PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE
(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

1. Duty to report on frauds:

I. Reporting to the Central Government- As per sub-section (12) of section 143 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 of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

The manner of reporting the matter to the Central Government is as follows:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

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(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

II. Reporting to the Audit Committee or Board - Sub-section (12) of section 143 of the Companies Act, 2013 further prescribes that in case of a fraud involving lesser than the specified amount [i.e. less than ₹ 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

In this regard, sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than the amount specified in sub-rule (1) [i.e. less than ₹ 1 crore], the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

(a) Nature of Fraud with description;

(b) Approximate amount involved; and

(c) Parties involved.

III. Disclosure in the Board's Report: Sub-section (12) of section 143 of the Companies Act, 2013 furthermore prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the auditor is also required to disclose in the Board's Report the following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year:

(a) Nature of Fraud with description;

(b) Approximate Amount involved;

(c) Parties involved, if remedial action not taken; and

(d) Remedial actions taken.

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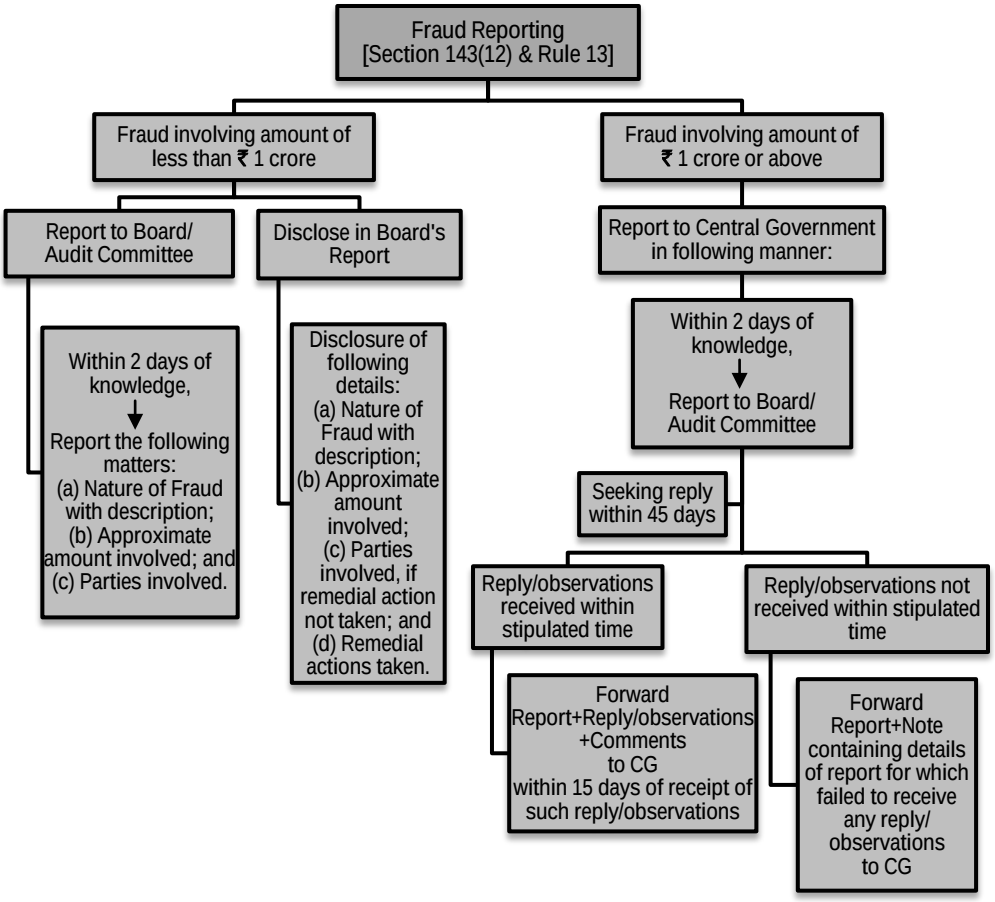

2. Ceiling on Number of Company Audits: As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the 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.

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3. Guidance Note on Reporting under Section 143(3)(f) and (h) of the Companies Act, 2013:

Introduction

1. Section 143 of the Companies Act, 2013 (hereinafter referred to as the "Act") deals with the powers and duties of the auditors of companies. Section 143(1) of the Act requires the auditor to make certain specific enquiries during the course of the audit. Section 143(2) of the Act requires the auditor to, *inter alia*, give his report to the members of company on the accounts examined by him, and on every financial statement which are laid before the company in a general meeting. Sub-section (3) of section 143 of the Act also lays down certain matters required to be reported upon by the auditor in his report. Sub-section (3) of section 143 of Act provides as follows:

"(3) The auditor's report shall also state -

(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(b) 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;

(c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

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(j) such other matters as may be prescribed.[1]

Scope of the Guidance Note

2. This Guidance Note is intended to assist the auditors in discharging their duties in respect of clauses (f) and (h) of sub-section (3) of section 143 of the Act. Clause (f) of the said sub-section creates a requirement for the auditor to consider observations or comments of the auditor on financial transactions or matters which have an adverse effect on the functioning of the company. Such observations or comments would ordinarily lead to the modification of or an emphasis of matter in the auditor's report on financial statements. It may be noted that the matters that lead to modification in the auditor's report on financial statements are matters that give rise to a qualified opinion, adverse opinion or a disclaimer of opinion[2]. Further, matters that lead to an emphasis of matter paragraphs are matters appropriately presented or disclosed in the financial statements that, in the auditor's judgement, are of such importance that they are fundamental to the users' understanding of the financial statements[3]. If the matter leading to the modification of the auditor's opinion or an emphasis of matter in the auditor's report on financial statements is likely to have an adverse effect on the functioning of the company, the auditor is required to report such matter. Under clause (h) of sub-section (3) of section 143 of the Act, the auditor is required to state whether any matter leading to a qualification, reservation or adverse remark, that is, effectively the modification of the auditor's report on financial statements, relates to the maintenance of accounts and other matters connected therewith.

Reporting under Section 143(3)(f) of the Act

3. The relevant extracts of section 143(3)(f) of the Act are reproduced below:

"(3). *The auditor's report shall also state –*

……

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;"

---

[1] Refer Rule 11 of Companies (Audit and Auditors) Rules, 2014.

[2] Reference may be made to Standard on Auditing (SA) 705, "Modifications to the Opinion in the Independent Auditor's Report."

[3] Reference may be made to paragraphs 6 and 7 of Standard on Auditing (SA) 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report."

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4. Clause (f) requires the auditor to report "the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company". An auditor's report may contain matters leading to modifications to the auditor's opinion or emphasis of matter in the auditor's report on the financial statements. Such matters may be related to issues which may have an adverse effect on the functioning of the company. The words "observations" or "comments" as appearing in clause (f) of section 143(3) are construed to have the same meaning as referring to "emphasis of matter paragraphs, situations leading to modification in the auditor's report. Accordingly, the auditor should have made an "observation" or "comment" in the auditor's report in order to determine the need to report under clause (f) of section 143(3). Therefore, only such "observations" or "comments" of the auditors on financial transactions or matters that have been made by the auditor in the auditor's report which have an adverse effect on the functioning of the company are required to be reported under this clause. For the sake of clarity, it may be noted that neither the auditor's observations nor the comments made by him have any adverse effect on the functioning of a company. These observations or comments made by the auditor might contain matters which might have an adverse effect on the functioning of a company.

5. The Act does not specify the meaning of the phrase 'adverse effect on the functioning of the company'. The expression should not be interpreted to mean that any event affecting the functioning of the company, observed by the auditor, should be reported upon even though it does not affect the financial statements, e.g., revocation of a license to manufacture one out of the many products during the year to which the financial statements relate, where such product that does not have any material contribution to the revenues of the company, etc. Such an interpretation would not only be beyond the scope of the audit of financial statements of the company but would also not be in accordance with the objective and concept of audit stipulated under the Act. A more logical and harmonious interpretation is that this reporting requirement does not intend to change the basic objective and the concept of audit of financial statements of a company, which is to examine the financial statements with a view to express an opinion thereon.

