

## PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

### PART – I : ACADEMIC UPDATE

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

#### Chapter 6 - The Company Audit

1. Additional requirement for claiming exemption under section 141(3)(g) for counting ceiling limit is available only if such company has not committed default in filing its financial statements under section 137 and annual returns under section 92 of the Act to the registrar as per notification dated 13 June 2017.
2. Notification No. G.S.R. 583(E) stated that requirements of reporting under section 143(3)(i) read Rule 10 A of the Companies (Audit and Auditors) Rules, 2014 of the Companies Act 2013 shall not apply to certain private companies. Clarification regarding applicability of exemption given to certain private companies under section 143(3)(i) (vide circular no. 08/2017) clarified that the exemption shall be applicable for those audit reports in respect of financial statements pertaining to financial year, commencing on or after 1st April, 2016, which are made on or after the date of the said notification.
3. As per provisions of Section 143(3)(i) of companies Act, The Auditor Report shall state whether the Company has adequate internal financial controls system in place and the operating effectiveness of such controls. MCA vide its notification dated 13th June 2017 (G.S.R. 583(E)) amended the notification of the Government of India, In the ministry of corporate of affair, vide no G.S.R. 464(E) dated 05th June 2015 providing exemption from Internal Financial Controls to following private companies which is one person Company (OPC) or a Small Company; or Which has turnover less than ₹ 50 Crores as per latest audited financial statement or which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less then ₹ 25 Crore. The above exemption shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 of the Companies Act 2013 or annual return under section 92 of Act with the Registrar. Further, in section 143 of the principal Act, (i) in sub-section (1), in the proviso, for the words "its subsidiaries", at both the places, the words "its subsidiaries and associate companies" shall be substituted; (ii) in sub-section (3), in clause (i), for the words "internal financial controls system", the words "internal financial controls with reference to financial statements" shall be substituted; (iii) in sub-section (14), in clause (a), for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

**4. Amendment due to Companies (Amendment) Act 2017**

- (i) By virtue of notification dated 21st March 2018, in exercise of the powers conferred by sub-section (3) of section 1 of the Companies Act, 2013 (18 of 2013), the Central Government hereby appoints the 21st March, 2018 as the date on which the provisions of subsections (3) and (11) of section 132 of the said Act shall come into force.
- (ii) As per section 140(2), the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in section 139(5) i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees *or the remuneration of the auditor, whichever is less*, but which may extend to five lakh rupees as per section 140(3).
- (iii) Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company shall not be eligible for appointment as an auditor of a company
- (iv) By virtue of notification dated February 23, 2018, the Central Government has exempted the companies engaged in defence production to the extent of application of relevant Accounting Standard on segment reporting.
- (v) The Order for reopening of accounts not to be made beyond eight financial years immediately preceding the current financial year unless and until Government has, under Section 128(5) issued a direction for keeping books of account longer than 8 years, reopening of accounts can be made for such longer period.
- (vi) As per Section 143(3)(i) The auditors of all the companies shall report on the adequacy of internal financial control systems and its operating effectiveness. As per the recent amendment, the auditors are required to report on Internal Financial Control with reference to financial statements.
- (vii) Right of access by the auditor of a holding company to the accounts and records of the associate company, whose accounts are required to be consolidated. As per the recent amendment, this right has been extended to associates also.
- (viii) Enabling provisions for opportunity of being heard in Section 130 for auditor/ Chartered Accountant of the Company. As of now, there is no provision in the section for serving notice to the auditor/ chartered accountant in case of reopening of accounts. As per the recent amendment in the section has been brought enabling the Court/ Tribunal to give notice to any other party/ person concerned.

(ix) Section 147 of the Companies Act, 2013 prescribes following punishments for contravention:

- (1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.
- (2) If an auditor of a company contravenes any of the provisions of section 139 section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees **or four times the remuneration of the auditor, which ever is less** .

It may be noted that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall **not be less than fifty thousand rupees** but which may extend to twenty-five lakh rupees **or eight times the remuneration of the auditor, which every is less**

- (3) Where an auditor has been convicted under sub-section (2), he shall be liable to:-
  - (i) refund the remuneration received by him to the company;
  - (ii) and pay for damages to the company statutory bodies or authorities or to **members or the creditors of the Company** for loss arising out of incorrect or misleading statements of particulars made in his audit report.
- (4) The Central Government shall, by notification, specify any statutory body or authority of an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages the such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.
- (5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil criminal as provided in this Act or in any other law for the time being in force, for such act shall be the partner or partners concerned of the audit firm and of the firm jointly and severally Provided that in case of criminal liability of an audit firm, in respect

of liability other *than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.*

#### Chapter 15 - Audit under Fiscal Laws:

### I. Audit provisions under Indirect Tax Laws

#### AMENDMENT IN CLAUSE 31(d) & (e) OF FORM 3CD

- Clause 31 (d): Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year:-
    - (i) ***name, address and Permanent Account Number (if available with the assessee) of payer;***
    - (ii) amount of loan or deposit or any specified advance received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year.
  - Clause 31 (e): Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received by a cheque or bank draft which is not an account payee cheque or account payee bank draft during the previous year:
    - (i) ***name, address and Permanent Account Number (if available with the assessee) of the payer;***
    - (ii) amount of loan or deposit or any specified advance received by a cheque or a bank draft which is not an account payee cheque or account payee bank draft during the previous year.
- (Particulars at (c), (d) and (e) need not be given in the case of a repayment of any loan or deposit or any specified advance taken or accepted from the Government, Government company, banking company or a corporation established by the Central, State or Provincial Act).

