee register to seek evidence whether the prescribed procedure of marking off the expired guarantees is being followed or not.
4. The auditor should check the relevant guarantee registers with the list of outstanding guarantees to obtain assurance that all outstanding guarantees are included in the amount disclosed in this behalf.
5. The auditor should also examine that expired guarantees are not included in this head. He should verify guarantees with the copies of the letters of guarantee issued by the bank and with the counter-guarantees received from the customers.
6. He should also verify the securities held as margin. If a claim has arisen, the auditor should consider whether a provision is required in terms of the requirements of AS 29, "Provisions, Contingent Liabilities and Contingent Assets".
7. The auditor should obtain a written confirmation from the management that all obligations in respect of guarantees have been duly recorded and that there are no guarantees issued upto the year-end which are yet to be recorded.

Question 7

Answer any **four (4)**. Write short notes:

- (a) *Power of Securities and Exchange Board of India to levy monetary fines and penalties under SEBI Act, 1992.*
- (b) *KYC norms for a Chartered Accountant in practice.*
- (c) *Besides statutory cost audit, circumstances that may warrant cost audit.*
- (d) *Eligibility criteria to be a Peer Reviewer.*
- (e) *Direction by Tribunal in case auditor acted in a fraudulent manner.* **(4 x 4 = 16 Marks)**

Answer

- (a) **Power of SEBI to levy monetary fines and penalties under SEBI Act, 1992:** SEBI Act, 1992 empowers SEBI to levy monetary fines and penalties on any person incurring a default under the Act in the following cases:

- (i) failure to furnish any document, information, books, other documents, return or report called for by the Board;
- (ii) failure to maintain books of account and records;
- (iii) failure by an intermediary to enter into an agreement with his client, redress the grievances of investors;
- (iv) failure by a person sponsoring or carrying on any collective investment scheme, including mutual funds, without obtaining certificate of registration;
- (v) failure by a stock broker to issue contract notes in the form and manner specified by the stock exchange, failure to deliver any security or failure to make payment of the amount due to the investor, charging of excess brokerage;
- (vi) any person dealing, communicating, counselling on the basis of some price sensitive information;
- (vii) failure by a person to disclose the aggregate of his shareholding in a body corporate before he acquires any shares of that body corporate and failure to make a public announcement to acquire shares at a minimum price in case of takeovers.

SEBI also has the power to suspend or cancel the certificate of registration of a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market. This includes depository, depository participant, custodian of securities, foreign institutional investor and credit rating agency also.

- (b) **KYC Norms for CA in Practice:** The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms).

Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI thought it necessary to issue such norms to be observed by the members of the profession who are in practice.

In light of this background, the Council of ICAI approved the following KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attest functions.

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

1. Where Client is an Individual/ Proprietor

A. General Information

- Name of the Individual
- PAN or Aadhar Card No. of the Individual
- Business Description
- Copy of last Audited Financial Statement

B. Engagement Information

- Type of Engagement

2. Where Client is a Corporate Entity

A. General Information

- Name and Address of the Entity
- Business Description
- Name of the Parent Company in case of Subsidiary
- Copy of last Audited Financial Statement

B. Engagement Information

- Type of Engagement

C. Regulatory Information

- Company PAN
- Company Identification No.
- Directors' Names & Addresses
- Directors' Identification No.

3. Where Client is a Non-Corporate Entity

A. General Information

- Name and Address of the Entity
- Copy of PAN

- Business Description
 - Partner's Names & Addresses (with their PAN/Aadhar Card/DIN No.)
 - Copy of last Audited Financial Statement
- B. Engagement Information
- Type of Engagement
- (c) **Statutory Cost Audit** : This is covered by the provisions of section 148 of the Companies Act, 2013. Apart from the aforesaid types of cost audit, the undernoted circumstances may warrant the introduction of cost audit:
- (i) **Price fixation** - The need for fixation of retention prices in the case of materials of national importance, like steel, cement etc. may be useful in knowing the true cost of production.
 - (ii) **Cost variation within the industry** - Where the cost of production varies significantly from unit to unit in the same industry, cost audit may be necessary to find the reasons for such differences.
 - (iii) **Inefficient management** - Where a factory is run inefficiently and uneconomically, institution of cost audit may be necessary. It may be particularly useful for the Government before it takes over any unit.
 - (iv) **Tax-assessment** - Where a duty or tax is levied on products based on cost of production, the levying authorities may ask for cost audit to determine the correct cost of production.
 - (v) **Trade disputes** - Cost audit may be useful in settling trade disputes about claim for higher wages, bonus, etc.
- (d) **Eligibility to be a Reviewer:**
- (i) A Peer Reviewer shall: -
 - (a) Be a member with at least 10 years of experience in practice.
 - (b) Is in Practice as per the Chartered Accountants Act, 1949.
 - (c) Should have undergone the requisite training as prescribed by the Board.
 - (d) Should furnish a declaration as prescribed by the Board, at the time of acceptance of Peer Review appointment.
 - (e) Should have signed the Declaration of Confidentiality as prescribed by the Board.
 - (f) Should have conducted audit of Level I Entities for at least 7 years to be eligible for conducting Peer Review of Level I Entities as referred to in Para II of this Statement.

- (ii) For being a Reviewer a member should not have: -
 - (a) Disciplinary action / proceedings pending against him.
 - (b) been found guilty by the Council or the Disciplinary Board or Committee at any time.
 - (c) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with transportation or imprisonment.
 - (d) any Obligation or conflict of interest in the Practice Unit or its Partners / Personnel.
- (iii) A Reviewer shall not accept any professional assignment from the Practice Unit for a period two years from the date of appointment.
- (e) **Power of Tribunal in case Auditor acted in a Fraudulent Manner:** As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either *suo moto* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

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

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

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