6. The scope of the audit and auditor's role remains as contemplated under the Standards on Auditing (SAs) and other relevant pronouncements issued by the Institute of Chartered Accountants of India as well as laid down in the Act, i.e., to lend credibility to the financial statements by reporting whether they reflect a true and fair view. SA 200, *Objective of the Independent Auditor and the Conduct of an Audit in Accordance with Standards of Auditing*, specifies that the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. An audit conducted in

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accordance with SAs and relevant ethical requirements enables the auditor to form the opinion of the true and fair view of the financial position and operating result of an enterprise. The auditor's opinion, therefore, does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. SAs require auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. At this juncture, it may also be noted that SA 200 also clearly states that the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

7. There is no change in the objective and scope of an audit of financial statements because of inclusion of clause (f) in sub-section (3) of section 143 of the Act. The auditor expresses his opinion on the true and fair view presented by the financial statements through his report which may be modified in certain circumstances. However, the auditor would now have to evaluate the subject matters leading to modification of the audit report or emphasis of matter in the auditor's report to make judgement as to which of them has an adverse effect on the functioning of the company within the overall context of audit of financial statements of the company. Only such matters which, in the opinion of the auditor, have an adverse effect on the functioning of the company should be reported under this clause. Conversely, such qualifications or adverse opinions or disclaimer of opinion or emphasis of matters of the auditor, which do not deal with matters that have adverse effect on the functioning of the company, need not be reported under this clause.

8. As far as inquiries under section 143(1) are concerned, the auditor is not required to report on these matters unless he has any comments to make on any of the items referred to therein. If the auditor has any comments or observations on any of the matters stated in section 143(1), the auditor should consider such comments or observations when reporting under this clause if they contain matters that may have any adverse effect on the functioning of the company.

9. Auditor's will need to apply professional judgement in considering matters of emphasis that may have an adverse effect on the functioning of the company. Ordinarily matters that are pervasive in nature such as going concern or matters that will significantly impact the operations of the company due to its size and

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nature will need to be reported under clause (f) of sub-section (3) of section 143 of the Act. Examples of emphasis of matter which may have an adverse effect on the functioning of the company include situations where:

- 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
- 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 matter which may not have an adverse effect on the functioning of the company include a situation where there is an emphasis of matter:

- on managerial remuneration which is subject to the approval of the Central Government;
- relating to accrual of a contractually receivable claim based on management estimate where the ultimate realisation could be different from the amount accrued;
- on frauds that have been dealt with in the financial statements of the company and would not have any continuing effect on the financial statements.

10. Another issue which arises is whether any observations or comments made by the auditor under clause (i) of section 143(3) in respect of the company's internal financial controls over financial reporting, which may have any adverse effect on the functioning of the company, should also be reported in terms of this clause. In this regard, it is noted that reporting under section 143(3)(i) is part of the auditor's report though it may be reported in an annexure to the auditor's report. Accordingly, if any observations or comments made by the auditor on the adequacy or operating effectiveness of internal financial controls over financial reporting contain such matters, which, in his opinion, may have any adverse effect on the functioning of the company, should also be reported under clause (f) of section 143(3) even if such observation did not result in a modification to the audit opinion on the financial statements of the company. An example in this regard may be where an auditor reports that the company did not have an appropriate internal control system for inventory with regard to receipts, issue for production and physical verification.

Reporting under Section 143(3)(h) of the Act

11. The relevant extracts of section 143(3)(h) of the Act are reproduced below:

"(3). *The auditor's report shall also state –*

……

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;"

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12. Clause (h) requires the auditor to report "any qualification, reservation or adverse remark" relating to the maintenance of accounts and other matters connected therewith. An auditor's report may contain matters leading to modifications in the auditor's report on financial statements. The matters that cause such modification may have a consequential effects or possible effects on the books of account maintained by the company and other matters connected therewith.

13. Section 128 of the Act, *inter alia*, states that every company shall prepare and keep its books of account and other relevant books and papers and financial statements that give a true and fair view of the state of affairs of the company. Section 129(1) of the Act, *inter alia*, states that the financial statements shall comply with the accounting standards notified under section 133 of the Act. Section 2(13) of the Act defines "books of account" to include records maintained in respect of—

    (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;

    (ii) all sales and purchases of goods and services by the company;

    (iii) the assets and liabilities of the company; and

    (iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

    Clause (b) of section 143(3) requires the auditor to, *inter alia,* 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.

14. Matters to be reported under clause (h) of section 143(3) needs to be evaluated based on the financial statements prepared under the Act. This is also consistent with the other reporting responsibilities of the auditor on books of account and compliance with notified/specified accounting standards that are reported by him under section 143(3). Accordingly, reporting under this clause is determined based on the financial statements prepared i.e., as at the balance sheet date.

15. The words "qualification", "adverse remark" and "reservation" used in clause (h) of section 143(3) should be considered to be similar to the terms "qualified opinion", "adverse opinion" and "disclaimer of opinion", respectively, referred to in SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

16. Accordingly, the auditor would need to report under clause (h) of section 143(3) any matter that causes a qualification, adverse remark or disclaimer of opinion on the financial statements since such matters will or possibly will have an effect on the books of account maintained by the company.

17. Further, reporting under clause (h) of section 143(3) will be required if the auditor makes any observation under clause (b) of section 143(3) relating to whether proper

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books of account as required by law have been kept by the company. For example, the auditor may have made an observation on maintenance of cost records under clause (b) of section 143(3) and this may not have had an effect on the financial statements of the company or the auditor's opinion on the financial statements.

18. As a corollary, reporting under clause (h) of section 143(3) will not be required if there are no modifications, i.e., no qualified, adverse or disclaimer of opinion, and there are no such observations under clause (b) of section 143(3) regarding books of account kept by the company.

19. Since clause (h) of section 143(3) requires the auditor to report under this clause only if the auditor has "any qualification, reservation or adverse remark", it is appropriate to conclude that a matter reported under emphasis of matter paragraph in the audit report need not be considered for reporting under this clause as an emphasis of matter is not in the nature of a qualification, reservation (disclaimer) or adverse remark.

20. Any material weakness in internal financial controls that is reported by the auditor under clause (i) of section 143(3) may not have an impact on the maintenance of books of account if such material weakness did not result in a modification to the opinion on the financial statements of the company. However, if the material weakness in internal financial controls resulted in a modification to the audit opinion on the financial statements, then such modification may be covered for reporting under clause (h) of section 143(3) as stated in paragraph 17 above.

21. The Appendix to this Guidance Note contains illustrations on matters that may give rise to reporting under section 143(3)(f) and/or section 143(3)(h) of the Companies Act, 2013.

APPENDIX

Illustrative Matters Forming Basis For Modified Opinion Or Emphasis Of Matter Paragraph in the Auditor's Report and Requiring Reporting Under Section 143(3)(f) and/or Section 143(3)(h) of the Companies Act, 2013

ILLUSTRATION 1

Basis for Qualified Opinion

The Company's inventories are carried in the Balance Sheet at ₹ XXX (*As at 31st March 20YY:* ₹ *YYY*). The Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from the Accounting Standard - 2 "Valuation of Inventories". The Company's records indicate that had the Management stated the inventories at the lower of cost and net realisable value, an amount of ₹ XXX (*As at 31st March 20YY:* ₹ *YYY*) would have been

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required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by ₹ XXX (*Previous year ended 31st March, 20YY:* ₹ *YYY*), and income tax, profit for the year and shareholders' funds would have been reduced by ₹ X, ₹ XX and ₹ XXX, respectively (*Previous year ended 31st March, 20YY:* ₹ *Y,* ₹ *YY and* ₹ *YYY, respectively*). This matter was also qualified in our report/ the report of the predecessor auditors on the financial statements for the year ended 31st March 20YY.[4]

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph above, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at 31st March, 20XX, and its profit/loss and its cash flows for the year ended on that date.