### II. Audit provisions under Indirect Tax Laws

#### Audit of Accounts [Section 35(5) read alongwith section 44(2) and rule 80]

As per sub-section 5 of section 35 read alongwith section 44(2) and rule 80 of the CGST Rules, 2017, every registered person must get his accounts audited by a Chartered Accountant or a Cost Accountant if his aggregate turnover\* during a FY exceeds ₹ 2 crores.

<b>*Meaning of Aggregate Turnover as defined under section 2(6) of the CGST Act:</b>	
<b><u>Includes Value of all outward supplies</u></b> - Taxable supplies - Exempt supplies - Exports - Inter-State supplies of persons having the same PAN be computed on all India basis.	<b><u>Excludes the following:-CGST</u></b> - SGST - UTGST - IGST - Compensation cess - Value of inward supplies on which tax is payable under reverse charge

### **Chapter 22 - Code of Ethics**

#### **Recent Decisions of Ethical Standards Board**

1. A Chartered Accountant in practice may be an equity research adviser, but he cannot publish retail report, as it would amount to other business or occupation.
2. A Chartered Accountant, who is a member of a Trust, cannot be the auditor of the said trust.
3. A Chartered Accountant in practice may engage himself as Registration Authority (RA) for obtaining digital signatures for clients.
4. A Chartered accountant can hold the credit card of a bank when he is also the auditor of the bank, provided the outstanding balance on the said card does not exceed rupees 10000 beyond the prescribed credit period limit on credit card given to him.
5. A Chartered Accountant in practice can act as mediator in Court, since acting as a "mediator" would be deemed to be covered within the meaning of "arbitrator"; which is inter-alia permitted to members in practice as per Regulation 191 of the Chartered Accountants Regulations, 1988.
6. A Chartered Accountant in practice is not permitted to accept audit assignment of a bank in case he has taken loan against a Fixed Deposit held by him in that bank.
7. The Ethical Standards Board in 2013 generally apply the stipulations contained in the then amended Rule 11U of Income Tax generally, wherein statutory auditor /tax auditor cannot be the valuer of unquoted equity shares of the same entity.

The Board has at its recent Meeting (January, 2017) has reviewed the above, and decided that where law prohibits for instance in the Income Tax Act and the rules framed thereunder, such prohibition on statutory auditor/tax auditor to be the valuer will continue, but where there is no specific restriction under any law, the said eventuality will be permissible, subject to compliance with the provisions, as contained in the Code of Ethics relating to independence.

8. The Ethical Standards Board had in 2011 decided that it is not permissible for a member who has been Director of a Company, upon resignation from the Company to be appointed as an auditor of the said Company, and the cooling period for the same may be 2 years.

The Board has at its recent Meeting (January, 2017) has reviewed the above, and noted that the Section 141 of Companies Act, 2013 on disqualification of auditors does not mention such prohibition; though threats pertaining to the said eventuality have been mentioned in Code of Ethics.

Further, the Board was of the view that a member may take decision in such situation based on the provisions of Companies Act, 2013 and provisions of Code of Ethics.

9. A chartered accountant in practice cannot become Financial Advisors and receive fees/commission from Financial Institutions such as Mutual Funds, Insurance Companies, NBFCs etc.
10. A chartered accountant cannot exercise lien over the client documents/records for non-payment of his fees.
11. It is not permissible for CA Firm to print its vision and values behind the visiting cards, as it would result in solicitation and therefore would be violative of the provisions of Clause (6) of Part-I of First Schedule to the Chartered Accountants Act, 1949.
12. It is not permissible for chartered accountants in practice to take agencies of UTI, GIC or NSDL.
13. It is permissible for a member in practice to be a settlor of a trust.
14. A member in practice cannot hold Customs Brokers Licence under section 146 of the Customs Act, 1962 read with Customs Brokers Licensing Regulations, 2013 in terms of the provisions of Code of Ethics.
15. A Chartered accountant in service may appear as tax representative before tax authorities on behalf of his employer, but not on behalf of other employees of the employer.
16. A chartered accountant who is the statutory auditor of a bank cannot for the same financial year accept stock audit of the same branch of the bank or any of the branches of the same bank or sister concern of the bank, for the same financial year.
17. A CA Firm which has been appointed as the internal auditor of a PF Trust by a Government Company cannot be appointed as its Statutory Auditor.
18. A concurrent auditor of a bank 'X' cannot be appointed as statutory auditor of bank 'Y', which is sponsored by 'X'.
19. A CA/CA Firm can act as the internal auditor of a company & statutory auditor of its employees PF Fund under the new Companies Act (2013).

20. The Ethical Standards Board while noting that there is requirement for a Director u/s 149(3) of the Companies Act, 2013 to reside in India for a minimum period of 182 days in the previous calendar year, decided that such a Director would be within the scope of Director Simplicitor (which is generally permitted as per ICAI norms), if he is non – executive director, required in the Board Meetings only, and not paid any remuneration except for attending such Board Meetings.

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

## PART – II : QUESTIONS AND ANSWERS

### QUESTIONS

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

1. (a) In the course of audit of ZED Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.
  - (b) In audit plan for TELCO Ltd, as the audit partner you want to highlight the sources of misstatements arising from other than fraud to your audit team and caution them. Identify the sources of misstatements.
  - (c) CA. Ashutosh has been appointed as an auditor of Awesome Health Ltd. for the financial year 2017-18 which was audited by CA. Amrawati in 2016-17. As the Auditor of Awesome Health Ltd., state the steps that CA. Ashutosh would take to ensure that the Closing Balances of the financial year 2016-17 have been brought to account in 2017-18 as Opening Balances and the Opening Balances do not contain any misstatements.
2. (a) JIO Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of JIO Ltd. as to how he can obtain an understanding of how JIO Ltd. uses the services of the outsourced agency in its operations.
  - (b) M/s Innocent Limited has entered into a transaction on 25th February, 2018, near year-end, whereby it has agreed to pay ₹ 5 lakhs per month to Mr. Yuvraj as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but ₹ 60 lakhs is provided in books of account as on March 31, 2018.

Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Innocent Limited, what would be your approach?

**Audit Planning Strategy and Execution**

3. (a) Key phases in the audit execution stage are Execution Planning, Risk and Control Evaluation, Testing and Reporting. Explain.
- (b) KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2017-18. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known actuaries. Due to difference of opinion, all the joint auditors consulted their respective actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma. Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.

**Risk Assessment and Internal Control**

4. During the course of audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

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

5. A real-time environment is a type of automated environment in which business operations and transactions are initiated, processed and recorded immediately as they happen without delay. It has several critical IT components that enable anytime, anywhere transactions to take place. You are required to name the components and its example of real-time environment.

**The Company Audit**

6. (a) Miranda Spinning Mills Ltd. is a sick company and has accumulated losses of ₹ 10 crores. The company has ₹ 12 crores in its share Premium Account. The Management desires to adjust the accumulated losses against the share premium balance. Advise the company giving your reasons.
- (b) Comment on the following with reference to Schedule III to the Companies Act, 2013:
  - (i) A company has disclosed performance guarantee and counter guarantees as Contingent Liabilities.
  - (ii) The parent company has recognized in the current year's financial statement, dividend declared by its subsidiary after the balance sheet date.

**Audit Report**

7. "When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion



section.” As an expert you are required to brief the special considerations required for expressing:

- (a) Qualified Opinion;
- (b) Adverse Opinion and
- (c) Disclaimer of Opinion.

#### **Audit Reports and Certificates for Special Purpose Engagement**

8. “There are numerous situations where regulatory authorities like SEBI, ROC, Income Tax, Central Board of Excise and Customs (CBEC), Reserve Bank of India etc. requires a professional accounting firm or the statutory auditor of the organization to provide opinion on certain specific matters which are provided by the organisation as part of statutory requirements.” In view of above give few examples of various types of Certificates produced before such regulating authorities.

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

9. Irregular Limited, a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India the revenue of the company is going down and there is slow down in other activities of the company. Therefore, it was expected that there would not be significant work for members of the Audit Committee. Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet once in a year only on March 31, 2018. They reviewed monthly information system of the Company and found no errors. As an auditor of Irregular Limited would you consider the decision taken by the Audit Committee is in line with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

#### **Audit of Consolidated Financial Statements**

10. Moon Ltd. acquired 51% shares of Star Ltd. during the year ending 31-3-2017. During the financial year 2017-18 the 20% shares of Star Ltd. were sold by Moon Ltd. Moon Ltd. while preparing the financial statements for the year ending 31-3-2017 and 31-3-2018 did not consider the financial statements of Star Ltd. for consolidation. As a statutory auditor how would you deal with it?

#### **Audit of Banks**

11. Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager:
- (a) The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year.

- (b) The bank is a consortium member of Cash Credit Facilities of ₹ 50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹ 1.75 crores towards interest the credits in X Ltd's account are to the tune of ₹ 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing.

**Audit of Insurance Companies**

12. Auditors should evaluate various sub-processes, employed by the Insurance Companies in accounting of premiums like collection of premium from the policy holders, booking of premium, banking, accounting and reconciliation of the same. In view of above, you are required to briefly discuss some illustrative points, auditors are required to follow during the Audit of Accounting of Premiums in case of Life Insurance Companies.

**Audit of Non-Banking Financial Companies**

13. You are appointed as the auditor of a NBFC which is an Investment company registered with RBI. What shall be the special points to be covered for the audit of NBFC in case of Investment companies?

**Audit under Fiscal Laws**

14. (a) You are doing the tax audit of a Limited Company. After submission of Tax Audit Report, management notices that there was apparent mistake of law and due to this mistake, revised the final accounts. As a tax auditor, company seeks your opinion whether the tax audit can also be revised or not.
- (b) XYZ Limited is looking for an auditor for getting its accounts audited as per GST. Being an expert in the indirect taxes field XYZ Limited is seeking your advice on types of audit to be envisaged as per GST Law. Explain.

**Special Audit Assignments**

15. (a) You are advisor of a Listed Company. The audit committee has recommended Environment Audit of the company to the management. Now, management wants to know what does an Environment Audit involve and how it can benefit the company?
- (b) Write a short note on Volatility Margin, its computation and its application.

**Audit of Public Sector Undertaking**

16. "A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

**Internal Audit, Management and Operational Audit**

17. Many modern enterprises have become huge and sophisticated. This has resulted in decentralisation of their activities and different type of audits. You are required to explain the difference to the management:
- (a) Internal & Operational Audit.
  - (b) Management Audit & Operational Audit.
  - (c) Financial Audit & Operational Audit.

**Due Diligence, Investigation and Forensic Audit**

18. A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.
- List out the points you will cover in your investigation before submitting your report to the General Manager.

**Professional Ethics**

19. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:
- (a) CA Kumar who is contesting Central Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period.
  - (b) A Chartered Accountant in practice, empanelled as IP (Insolvency Professional) has mentioned the same on his visiting cards, letter heads and other communications also. Mr. A, who is residing in his neighbourhood has filed a complaint for professional misconduct against the said member for such mention of insolvency professional on circulations.
  - (c) Mr. P, a Chartered Accountant in practice entered into a partnership with Mr. L, an advocate for sharing of fees for work sent by one to the other. However, due to some disputes, the partnership was dissolved after 1 month without any fees having been received.
  - (d) Mr. D, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.