……

……

Report on Other Legal and Regulatory Requirements

As required by Section 143 (3) of the Act, we report that:

(a) We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;

……

……

(f) The matter described in the Basis for Qualified Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

……

……

(h) The qualification relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Qualified Opinion paragraph above."

[4] Where applicable and only in such case, disclosure of previous year figures is required - Attention of the readers is drawn to the provisions of Standard on Auditing (SA) 710, *Comparative Information—Corresponding Figures And Comparative Financial Statements* .

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ILLUSTRATION 2#

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at 31st March, 20XX, and its profit/loss and its cash flows for the year ended on that date.

Emphasis of Matters

We draw attention to the following matters in the Notes to the financial statements:

(a) Note X to the financial statements which, describes the uncertainty related to the outcome of the lawsuit filed against the Company by XYZ Company.

(b) Note Y in the financial statements which indicates that the Company has accumulated losses and its net worth has been fully / substantially eroded, the Company has incurred a net loss/net cash loss during the current and previous year(s) and, the Company's current liabilities exceeded its current assets as at the balance sheet date. These conditions, along with other matters set forth in Note Y, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern. However, the financial statements of the Company have been prepared on a going concern basis for the reasons stated in the said Note.

Our opinion is not modified in respect of these matters.

…….

Report on Other Legal and Regulatory Requirements

As required by Section 143 (3) of the Act, we report that:

……

(f) The going concern matter described in sub-paragraph (b) under the Emphasis of Matters paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

In this case there is nothing reportable under sec 143(3)(h).

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ILLUSTRATION 3

Basis for Qualified Opinion

ABC Company Limited's investment in XYZ Company, a foreign associate whose net worth has been fully/substantially eroded, is carried at ₹ XXX in the Balance Sheet as at March 31, 20XX. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company Limited's investment in XYZ Company as at March 31, 20XX because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the possible effects[5] of the matter described in the Basis for Qualified Opinion paragraph, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at 31st March 20XX, and its profit/loss and its cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

As required by section 143 (3) of the Act, we report that:

……

……

(f) The matter described in the Basis for Qualified Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

……

(h) The qualification relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Qualified Opinion paragraph above.

ILLUSTRATION 4

Basis for Adverse Opinion

The Company's financing arrangements expired and the amount outstanding was payable on March 31, 20XX. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue

[5] Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

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as a going concern and, therefore, it may be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion paragraph, the financial statements do not give the information required by the Companies Act, 2013 in the manner so required and also do not give a true and fair view in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at 31st March, 20XX, and its profit/loss and its cash flows for the year ended on that date.

……..

Report on Other Legal and Regulatory Requirements

As required by section 143 (3) of the Act, we report that:

……..

(f) The matter described in the Basis for Adverse Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

……..

(h) The adverse remarks relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Adverse Opinion paragraph above.

ILLUSTRATION 5

Basis for Disclaimer of Opinion

We were appointed as auditors of the Company after March 31, 20X1 and thus could not observe the counting of physical inventories at the beginning and end of the year. Accordingly, we were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 20X0 and March 31, 20X1 which are stated in the Balance Sheet at ₹ XXX and ₹ XXX, respectively.

In addition, the introduction of a new computerised accounts receivable system in September 20X0 resulted in numerous errors in accounts receivable. As of the date of our audit report, Management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ₹ XXX as at March 31, 20X1.

As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and

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accounts receivable in the Balance Sheet, and the corresponding elements making up the Statement of Profit and Loss and Cash Flow Statement.

Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

As required by section 143 (3) of the Act, we report that:

……

……..

(f) The matter described in the Basis for Disclaimer of Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

.....

(h) The reservation relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Disclaimer of Opinion paragraph above.

4. Reporting under Companies (Auditor's Report) Order, 2016 [CARO, 2016]: In exercise of the powers conferred by sub-section (11) of section 143 of the Companies Act, 2013 (18 of 2013) and in supersession of the Companies (Auditor's Report) Order, 2015 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (ii), vide number S.O. 990 (E), dated the 10th April, 2015, except as respects things done or omitted to be done before such supersession, the Central Government, after consultation with the, committee constituted under proviso to sub-section (11) of section 143 of the Companies Act, 2013 hereby makes the following Order dated 29th March, 2016, namely:—

I. Short title, application and commencement-

(1) This Order may be called the Companies (Auditor's Report) Order, 2016.

(2) Applicability of the Order: The CARO, 2016 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13 [hereinafter referred to as the Companies Act],

However, the Order specifically exempts the following class of companies-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act,1938 (4 of 1938);

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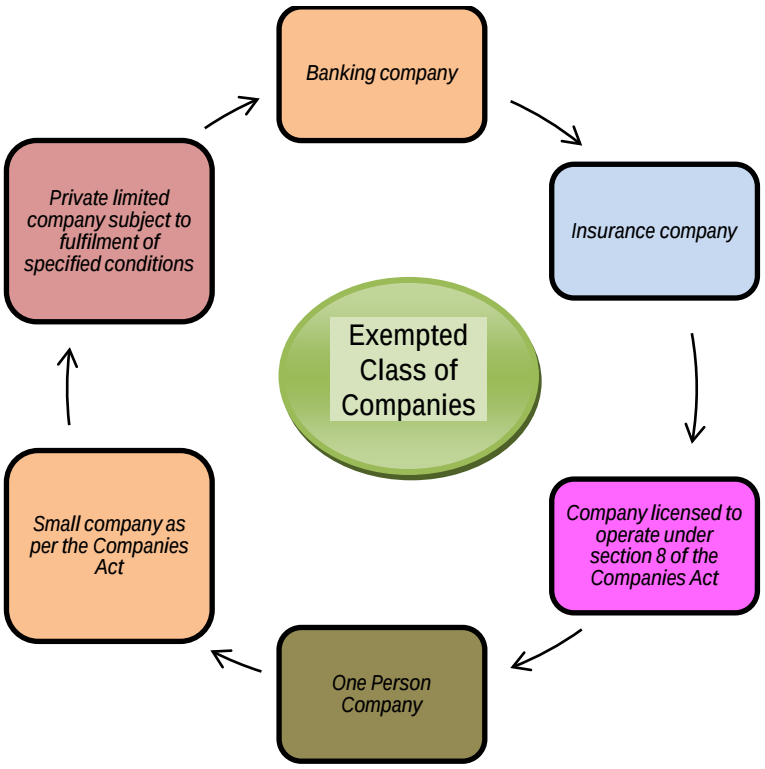
(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

Exempted Class of Companies



II. Auditor's report to contain matters specified in paragraphs 3 and 4. - Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable:

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It may be noted that the Order shall not apply to the auditor's report on consolidated financial statements.

III. Matters to be included in the auditor's report. - The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

(ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

(iii) whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(iv) in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

(v) in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

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(vi) whether maintenance of cost records has been specified by the Central Government under section 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.

(vii) (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).

(viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

(ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(x) 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;

(xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

(xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;

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(xiv) whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;

(xvi) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

IV. Reasons to be stated for unfavourable or qualified answers.-

(1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

5. Companies (Cost Records and Audit) Rules, 2014: The Central Government has amended the Companies (Cost Records and Audit) Rules, 2014 dated 31st December, 2014 which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ₹ 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006.

The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Some of the companies/industry/sector/product/service prescribed under the said rule are given below:

(A) Regulated Sectors-

(i) Telecommunication services made available to users by means of any transmission or reception of signs, signals, images etc. (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India.

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(ii) Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003, other than for captive generation.

(iii) Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board.

(iv) Drugs and Pharmaceutical.

(v) Fertilisers.