20. Write a short note on the following:
- (a) The purpose of communicating key audit matters.
  - (b) Objective of Quality Review
  - (c) Stepwise approach adopted by the Peer reviewer.
  - (d) Auditor's responsibilities regarding comparatives.

### SUGGESTED ANSWERS/HINTS

1. (a) As per **SA 330 on “The Auditor’s Responses to Assessed Risks”**, changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.
- The auditor’s decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.
- Factors that may warrant a re-test of controls are-
- (i) A deficient control environment.
  - (ii) Deficient monitoring of controls.
  - (iii) A significant manual element to the relevant controls.
  - (iv) Personnel changes that significantly affect the application of the control.
  - (v) Changing circumstances that indicate the need for changes in the control.
  - (vi) Deficient general IT-controls.
- (b) According to **SA 450 “Evaluation of Misstatements identified during the Audit”**, the following are the sources of misstatements arising from other than fraud -
- (i) An inaccuracy in gathering or processing data from which the financial statements are prepared;
  - (ii) An omission of an amount or disclosure;
  - (iii) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and
  - (iv) Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.
- (c) **Obtaining sufficient appropriate audit evidence while conducting Initial Audit Engagement:** According to SA 510 on “Initial Audit Engagements- Opening Balances”, the objective of the Auditor while conducting an initial audit engagement

with respect to opening balances is to obtain sufficient appropriate audit evidence so that the-

- (i) opening balances of the preceding period have been correctly brought forward to the current period;
- (ii) opening balances do not contain any misstatement that materially affect the current period's financial statements; and
- (iii) appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Being a new assignment, audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection/ payment of opening accounts receivable/ accounts payable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as property plant and equipment, investments, long term debts, the auditor will examine the records relating to opening balances. The auditor may also be able to get the confirmation from third parties (e.g., balances of long term loan obtained from banks can be confirmed from the Bank Loan statement).

2. (a) As per **SA 402 on "Audit Considerations Relating to an Entity Using a Service Organisation"**, when obtaining an understanding of the user entity in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:
- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
  - (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
  - (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and
  - (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

- (b) As per **SA 240 on “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”**, fraud can be committed by management overriding controls using such techniques as Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

Keeping in view the above, it is clear that Company has passed fictitious journal entries near year end to manipulate the operating results. Also Auditor’s enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable.

Accordingly, the auditor would adopt the following approach-

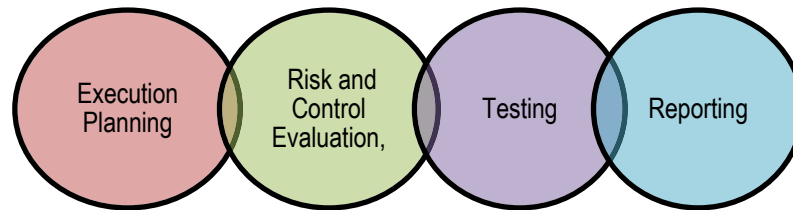
If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor shall:

- (i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- (iii) If the auditor withdraws:
  - (1) Discuss with the appropriate level of management and those charged with governance, the auditor’s withdrawal from the engagement and the reasons for the withdrawal; and
  - (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor’s withdrawal from the engagement and the reasons for the withdrawal.

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

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

3. (a) Key phases in the audit execution stage are Execution Planning, Risk and Control Evaluation, Testing and Reporting.



**Image showing Stages of Audit Execution**

1. **Execution Planning:** Prior to commencement of an audit engagement, it is important to lay down the roadmap for audit execution to ensure timely and quality audit results. The auditors need to plan their work in order to carry out the audit in an effective, efficient and timely manner. A detailed audit program is prepared laying down the audit objectives, scope and audit approach. The manpower requirement, audit team qualifications, and the time element, etc. are some of the important considerations during execution planning. In order to plan effectively, the auditor may need some more information about the audit area. A preliminary survey would help in gathering the required information.
2. **Risk and Control Evaluation:** For each segment of audit, the auditors should conduct a detailed risk and control assessment i.e. list the risks that must be reviewed in that segment, capture for each risk the controls that exist or those that are needed to protect against the risk and show for each control, the work steps required to test the effectiveness of the controls. While making Risk & Control assessment it is necessary to borne in mind Materiality levels as the same is linked with Audit Risks.
3. **Testing:** Once a comprehensive understanding is gained of the key risks and the controls to be evaluated in a given audit area, the auditors should test the operating effectiveness of the controls to determine whether controls are operating as designed. There are multiple test methods which can be used to arrive at the conclusions on the effectiveness of the controls
4. **Reporting:** SA 700, "Forming an Opinion and Reporting on Financial Statements" establishes standards on the form and content of the auditor's report issued as a result of an audit performed by an auditor of the financial statements of an entity. The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply

with the relevant statutory requirements such as compliance of Provisions & Enactments of the Company Law, Accounting Standards framed by ICAI, latest Guidelines etc.

The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole. A measure of uniformity in the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur. A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report.

**5 Other Important Considerations:** In addition to above, there are certain other consideration which auditor is required to take care while executing the audit such as using the work of other auditor, using the work of an auditor's expert etc.

**(b) Using the work of an Auditor's Expert:** As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert.

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on found faulty. Further, Mr. Z is not agreed with this report therefore he submitted a separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.



Mr. X and Mr. Y will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.