(vi) Sugar and industrial alcohol.

(B) Non-Regulated Sectors-

(i) Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items.

(ii) Turbo jets and turbo propellers.

(iii) Tyres and Tubes.

(iv) Steel.

(v) Cement.

(vi) Production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent), etc. The rule excludes the foreign companies having only liaison offices.

As per Rule 5 of the Companies (Cost Records and Audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year, is required to maintain cost records in Form CRA-1. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Additionally, as per clause (vi) to Paragraph 3 of the CARO, 2016, where maintenance of cost records has been specified by the Government under section 148(1) of the Companies Act, 2013, the auditor has to report whether such accounts and records have been made and maintained.

Applicability of Cost Audit: Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of cost audit depending on the turnover of the company as follows-

(i) Classes of companies specified under item (A) "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 25 crore or more.

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(ii) Classes of companies specified under item (B) "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 35 crore or more.

Casual Vacancy in the Office of a Cost Auditor: Any casual vacancy in the office of a Cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the central government in Form CRA-2 within 30 days of such appointment of cost auditor.

PART – II: QUESTIONS AND ANSWERS

QUESTIONS

1. State with reason (in short) whether the following statements are true or false:

   (i) The company shall place the matter relating to appointment of auditors for ratification by members at 5th AGM only.

   (ii) There is no need of written consent of the auditor for appointing him as an auditor in a company.

   (iii) Letter of weakness is issued by the management.

   (iv) Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company kept at the registered office of the company only.

   (v) Scrutiny of Bank Reconciliation statement is one of the audit techniques.

   (vi) The remuneration of subsequent auditors appointed under the Companies Act, 2013 shall be fixed by the Board of Directors.

   (vii) At every annual general meeting of a company, the Board of directors of the company shall lay before the company the financial statements for the financial year.

   (viii) Purchase invoice is an example of internal evidence.

   (ix) Standards on Review Engagements (SREs) - to be applied in the audit of historical financial information.

   (x) Check list is a complete and exhaustive description of the system as found in operation by the auditor.

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Nature of Auditing

2. (a) Mention briefly the conditions or events, which increase the risk of fraud or error leading to material misstatement in Financial Statements.

   (b) "The process of auditing is such that it suffers from certain limitations which cannot be overcome irrespective of the nature and extent of audit procedures." Explain.

3. (a) The auditor is responsible for maintaining an attitude of professional skepticism throughout the audit. Do you agree with the statement?

   (b) "Having accounts audited by independent auditor, among other advantages, acts as a moral check on the employees from committing fraud." Explain stating the advantages of Independent audit.

4. (a) "Auditor is expected to be familiar with the overall economic environment in which his client is operating." Discuss.

   (b) Give six examples of operating Conditions that may cast doubt about going concern assumption.

Basic Concepts in Auditing

5. "Risk of material misstatement at the assertion level for classes of transactions, account balances and disclosures need to be considered." Explain stating the different categories of assertions used by the auditor.

6. (a) "Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements whereas for some accounting estimates there may be relatively high estimation uncertainty particularly where they are based on significant assumptions". Explain by giving examples.

   (b) Discuss the concept of "True and Fair".

7. (a) Explain the test of controls and substantive procedures as audit procedure of obtaining sufficient appropriate audit evidence for forming an audit opinion.

   (b) The audit working papers constitute the link between the auditor's report and the client's records. Discuss stating clearly the objectives of audit working papers.

Preparation for an Audit

8. (a) Discuss the methods of Sampling in the light of SA 530.

   (b) Mention any four areas where surprise checks can significantly improve the effectiveness of an audit.

9. (a) "SA 320 "Materiality in Planning and Performing an Audit", establishes standards on the concept of materiality and the relationship with audit risk while conducting an audit. Hence, the auditor requires more reliable evidence in support of material items". Explain.

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(b) For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. Describe some of the techniques commonly adopted by the auditors.

Internal Control

10. (a) Your firm of Chartered Accountants has been allotted Information Systems Audit of 4 branches of SBI. How would you assess the reliability of internal control system in computerised information system?

(b) Explain the important requirements which should be kept in mind to establish or evaluate a system of internal control for application process at Service Bureau?

11. (a) Explain the special steps involved in framing a system of Internal Check.

(b) What is an Audit Trail? Briefly state the special audit techniques using the computer as an audit tool.

Vouching & Verification of Assets and Liabilities

12. (a) "It is necessary that transactions of one period be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained." Explain

(b) "No entry is passed for cheques received by the auditee on the last day of the year and not yet deposited with the bank". Give your comments and observations.

13. How will you verify/vouch the following:

(a) Contingent Liabilities.

(b) Goods sent on consignment.

(c) Sales Commission Expenditure.

(d) Endowment Policies.

14. Explain the factors to be considered while "Vouching of travelling expenses".

The Company Audit

15. (a) Discuss the provisions contained in the Companies Act, 2013 regarding Appointment of First Auditor of a Non-Government Company.

(b) "Provisions regarding rotation of auditors affect only specific class of companies". Discuss.

16. State the circumstances which could lead to any of the following in an Auditor's Report:

(a) A modification of opinion

(b) Disclaimer of opinion

(c) Adverse opinion

(d) Qualified opinion.

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17. (a) ABC Company Ltd. removed its First Auditor before the expiry of his term without obtaining approval of the Central Government. Comment.

(b) Breifly discuss the provisions of the Companies Act, 2013 with regard to issue of shares at a discount.

(c) A vacancy arose in the office of an auditor of XYZ Ltd due to death of the Auditor Mr Z and the Managing Director of the company filled that vacancy. Comment citing the provisions of the Companies Act, 2013.

18. (a) Sri & Company, a firm of Chartered Accountants was appointed as statutory auditors of Aaradhana Company Ltd. Aaradhana Company Ltd. holds 51% shares in Sarang Company Ltd. Mr. Sri, one of the partners of Sri & Company, owed ₹ 1,500 as on the date of appointment to Sarang Company Ltd. for goods purchased in normal course of business. Comment.

(b) Audit Committee is to be formed by each and every company and the auditor has right to vote in the meeting of such Audit Committee. Comment.

(c) "CARO, 2016 applies to all companies". Discuss.

Special Audits

19. (a) What role is played by Comptroller and Auditor General of India in the audit of a Government company?

(b) "Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG." Discuss.

20. Mention any ten special points to be examined by you in the audit of Income and Expenditure of a Charitable Institution running a hospital.

SUGGESTED ANSWERS / HINTS

1. (i) Incorrect: The company shall place the matter relating to appointment of auditors for ratification by members at every AGM.

(ii) Incorrect: Before appointing an auditor, the written consent of the auditor to such appointment and a certificate from him that appointment shall be in accordance with the conditions as may be prescribed shall be obtained from the auditor.

(iii) Incorrect: Letter of weakness is a report issued by the auditor stating the weakness in the internal control mechanism. It also suggests measures by which the weakness in the system to be corrected and the control system be made better protected.

(iv) Incorrect: As per Section 143(1) of the Companies Act, 2013, every auditor of a company shall have a right of access at all times to the books of account and

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vouchers of the company kept not only at the registered office of the company but also at any other place too.

(v) Correct: For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. Scrutiny of Bank Reconciliation statement is one of the audit techniques commonly adopted by the auditors.

(vi) Incorrect: According to Section 142 of the Companies Act, 2013, the remuneration of subsequent auditors of a company shall be fixed in its general meeting or in such manner as may be determined therein.

(vii) Correct: As per Section 129(2) of the Companies Act, 2013, at every annual general meeting of a company, it shall be the duty of the Board of Directors of the company to lay before the company the financial statements for the financial year.

(viii) Incorrect: Internal evidence is the evidence that originates within the client's organisation. Since purchase invoice originates outside the client's organisation, therefore, it is an example of external evidence.

(ix) Incorrect: Standards on Review Engagements (SREs*)* - to be applied in the review of historical financial information.

(x) Incorrect: Narrative Record is a complete and exhaustive description of the system as found in operation by the auditor. On the other hand, a Check List is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer.

2. (a) Conditions Which Increase the Risk of Fraud or Error: In planning and performing an examination, the auditor should take into consideration the risk of material misstatements of the financial information caused by fraud or error. Weaknesses in the design of the internal control system and non-compliance with identified control procedures amongst other conditions or events which increase the risk of fraud or error are-

(i) Weaknesses in the design of internal control system and non-compliance with the laid down control procedures, e.g., a single person is responsible for the receipt of all *dak* and marking it to the relevant sections or two persons are responsible for receipt of *dak* but the same is not followed in actual practice, etc.

(ii) Doubts about the integrity or competence of the management, e.g., domination by one person, high turnover rate of employees, frequent change of legal counsels or auditors, significant and prolonged understaffing of the accounts department, etc.

(iii) Unusual pressures within the entity, for example, industry is doing well but the company is not performing accordingly, heavy dependence on a single line of

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product, inadequate working capital, entity needs raising share prices to support the market price in the wake of public offer, etc.

(iv) Unusual transactions such as transactions with related parties, excessive payment for certain services to lawyers, etc.

(v) Problems in obtaining sufficient and appropriate audit evidence, e.g., inadequate documentation, significant differences between the figures as per the accounting records and confirmation received from third parties, etc.

(b) Inherent limitations of Audit: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the objectives of an audit of financial statements, prepared with in a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements. In forming his opinion on the financial statements, the auditor follows procedures designed to satisfy him that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The process of auditing, however, is such that it suffers from certain limitations, i.e. the limitation which cannot be overcome irrespective of the nature and extent of audit procedures. The limitations of an audit arise from:

(i) The Nature of Financial Reporting: The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures.

(ii) The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

(1) There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.

(2) Fraud may involve sophisticated and carefully organised schemes designed to conceal it. The auditor is neither trained as nor expected to be an expert in the authentication of documents.

(3) An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

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(iii) Timeliness of Financial Reporting and the Balance between Benefit and Cost: The relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

(iv) Other Matters that Affect the Limitations of an Audit: In the case of certain assertions or subject matters, the potential effects of the limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Because of the 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 SAs.

3. (a) Professional Skepticism: As per SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Therefore, professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of overlooking unusual circumstances, over generalising when drawing conclusions from audit observations or using

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inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Further, while obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. This requirement is also designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

Therefore, we do agree with the statement.

(b) Advantages of Independent Audit: Advantages of having the accounts audited by an independent auditor are:-

(i) It safeguards the financial interest of persons not associated with the management like partners or shareholders.

(ii) It acts as a moral check on the employees from committing fraud.

(iii) It is helpful in settling tax liability, negotiations for loans and for determining purchase consideration for sale/merger.

(iv) It is also helpful in settling trade or labour disputes for higher wages/bonus.

(v) It helps in detection and minimizing wastages and losses.

(vi) It ensures maintenance of adequate books and records, statutory register etc.

4. (a) Auditing and Economics: As, it is well known, accounting is concerned with the accumulation and presentation of data relating to economic activity. Though the concept of income as put forward by economists is different as compared to the accountants concept of income, still, there are lot of similar grounds on which the accounting has flourished. From the auditing view point, the auditors are more concerned with Micro economics rather than with the Macro economics. The knowledge of Macro economics should include the nature of economic force that affect the firm, relationship of price, productivity and the role of Government and Government regulations. Auditor is expected to be familiar with the overall economic environment in which his client is operating.

(b) Operating Conditions Casting Doubt About Going Concern Assumption: The following are examples of operating events or conditions that, may cast significant doubt about the going concern assumption-

(i) Management intentions to liquidate the entity or to cease operations.

(ii) Loss of key management without replacement.

(iii) Loss of a major market, key customer(s), franchise, license, or principal supplier(s).

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(iv) Labour difficulties.

(v) Shortages of important supplies.

(vi) Emergence of a highly successful competitor.

5. Risk of Material Misstatement at the Assertion Level: According to SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions.

Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms-

(a) Assertions about classes of transactions and events for the period under audit:

(i) Occurrence—transactions and events that have been recorded have occurred and pertain to the entity.

(ii) Completeness—all transactions and events that should have been recorded have been recorded.

(iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.

(iv) Cut-off—transactions and events have been recorded in the correct accounting period.

(v) Classification—transactions and events have been recorded in the proper accounts.

(b) Assertions about account balances at the period end:

(i) Existence—assets, liabilities, and equity interests exist.

(ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

(iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.

(iv) Valuation and allocation—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

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(c) Assertions about presentation and disclosure:

(i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.

(ii) Completeness—all disclosures that should have been included in the financial statements have been included.

(iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.

(iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts

6. (a) Accounting Estimates: Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in business activities that are not complex.
- Accounting estimates that are frequently made and updated because they relate to routine transactions.

For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.

Additional examples of accounting estimates are:

- Allowance for doubtful accounts.
- Inventory obsolescence.
- Warranty obligations.
- Depreciation method or asset useful life.
- Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
- Outcome of long term contracts.
- Financial Obligations / Costs arising from litigation settlements and judgments.

(b) Concept of "True and Fair": The concept of "true and fair" is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and

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the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.

This requires that the auditor should examine the accounts with a view to verifying that all assets and liabilities, incomes and expenses are stated at the amounts which are in accordance with accounting principles and policies, and no material item has been omitted.

The importance of the concept of true and fair view can also be understood and appreciated from the facts that sections 128, 129 and 143 of the Companies Act, 2013 also discusses this concept in relation to account books, financial statements and reporting on financial statements respectively.

Section 128(1) of the said Act provides 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. The company shall be in a position to explain the transactions effected both at the registered office and its branches. Such books of Accounts shall be kept on accrual basis and according to the double entry system of accounting.

Section 129(1) of the Companies Act, 2013 provides that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 of the Companies Act, 2013, (in which the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority) and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III to the said Act.

The term "financial statement" shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under the said Act.

It may be noted that nothing contained in sub-section (1) shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

However, the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose-

(a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;

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(b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;

(c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;

(d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

It may be noted that where the financial statements of a company do not comply with the accounting standards referred to in sub-section (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

Further, according to section 143(2) of the said Act, the auditor is required to make a report to the members of the company indicating that, to the best of his information and knowledge, the financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

SA 700 "Forming an Opinion and Reporting on Financial Statements", requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion. The auditor is required to express his opinion on the financial statements that it gives a true and fair view in conformity with the accounting principles generally accepted in India (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX; (b) in the case of the Statement of Profit and Loss, of the profit/ loss for the year ended on that date; and (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

7. (a) Collection of Evidence to Form Audit Opinion: Auditor should obtain sufficient and appropriate audit evidence and test them before framing an opinion about the assertions the financial statements reveal. For this, the auditor checks evidences through (a) Test of Controls and (b) Substantive Procedure.

According to SA 330 "The Auditor's Responses to Assessed Risks" , 'test of controls' means an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

(i) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e.,

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the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or

(ii) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

SA 330 further explains the 'substantive procedure' as an audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

(i) Tests of details (of classes of transactions, account balances, and disclosures), and

(ii) Substantive analytical procedures.

Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures.

(b) Audit Working Papers: The audit working papers constitute the link between the auditor's report and the client's records. SA 230 on "Audit Documentation" states that Audit Working papers are the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. The object of Audit working papers is to provide:

(i) Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor; and

(ii) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Besides above, they serve a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

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Working papers should contain audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained. The auditor shall assemble the audit working papers in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. The retention period for audit working papers ordinarily is no shorter than ten years from the date of the auditor's report, or, if later, the date of the group auditor's report. Unless otherwise specified by law or regulation, audit working papers are the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients.