4. **Important Points to be kept in Mind While Drafting Letter of Weakness:** As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and
- (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
  - (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
  - (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
  - (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.
5. **Real Time Environment: IT Components:** To facilitate transactions in real-time, it is essential to have the systems, networks and applications available during all times. A real-time environment has several critical IT components that enable anytime, anywhere transactions to take place. Any failure even in one component could render the real-time system unavailable and could result in a loss of revenue. IT Components include:
- (i) **Applications:** For example, ERP applications SAP, Oracle R12, Core banking applications.
  - (ii) **Middleware.:** For example, Webservers like Apache, ATM switches.
  - (iii) **Networks:** For example, Wide Area Networks, Internet hosting.
  - (iv) **Hardware:** For example, Data centers, Backup and Storage devices, Power supply.
6. (a) Application of Share Premium Account: Section 52 of the Companies Act, 2013 (herein after referred as the Act) deals with the application of premium received on issue of shares. Sub-section (1) of the said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the

aggregate amount of the premium received on those shares shall be transferred to an account called "Securities Premium Account" and the provisions of this Act relating to reduction of share capital of a company except as provided in this section shall apply as if the securities premium account was the paid up share capital of the company. Sub-section (2) of the said section provides that notwithstanding anything contained in sub-section (1), securities premium account may be applied by the company for issue of bonus shares; writing off the preliminary expenses; writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; in providing for the premium payable on redemption of any redeemable preference shares or any debentures of the company; for the purchase of its own shares or other securities. In view of these provisions of the Companies Act, 2013, it is not permitted to adjust its accumulated losses against the securities premium account.

- (b) (i) A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.

However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due.

Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

- (ii) The Schedule III does not prescribe to recognise dividend declared by subsidiary company as given in the scenario. Accordingly, dividend income from subsidiary companies should be recognised in accordance with AS-9, i.e. only when they have a right to receive the same on or before the Balance sheet date. Normally, the right to receive is established only when the dividend is approved by the shareholder at the AGM of the investee company. Therefore, treatment done by the company is not in order.

7. (a) **Special consideration required for expressing Qualified Opinion:** When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:

- (i) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (ii) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase “except for the possible effects of the matter(s) ...” for the modified opinion.

**(b) Special consideration needed for expressing Adverse Opinion:** When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor’s opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

- (i) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (ii) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].








**(c) Special consideration is required for expressing Disclaimer of Opinion:** When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

- (i) State that the auditor does not express an opinion on the accompanying financial statements;
- (ii) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (iii) Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor’s report shall not include a Key Audit Matters section in accordance with SA 701.

8. There are numerous situations where regulatory authorities like SEBI, ROC, Income Tax, Central Board of Excise and Customs (CBEC), Reserve Bank of India etc. requires a

professional accounting firm or the statutory auditor of the organization to provide opinion on certain specific matters which are provided by the organisation as part of statutory requirements.

Sr. No.	Authorities	Examples of Various types of Certificates
1.	Reserve Bank of India	<ul style="list-style-type: none"> <li> Certificate of unhedged foreign currency exposure as at year end</li> <li> Certificate for adherence to guidelines as per RBI circular</li> <li> Annual activity certificate for branch office, Liaison office, Project office etc.</li> <li> Certificate of probable exposure</li> </ul>
2.	Companies Act, 2013	Certificate pursuant to proviso to Section 230(7) of the Companies Act, 2013 in relating to accounting treatment prescribed under the Scheme of Arrangement.
3.	Income Tax Act, 1961	Reporting on Expenditure incurred on R&D Centre approved under Section 35(2AB)
4.	SEBI	Certificate for accounting treatment in case of a merger of two entities or reorganization, Income Tax authorities requires auditor to certify amount eligible Minimum Alternative tax under Section 115JB of Income tax Act, 1961
5.	Others	<ul style="list-style-type: none"> <li> Certificate for net worth required for a tender document</li> <li> Certificate for value of fixed assets in a particular location required by a regulatory agency to process tax incentives</li> <li> Certificate of service tax refund or VAT refund</li> </ul>

9. One of the following additional requirement as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent directors present.

Besides, there is a mandatory review requirement and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly

information system of the company and the same is not sufficient as per LODR Regulations.

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

- (i) Management discussion and analysis of financial condition and results of operations;
- (ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
- (iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
- (iv) Internal audit reports relating to internal control weaknesses; and
- (v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee;
- (vi) Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

Applying the above, the decision taken by the audit committee is not in line with the LODR Regulations.

- 10. Consolidation of Financial Statements:** Accounting Standard 21 “Consolidated Financial Statements”, states that a subsidiary should be excluded from consolidation when control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are acquired & held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 “Accounting for Investments”.

In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary is temporary, the auditor should verify that the intention of the parent, to dispose the subsidiary, in the near future, existed at the time of acquisition of the subsidiary. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements.

As per Ind AS 110, there is no such exemption for ‘temporary control’, or “for operation under severe long-term funds transfer restrictions” and consolidation is mandatory for Ind AS compliant financial statement in this case.

However, as per section 129(3) of the Companies Act, 2013 where a company having subsidiary, which is not required to prepare consolidated financial statements under the

applicable Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

**Conclusion:** In the given case, Moon Ltd. has acquired 51% shares of Star Ltd. during the year ending 31.03.2017 and sold 20% shares during the year 2017-18. Moon Ltd. did not consolidate the financial statements of Star Ltd. for the year ending 31.03.2017 and 31.03.2018.

The intention of Moon Ltd. is quite clear that the control in Star Ltd. is temporary as the former company disposed off the acquired shares in the next year of its purchase. Therefore, Moon Ltd. is not required to prepare consolidated financial statement as per AS 21 however, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013, Moon Ltd. is required to make disclosures in the financial statements as per the provisions provided in Schedule III to the Companies Act' 2013.