8. (a) Methods of Sampling: 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). Stratified Sampling is one of the methods of Random Sampling. This method involves dividing the whole population to be tested in a few groups called strata and taking a sample from each of them. Each stratum is treated as if it were a separate population and if proportionate items are selected from each of the stratum. The groups into which the whole population is divided is determined by the auditor on the basis of his judgement e.g. entire expense vouchers may be divided into:

(1) Vouchers above ₹ 1,00,000

(2) Vouchers between ₹ 25,000 and ₹ 1,00,000

(3) Vouchers below ₹ 25,000

The auditor can then decide to check all vouchers above ₹ 1,00,000, 50% between ₹ 25,000 and ₹ 1,00,000 and 25% of those below ₹ 25,000.

The reasoning behind the stratified sampling is that for a highly diversified population, weights should be allocated to reflect these differences. This is achieved by selecting different proportions from each strata. It can be seen that the stratified sampling is simply an extension of simple random sampling.

(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.

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(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.

(b) Where Surprise Checks can Significantly Improve the Effectiveness of an Audit: Surprise checks constitute an important part of normal audit procedure. An element of surprise both with regard to the time of checking and selection of items, significantly improves the effectiveness of an audit. Normally, areas over which surprise check can be employed are-

(i) Verification of cash and investments.

(ii) Inventory.

(iii) Internal control and internal checks.

(iv) Books of prime entries and statutory registers.

9. (a) Concept of Materiality: SA 320 "Materiality in Planning and Performing an Audit", establishes standards on the concept of materiality and the relationship with audit risk while conducting an audit. Hence, the auditor requires more reliable evidence in support of material items. SA 320 defines material items as relatively important and relevant items, i.e., items the knowledge of which would influence the decision of the user of financial statements. Financial statements materially affect if such statement is erroneously stated or omitted to be stated there in and economic decision of the users taken on the basis of such information is influenced by such misstatements or omissions.

The auditor has to ensure that such items are properly and distinctly disclosed in the financial statements.

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The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not.

There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

Factors to be considered for determining materiality:

(i) Item of materiality may be determined individually or in aggregate.

(ii) The materiality depends on the regulatory or legal considerations.

(iii) Materiality is not often reckoned with respect to quantitative details above. It has qualitative dimensions as well.

(iv) Even insignificant items in terms of quality may be material in special circumstances.

(v) Sometimes the materiality of an item in terms of quantity is described in law itself. For example, Schedule III requires disclosure of items of expenditures which are in excess of one percent of the revenue from operations or ₹ 1,00,000, whichever is higher.

(vi) An item whose impact is insignificant at present, but in future it may be significant, may be material item.

(b) Audit Techniques: For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. Some of the techniques commonly adopted by the auditors are the following:

(i) Posting checking

(ii) Casting checking

(iii) Physical examination and count

(iv) Confirmation

(v) Inquiry

(vi) Year-end scrutiny

(vii) Re-computation

(viii) Tracing in subsequent period

(ix) Bank Reconciliation

It may be noted that the two terms, procedure and techniques, are often used inter-changeably; in fact, however, a distinction does exist. Procedure may comprise a

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number of techniques and represents the broad frame of the manner of handling the audit work; techniques stand for the methods employed for carrying out the procedure. For example, procedure requires an examination of the documentary evidence. This job is performed by the procedure known as vouching which would involve techniques of inspection and checking computation of documentary evidence.

10. (a) Reliability of Internal Control System in CIS: For evaluating the reliability of internal control system in CIS, the auditor would consider the followings -

(i) That authorised, correct and complete data is made available for processing.

(ii) That it provides for timely detection and corrections of errors.

(iii) That in case of interruption due to mechanical, power or processing failures, the system restarts without distorting the completion of entries and records.

(iv) That it ensures the accuracy and completeness of output.

(v) That it provides security to application softwares & data files against fraud etc.

(vi) That it prevents unauthorised amendments to programs.

(b) Requirements of Internal Control System at a Service Bureau: Various requirements to establish or evaluate a system of internal control for applications processed at a service bureau are stated below-

(i) Liaison between bureau and user should be clearly defined. Senior member of the user's staff is appointed as liaison officer.

(ii) Need for a system testing including all clerical procedures at the user company.

(iii) Control over physical movement of data and in this respect whether a copy or microfilm of documents sent to the service bureau is kept.

(iv) Planning procedure so that error is identified by documents provided by the bureau. The user must ensure that prompt correction and resubmission of rejection to meet the bureau processing schedule.

(v) Establishing a system in the user company to ensure that all exceptional reports are received from bureau.

(vi) Establish clerical control to verify the accuracy of computer processing.

(vii) Normally, user has no physical control over the files; therefore, high control over the maintenance of data on master files should be established.

11. (a) General Considerations in Framing a System of Internal Check: The term "internal check" is defined as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being

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the prevention or early detection of errors or fraud". The following aspects should be considered in framing a system of internal check:

(i) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.

(ii) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.

(iii) Every member of the staff should be encouraged to go on leave at least once in a year so that frauds successfully concealed by such a person can be detected in his absence.

(iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.

(v) There should be an accounting control in respect of each important class of assets, in addition, these should be periodically inspected so as to establish their physical condition.

(vi) The system of Budgetary Control should be introduced.

(vii) For inventory-taking, at the close of the year, trading activities should, if possible, be suspended. The task of inventory-taking, and evaluation should be done by staff belonging to other than inventory section.

(viii) The financial and administrative powers should be sub divided very judicially and the effect of such division should be reviewed periodically.

(ix) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.

(b) Audit Trail: 'Audit trail' refers to a situation where it is possible to relate, on a "one – to –one" basis, the original input with the final output. In a manual accounting system, it is possible to relate the recording of a transaction of each successive stage enabling an auditor to locate and identify all documents from beginning to end for the purposes of examining documents, totalling and cross – referencing. In first and early second generation computer systems, a complete audit trail was generally available. However, with the advent of modern machines, the CIS environment has become more complex. This led to use of exception reporting by the management which effectively eliminated the audit trail between input and output. The lack of visible evidence may occur at different stages in the accounting process, for example-

(i) Input documents may be non-existent where sales orders are entered online. In addition, accounting transactions such as discounts and interest calculations may be generated by computer programmes with no visible authorization of individual transactions.

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(ii) The system may not produce a visible audit trail of transactions processed through the computer. Delivery notes and suppliers invoices may be matched by a computer programme. In addition, programmed control procedures such as checking customer credit limits, may provide visible evidence only on an exception basis. In such cases, there may be no visible evidence that all transactions have been processed.

(iii) Output reports may not be produced by system or a printed report may only contain summary totals while supporting details are retained in computer files.

Special Audit Techniques: In the absence of audit trail, the auditor needs the assurance that the programmes are functioning correctly in respect of specific items by using special audit techniques. The absence of input documents or the lack of visible audit trail may require the use of Computer Assisted Audit Techniques (CAATs) i.e. using the computer as an audit tool. The auditor can use the computer to test-

- the logic and controls existing within the system, and
- the records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor. The effectiveness and efficiency of auditing procedure may be enhanced through the use of CAATs. Properly, two common types of CAATs are in vogue, viz., test pack or test data and audit software or computer audit programmes.

12. (a) Cut-off Arrangement: Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained. The arrangement that is made for this purpose is technically known as "cut-off arrangement". It essentially forms part of the internal control system of the organisation. Accounts, other than sales, purchase and inventory are not usually affected by the continuity of the business and therefore, this arrangement is generally applied only to sales, purchase and inventory. The auditor satisfies by examination and test-checks that the cut-off procedures are adequately followed and ensure that:

(i) Goods purchased, property in which passed on to the client, have in fact been included in the inventories and that the liability has been provided for in case credit purchase.

(ii) Goods sold have been excluded from the inventories and credit has been taken for the sales. If the value of sales is to be received, the concerned party has been debited.