However, if the Moon Ltd. is required to prepare its financial statements under Ind AS, it shall have to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" is not available under Ind AS 110. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

11. (a) It is not a prudent practice to treat dividend on shares of corporate bodies and units of mutual funds as income unless these are actually received. Accordingly, income from dividend on shares of corporate bodies and units of mutual funds should be booked on cash basis. In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government. Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This is also in accordance with AS 9 as well. In the instant case, therefore, the recognition of income by the bank on accrual basis is not in order.
- (b) The bank is a consortium member of cash credit facilities of ₹ 50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹ 1.75 crores towards interest, the credits in X Ltd's account are to the tune of ₹ 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may

classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.

**12. Following are the certain illustrative points, Auditors are required to follow during the Audit of Accounting of Premiums:**

**1. Collection of Premium:**

- ◆ Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.
- ◆ Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.

**2. Calculation of Premium:**

- ◆ Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly.
- ◆ Check that system employed as such is equipped to calculate all types of premium modes correctly.

**3. Recognition of Income:**

- ◆ Check that premium is recognised only on the basis of 'Issued Policies' and not on underwriting dates.
- ◆ Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies.
- ◆ Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.

**4. Accounting of 'Advance Premium':**

- ◆ Check, whether system has capability to identify regular and advance premium.
- ◆ Check whether there is a process of applying advance premium to a contract when premium is due.

**5. Reporting of Premium figures to IRDA/ Management:**

- ◆ Check the methodology for generation of MIS from the system and there is no manual intervention.
- ◆ Check the procedure for Maker/ Checker before finalising the MIS.
- ◆ Check whether there is a reconciliation process between premium Income as per financials and as reported.

**6. Other Areas:**

- ◆ Check whether there are appropriate SOPs developed by the Companies and are strictly followed by all the departments/ branches of the Company.
- ◆ Ensure duly approved Delegation of Authority parameters matrix already in place for authorisation limits.
- ◆ Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel.
- ◆ Check that the Company conducts premium reconciliation on daily basis.
- ◆ Check the robustness of interface between administration and accounting system.

Auditors may also refer to IRDA (Preparation of Financial Statements & Auditors Report of Insurance Companies) Regulations, 2000 for premium accounting.

**13. Special points that may be covered in the audit of NBFCs in case of Investment Companies are given below:**

- (i) Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- (ii) NBFC Prudential Norms stipulates that NBFCs should not lend more than 15% of its owned funds to any single borrower and not more than 25% to any single group of borrower. The ceiling on investments in shares by a NBFC in a single entity and the aggregate of investments in a single group of entities has been fixed at 15% and 25% respectively. Moreover, a composite limit of credit to and investments in a single entity/group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC. Verify that the credit facilities extended and investments made by the concerned NBFC are in accordance with the prescribed ceiling.
- (iii) Verify whether the NBFC has not advanced any loans against the security of its own shares.
- (iv) Verify that dividend income wherever declared by a company, has been duly received by a NBFC and interest wherever due [except in case of NPAs] has been duly accounted for.
- (v) Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
- (vi) Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.
- (vii) Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of



securities, wherever applicable, have been made there against, as required by the Directions.

- (viii) Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- (ix) Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- (x) An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- (xi) In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- (xii) In the case of securities lent/borrowed under the Securities Lending Scheme of SEBI, verify the agreement entered into with the approved intermediary (i.e. the person through whom the lender will deposit and the borrower will borrow the securities for lending/borrowing) with regards to the period of depositing/lending securities, fees for depositing/lending, collateral securities and provision for the return including pre-mature return of the securities deposited/lent.
- (xiii) Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.)
- (xiv) Verify charges received or paid in respect of securities lent/borrowed.
- (xv) Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.

**14. (a) Revision of Tax Audit Report:**

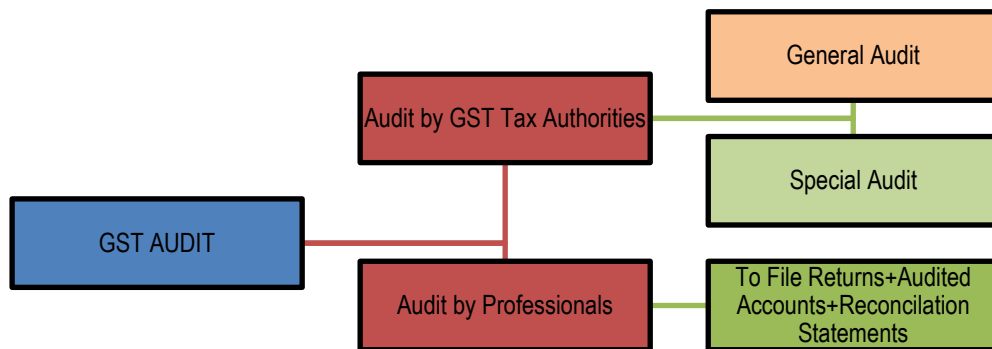
- (i) Normally, the report of the tax auditor cannot be revised later.
- (ii) However, when the accounts are revised in the following circumstances, the tax Auditor may have to revise his Tax audit report also.
  - (a) Revision of accounts of a company after its adoption in the annual general meeting.
  - (b) Change in law with retrospective effect.
  - (c) Change in interpretation of law (e.g.) CBDT Circular, Notifications, Judgments, etc.

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

Thus, the Tax Audit Report can be changed under the given circumstances.