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The auditor may examine a sample of documents, evidencing the movement of inventory into and out of stores, including documents pertaining to period shortly before and after the cut-off date and check whether inventories represented by those documents were included or excluded as appropriate during inventory taking for perfect and correct presentation in the financial statements.

(b) Cheques Received on the Last Day of Accounting Year: It is a quite normal that in any ongoing business entity many a times cheques are received from the customers on the last day of the accounting year. It is also quite likely, that cheques received on the last day of the accounting year could not be deposited in the bank. Though normally speaking, it is expected that all cheques should be deposited in the bank daily. But there may be a possibility that such cheques which are received particularly during the late hours could not be deposited in the bank. Therefore, it is quite important to ensure that the system of internal control is effective and such cheques should be properly accounted for to avoid any frauds and that the financial statements reflect a true and fair view.

As far as internal control system is concerned, it should be ensured that a list of such cheques is prepared in duplicate and a copy of the same has been sent to person controlling the trade receivables' ledger and a second copy is handed over to cashier along with the cheques received. The person who is controlling the trade receivables' ledger should ensure that proper accounting entries have been passed by crediting respective trade receivables' accounts. The balance of cheques-in-hand should also be disclosed along with the cash and bank balances in the financial statements.

13. (a) Contingent liabilities: Accounting Standard (AS) 29 on 'Provisions, Contingent Liabilities and Contingent Assets', defines 'Contingent Liability' as a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or as a present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a reliable estimate of the amount of the obligation cannot be made.

The auditor may take following steps to vouch or verify the contingent liabilities:

(i) Inspect the minute books of the company to ascertain all contingent liabilities known to the company.

(ii) Examine the contracts entered into by the company and the likelihood of contingent liabilities emanating therefrom.

(iii) Scrutinise the lawyer's bills to track unreported contingent liabilities.

(iv) Examine bank letters in respect of bills discounted and not matured.

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(v) Examine bank letters to ascertain guarantees on behalf of other companies or individuals.

(vi) Discuss with various functional officers of the company about the possibility of contingent liability existing in their respective field.

(vii) Obtain a certificate from the management that all known contingent liabilities have been included in the accounts and they have been properly disclosed.

(viii) Ensure that proper disclosure has been made as per Schedule III to the Companies Act, 2013 and AS 29, "Provisions, Contingent Liabilities and Contingent Assets".

(b) Goods Sent on Consignment:

(i) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.

(ii) Reconcile the figure of the goods on hand, as given in the last accounts sales, with the Performa invoices and accounts sales received during the year. If any consignment inventory was in the hands of the consignee at the beginning of the year, the same should be taken into account in the reconciliation.

(iii) Obtain confirmation from the consignee for the goods held on consignment on the balance sheet date. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.

(iv) Ensure that the quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues, customs due, etc., unless the value is lower. In case net realisable value is lower, the inventory in hand of the consignee should be valued at net realisable value. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.

(v) See that goods in hand with the consignee have been shown distinctly under inventories.

(c) Sales Commission Expenditure:

(i) Ascertain agreement, if any, in respect of sales transaction actually occurred during the year carried out by authorized parties on its behalf. If yes, the commission should be in accordance with the terms and conditions as specified.

(ii) Check evidence of services rendered by the party to whom commission is paid with reference to correspondence etc.

(iii) Ensure that the sales in fact have taken place and the same has been charged to Statement of Profit and Loss.

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(iv) Compare the amount incurred in previous years with reference to total turnover.

(v) Check entries regarding TDS on commission at the time of credit to Payee's Account, or payment, whichever is earlier.

(vi) Ensure that the payment has been made through cheque only, if limit as stated in the clause of tax audit is exceeded.

(d) Endowment Policies:

(i) Ascertain the specific purpose for which the endowment policy is taken, e.g., Sinking Fund policies for redemption of debentures, redemption of leases or policies taken for other similar purposes, etc.

(ii) Verify the terms and conditions of policies and ensure that all such conditions are in force and being followed.

(iii) Check that premium has been deposited in time and the policy is in force.

(iv) Examine that proper disclosures have been made in the financial statements in respect of items for which the policy has been taken.

14. Vouching of Travelling Expenses: The following factors are to be considered while "Vouching of Travelling Expenses":

(i) Travelling expenses are normally payable to staff according to rules approved by directors or partners. Where no rules exist, the auditor should recommend that these be framed for controlling the expenditure. In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred. A voucher should be demanded for all items of expenses incurred, except those which are capable of independent verification.

(ii) As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business and that the directors were entitled to receive the amount from the business.

(iii) The voucher for travelling expenses should normally contain the under mentioned information:

(1) Name and designation of the person claiming the amount.

(2) Particulars of the journey.

(3) Amount of railway or air fare.

(4) Amount of boarding or lodging expenses or daily allowance alongwith the dates and times of arrival and departure from each station.

(5) Other expenses claimed

(iv) If the journey was undertaken by air, the counterfoil of the air ticket should be attached to the voucher; this should be inspected. For travel by rail or road, the amount of the fare claimed should be checked from some independent source.

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(v) Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified.

(vi) The evidence in regard to sundry expenses claimed is generally not attached to T.A. bills. So long as the amount appears to be reasonable it is usually not questioned. All vouchers for travelling expenses should be authorised by some responsible official. In the case of foreign travel or any extraordinary travel, the expenses, before being paid, should be sanctioned by the Board.

(vii) The travelling advance taken, if any, should be settled on receipt of final bills. At the year end, the amount not settled should be shown appropriately in the Balance Sheet.

(viii) Unless the articles specifically provide or their payment has been authorised by a resolution of shareholders, directors are not entitled to charge travelling expenses for attending Board Meetings.

15. (a) Appointment of First Auditor of a Non-Government Company: As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

(b) Applicability of provisions related to Rotation of Auditors: The provisions related to rotation of auditor as provided under section 139(2) of the Companies Act, 2013 are applicable to all listed companies and other class or classes of companies as prescribed under Companies (Audit and Auditors) Rules, 2014.

As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies excluding one person companies and small companies -

(I) all unlisted public companies having paid up share capital of rupees ten crore or more;

(II) all private limited companies having paid up share capital of rupees twenty crore or more;

(III) all companies having paid up share capital of below threshold limit mentioned in (I) and (II) above, but having public borrowings from financial institutions,

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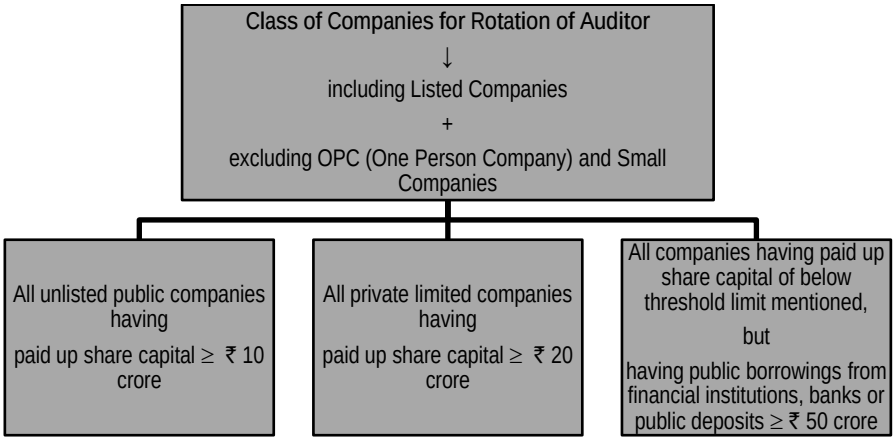
banks or public deposits of rupees fifty crores or more.