**(b) Types of Audit under GST Law:** GST envisages three types of Audit.

- (1) Audit of accounts [Section 35(5) read alongwith section 44(2) and rule 80]
- (2) Audit by Tax Authorities wherein the Commissioner or any officer authorised by him, can undertake audit of any registered person for such period, at such frequency and in such manner as may be prescribed. [Section 65 and rule 101]
- (3) Special Audit wherein the registered person can be directed to get his records including books of account examined and audited by a chartered accountant or a cost accountant during any stage of scrutiny, inquiry, investigation or any other proceedings; depending upon the complexity of the case. [Section 66 and rule 102]



**1. Audit of Accounts [Section 35(5) read alongwith section 44(2) and rule 80]**

As per sub-section 5 of section 35 read alongwith section 44(2) and rule 80 of the CGST Rules, 2017 stipulates as follows:

<p>Every registered person must get his accounts audited by a Chartered Accountant or a Cost Accountant if his aggregate turnover during a FY exceeds ₹ 2 crores.</p>	<p>Such registered person is required to furnish electronically through the common portal alongwith Annual Return a copy of:</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Audited annual accounts</li> <li><input type="checkbox"/> A Reconciliation Statement, duly certified, in prescribed FORM GSTR-9C.</li> </ul>
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**Reconciliation Statement** will reconcile the value of supplies declared in the return furnished for the financial year with the audited annual financial statement

and such other particulars, as may be prescribed.

**2. Audit under section 65:**

Section	Description	Remarks
Section 65	Audit by tax authorities	The audit under Section 66 is a special audit to be conducted by a Chartered Accountant or Cost Accountant nominated by the Commissioner whereas the audit under Section 65 is a routine audit by the tax office.

**3. Special Audit under section 66:**

Availing the services of experts is an age old practice of due process of law. These experts have done yeoman service to the process of delivering justice. One such facility extended by the Act is in Section 66 where an officer not below the rank of Assistant Commissioner, duly approved, may avail the services of a Chartered Accountant or Cost Accountant to conduct a detailed examination of specific areas of operations of a registered person. Availing the services of the expert be it a Chartered Accountant or Cost Accountant is permitted by this section only when the officer considering the nature & complexity of the business and in the interest of revenue is of the opinion that:

- Value has not been correctly declared; or
- Credit availed is not within the normal limits.

It would be interesting to know how these 'subjective' conclusions will be drawn and how the proper officers determines what is the normal limit of input credit availed.

**15. (a) Environment Audit: An Environment Audit involve:**

- ◆ A rigorous environmental audit will do more than simply ensure legislative compliance; it will aim to identify the Best Practicable Environmental Option (BPEO) for your company. A good audit will help in run a tighter, more efficient company.
- ◆ Evaluating operational practices to determine whether they can be made more efficient in terms of resource use and waste production, or altered to minimize risk of pollution.
- ◆ Examining the way in which the company deals with the waste it produces to see if more effective waste management options could be deployed.
- ◆ Taking a good look at the material and energy resources company uses to see whether more environmentally sound alternatives could be substituted.
- ◆ Developing contingency plans for environmental mishaps

**Advantage of Environment Audit**

- ◆ Ensure that the company is staying within the bounds of the law
- ◆ Cut effluent and waste disposal costs
- ◆ Reduce material and energy bills
- ◆ Improve your corporate image
- ◆ Assist in formulation of an environmental policy.

- (b) **Volatility Margin:** Volatility margin is imposed to curb excessive volatility in the market and to act as a deterrent to building up of excessive outstanding positions.

**Computation:** Price variations on account of calls, bonuses, rights, mergers, amalgamations and schemes of arrangements are adjusted for determining volatile securities and adjustments in prices is made for the purpose of computation of volatility, when securities are traded ex-benefits.

**Application:** Securities that attract volatility margin and the applicable margin rates are announced on the last day of the trading cycle and are applicable from the first day of the succeeding trading cycle. The volatility margin is levied on the net outstanding positions of the member, in each security, based on the respective margin rates.

**16. According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:**

- (i) **Economy-** It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (**e.g. human, financial and material**) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

- (ii) **Efficiency-** It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

**Auditing efficiency embraces aspects such as whether:**

- (a) sound procurement practices are followed;
- (b) resources are properly protected and maintained;
- (c) human, financial and other resources are efficiently used;
- (d) optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;

- (e) public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
  - (f) efficient operating procedures are used; and
  - (g) the objectives of public sector programmes are met cost-effectively.
- (iii) **Effectiveness-** It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

**In auditing effectiveness, performance audit may, for instance:**

- (a) assess whether the objectives of and the means provided (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;
  - (b) determine the extent to which a program achieves a desired level of program results;
  - (c) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to the policy or to other causes;
  - (d) identify factors inhibiting satisfactory performance or goal-fulfilment;
  - (e) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes;
  - (f) assess the effectiveness of the program and/or of individual program components;
  - (g) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
  - (h) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;
  - (i) assess compliance with laws and regulations applicable to the program; and
  - (j) identify ways of making programmes work more effectively.
17. (a) **Difference between Internal & Operational Audit:** There probably may not be much of difference in viewing operational audit as a review and appraisal of operations of an organisation carried on by a competent independent person. Auditing whether carried on by an internal staff or by an external person, should necessarily be an independent activity to maintain its objectivity and usefulness.

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

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

the resulting accounting data are reliable.

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

Also he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would be interested in such matters as reorder policy, obsolescence policy and the overall inventory management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

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

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

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

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

Performance yardsticks can be found in the management objectives, goals and plans, budgets, records of past performance, policies and procedures. Industry

standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments.

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

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

**(b) Difference between Management Audit & Operational Audit**

- ◆ Management audit is concerned with the “Quality of managing”, whereas operational audit focuses on the “Quality of operations”.
- ◆ Management audit is the “**Audit of management**” while operational audit is the “**Audit for the management**”.
- ◆ The basic difference between the two audits, then, is not in method, but in the level of appraisal. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfilment of plans in conformity with the prescribed policies.

**(c) Differences between Financial and Operational Auditing** - The major differences between financial and operational auditing can be described as follows:

- (i) **Purpose** - The financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes on effectiveness and efficiency of operations for future performance.
- (ii) **Area** - Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization.
- (iii) **Reporting** - The financial audit report is sent to all stock holders, bankers and other persons having stake in the Organisation. However the operational audit report is primarily for the management.
- (iv) **End Task** - The financial audit has reporting the findings to the persons getting

the report as its end objective, however, the operational auditing is not limited to reporting only but includes suggestions for improvement also.

**18. Investigation on Behalf of the Bank for Advances:** A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points:

- (i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.
- (ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.
- (iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.
- (iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- (v) The history of growth and development of the company and its performance during the past 5 years.
- (vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

- (a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
  - (i) Sales to Average Inventories held.



- (ii) Sales to Fixed Assets.
  - (iii) Equity to Fixed Assets.
  - (iv) Current Assets to Current Liabilities.
  - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
  - (vi) Equity to Long Term Loans.
  - (vii) Sales to Book Debts.
  - (viii) Return on Capital Employed.
- (c) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

**Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank** - The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

(a) **Fixed assets** - A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.

(b) **Inventory** - The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued.

Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.

If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

(c) **Trade Receivables, including bills receivable** - Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

- (i) debts due in respect of which the period of credit has not expired;
- (ii) debts due within six months; and
- (iii) debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

- (d) **Investments** - The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.
- (e) **Secured Loans** - Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for repayment of a liability should be disclosed.
- (f) **Provision of Taxation** - The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears to be inadequate, the fact should be stated along with the extent of the shortfall.
- (g) **Other Liabilities** - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.
- (h) **Insurance** - A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.
- (i) **Contingent Liabilities** - By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.
- (j) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

19. (a) **Other Misconduct:** CA Kumar has engaged his Articled Assistant for his own election campaigning for the central Council elections of ICAI.

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

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

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

- (b) As per the Clause 7 of Part 1 of the First Schedule, if any Chartered Accountant advertises his professional attainments or services, or uses any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the ICAI or any other institution that has been recognized by the Central Government or may be recognized by the council, will be guilty of professional misconduct.

Here a Chartered Accountant empanelled as IP (Insolvency Professional) can mention 'Insolvency Professional' on his visiting cards, Letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause-7 of Part-1 of First Schedule to the Chartered Accountants Act, 1949. Thus, complaint of neighbour is not enforceable/valid.

- (c) **Partnership with an Advocate:** As per Clause (4) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant will be guilty of professional misconduct if he enters into partnership with any person other than a chartered accountant in practice or a person resident without India who but for his residence abroad would be entitled to be registered as a member under Clause (v) of Sub-section (1) of Section 4 or whose qualification are recognized by the Central Government or the Council for the purpose of permitting such partnership.

However, Regulation 53B of the Chartered Accountants Regulations, 1988 permits a Chartered Accountant in practice to enter into partnership with other prescribed Professionals which includes an Advocate, a member of Bar Council of India.

In the instant case, Mr. P, a chartered accountant, has entered into partnership with Mr. L, an advocate.

Thus, he would not be guilty of professional misconduct as per Clause (4) of Part I of First Schedule read with Regulation 53B.

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

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

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

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

20. (a) **Purpose of Communicating Key Audit Matters :** The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

- (b) **Objectives of Quality Review:** Quality review is directed towards evaluation of audit quality and adherence to various statutory and other regulatory requirements. They are designed to identify and address weaknesses and deficiencies related to how the audits were performed by the audit firms. To achieve that goal, quality reviews included reviews of certain aspects of selected statutory audits performed by the firm and reviews of other matters related to the firm's quality control system.

In the course of reviewing aspects of selected audits, a review may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, aspects in which an entity's financial statements do not

present fairly the financial position or the results of operations in conformity with the applicable Generally Accepted Accounting Principles (GAAP) and other technical standards. **It is not the purpose of a review, however, to review all of a firm's audits or to identify every aspect in which a reviewed audit is deficient.** Accordingly, a review should not be understood to provide any assurance that the firm's audits, or its clients' financial statements or reporting thereon, are free of any deficiencies.

**(c) Stepwise Approach of the Peer Reviewer:** The stepwise approach which may be adopted by the reviewer is discussed below-

- (i) The reviewer should gain an understanding of the engagement letter since an assurance engagement or for that matter any other kind of engagement should begin with an engagement letter. This understanding would help him in planning the review of documentation.
- (ii) The number of assurance engagements to be selected requires the exercise of judgement by the reviewer based on the evaluation of replies given in the questionnaire and the size of the practice unit.
- (iii) The practice unit may have policies and procedures for accepting a particular engagement. The reviewer should, wherever possible, examine that the policies and procedures for acceptance of audit have been complied with and necessary documentation with regard to the same exists.
- (iv) The reviewer may follow a combination of compliance procedures and substantive procedures throughout the peer review process.
- (v) Finally, the reviewer while evaluating records may consider the following:
  - determine that any significant issues, matters, problems that arose during the course of the engagement have been appropriately considered, resolved and documented;
  - determine that adequate audit evidence or other relevant evidence in relation to the engagement is obtained to support the reasonableness of the conclusions drawn; and
  - determine that significant decisions relating to the engagement, use of professional judgement, resolution of significant matters have been properly documented.

**(d) Auditor's responsibilities regarding comparatives:** SA 710, "Comparative Information – Corresponding Figures and Comparative Financial Statements", establishes standards on the auditor's responsibilities regarding comparatives.

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether

such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

- (i) The comparative information agrees with the amounts and other disclosures presented in the prior period; and
- (ii) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 (Revised).

As required by SA 580 (Revised), the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.