16. (a) Modification of Opinion: The auditor shall modify the opinion in the auditor's report when-

(i) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(ii) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

(b) Disclaimer of Opinion: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

(c) Adverse Opinion: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(d) Qualified Opinion: The auditor shall express a qualified opinion when-

(i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not

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pervasive, to the financial statements; or

(ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

17. (a) Removal of Auditor Before Expiry: As per sub-section (1) of Section 140 of the Companies Act, 2013, an auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the prior approval of the Central Government in that behalf as per Rule 7 prescribed under Companies (Audit & Auditors) Rules, 2014:

(i) The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

(ii) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.

(iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

In the instant case, the first auditor was removed by the company before the expiry of his term without obtaining approval of the Central Government.

Therefore, it may be concluded that the action of the company for removal of the auditor before expiry of term is not justified and auditor may be removed from his office only by following the above mentioned procedure.

(b) Issue of Shares at a Discount: According to Section 53 of the Companies Act, 2013, except sweat equity shares issued as mentioned in section 54, any share issued by a company at a discounted price shall be void.

Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

(c) Filling of Casual Vacancy: Section 139(8) of the Companies Act, 2013 states that any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within

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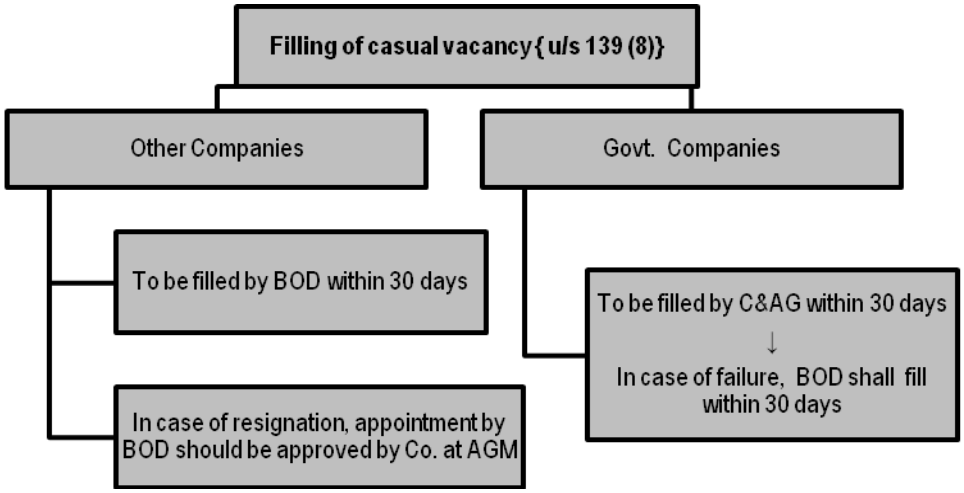
thirty days. But if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

In the given case, vacancy in the office of an auditor has arisen because of death and not due to resignation, therefore applying the above provisions it would be filled by the Board of Directors within thirty days. Appointment made by the Managing Director of the Company is not valid.



18. (a) Indebtness to the Subsidiary Company: As per Section 141(3)(d)(ii) of the Companies Act, 2013, a person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, for an amount exceeding ₹ 5,00,000, then he is not qualified for appointment as an auditor of a company.

Where an auditor purchases goods or services from a company audited by him or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, whether in normal course of business, he is definitely indebted to the company and if the amount outstanding exceeds ₹ 5,00,000, he is disqualified for appointment as an auditor of the company. In such a case, he becomes indebted to the company and consequently he has deemed to have vacated his office.

In the given case, Sri & Company, a firm of Chartered Accountants was appointed as statutory auditors of Aaradhana Company Ltd. where the company holds 51% shares in Sarang Company Ltd. Mr. Sri, one of the partners of Sri & Company owed ₹ 1,500 as on the date of appointment to Sarang Company Ltd. for goods purchased.

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Accordingly, the partner Mr Sri is not disqualified to be appointed as auditor of the company as he is indebted to the company for an amount not exceeding ₹ 5,00,000.

Due to this, Sri & Company, is not disqualified to be appointed as an auditor of Aaradhana Company Ltd.

(b) Formation of Audit Committee: As per section 177 of the Companies Act, 2013 read with the Companies (Meeting of Board and its Powers) Rules, 2014, audit committee is to be formed by every listed companies and following classes of companies:

(i) all public companies with a paid up capital of ten crore rupees or more,

(ii) all public companies having turnover of one hundred crore rupees or more,

(iii) all public companies having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Further, the auditor shall have the right to be heard in the meetings of the Audit Committee when it considers the Auditor's Report but shall not have the right to vote.

(c) Applicability of CARO, 2016: It shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 except–

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act,1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

From the above it is clear that CARO, 2016 does not apply to all companies.

19. (a) Role of C&AG in the Audit of a Government company: Role of C&AG is prescribed under sub section (5), (6) and (7) of section 143 of the Companies Act, 2013.

In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be

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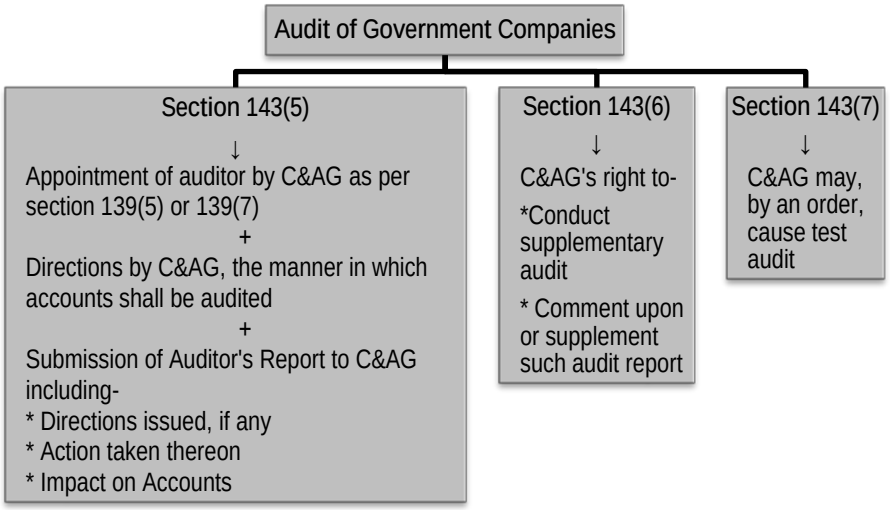
audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.



The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to,

(i) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

(ii) comment upon or supplement such audit report: It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Test Audit: Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the

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accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

(b) Audit of Stores and Inventories: Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out. The aim is also to bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control. The audit of purchase of stores is conducted in the same manner as audit of expenditure, namely, that these are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority. The auditor has to ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit. Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

20. Audit of Hospital: While auditing the Income and Expenditure Account of a charitable institution running a hospital, following special points may be examined -

(i) Verify the register of patients with duplicate copy of bills and patients admission record to see that bills have been properly and correctly prepared for all the services, tests and treatments.

(ii) Check cash collections from patients by tracing the receipt issued into cash book.

(iii) Check receipt of interest, rent, dividend etc., with receipt counterfoil into cash book and bank book and ensure that all such income has been duly accounted for.

(iv) Check collection of subscription, donations from the receipt issued, correspondence etc., into cash book.

(v) Verify that all grants from government and other bodies have been duly accounted for and have been applied in the manner as specified.

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(vi) Verify all recurring nature of revenue expenditure, with necessary evidence like bill, authority, period etc.

(vii) Examine the internal check as regards the receipt and issue of stores, medicines, linen etc., to ensure that these have been properly recorded and issued/consumed only on proper authorisation.

(viii) See that depreciation has been written off in respect of all the assets at appropriate rate and method as in the earlier year.

(ix) Verify the receipts from supply of food and canteen receipts and compare the same with previous year as regards number of patients.

(x) Ensure that all outstanding liabilities have been adequately provided for and similarly all accrued incomes and receipts have been duly accounted for.

(xi) Obtain inventory of stock and stores as at the end of the year and physically check a percentage of items.

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