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PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

Answer any **four** from the rest

Question 1

- (a) *Toddle Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31st March, 2017. The Financial Statements for the year ended 31/03/2017 had been prepared on the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above.*
- (b) *The Property, Plant and Equipment of ABC Ltd. included ₹ 25.75 crores of earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected ten years back. As an Auditor, what may be your reporting concern as regards matters specified above?*
- (c) *Y& Co., Chartered Accountants have come across in the course of audit of a company that certain machinery had been imported for production of new product. Although the Auditors have applied the concept of materiality for the Financial Statements as a whole, they now want to re-evaluate the materiality concept for this transaction involving foreign exchange. Give your views in this regard?*
- (d) *B is the Principal Auditor of ABC Co. Ltd., with 8 branches audited by 8 Branch Auditors. B wanted to ensure that the works of Branch Auditors were adequate for the purpose of his audit. Hence he insisted on Branch Auditors to get familiar with a check list he prepared for branches and, besides, required them to share the working papers compiled by them for his review and return. Is Principal Auditor within his right in asking for such sharing of working papers?* **(5 x 4 = 20 Marks)**

Answer

- (a) **Closure of Business:** As per SA 570 "Going Concern", management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern.

As per SA 570, if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

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Even when no material uncertainty exists, it requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Further, as per SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report", when matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is, by its nature, a key audit matter. SA 701 also emphasises on auditor's responsibility to communicate key audit matters in the auditor's report.

As per the facts given in the case, intention of the Toddle Limited had definite plan of its business being closed down within short period from 31 March, 2017. However, financial statements for the year ended 31.03.2017 had been prepared on the same basis as it had been in earlier periods with an additional note.

Thus, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern is a key audit matter. Therefore, the auditor is required to Communicate the Key Audit Matters in accordance with SA 570 in above stated manner. Simple reference as to a possible cessation of business and making of adjustments, if any, be made at the time of cessation only by the auditor in his report is not sufficient.

- (b) **Disclosure in Audit Report:** The auditor is required to specifically include certain matters as per CARO, 2016 under section 143 of the Companies Act, 2013.

According to clause (i) (a) of CARO, 2016 the auditor has to comment whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; and as per clause (i) (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

In the given case, ABC Ltd. has intention to sale its earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down and these assets are appearing at residual value. Further, inspection of such machines (though it is a retired machine, however value is ₹ 25.75 crores which is material amount) was done 10 years back, is not in compliance with CARO, 2016.

Hence, this fact needs to be disclosed in the Audit Report as per clause (i) (a) and (b) of Paragraph 3 of CARO 2016.

- (c) **Re-evaluation of the Materiality Concept:** In the instant case, Y & Co., as an auditor has applied the concept of materiality for the financial statements as a whole. But they want to re-evaluate the materiality concept on the basis of additional information of import of machinery for production of new product which draws attention to a particular aspect of the company's business.

As per SA 320 “Materiality in Planning and Performing an Audit”, while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Y & Co. can re-evaluate the materiality concepts after considering the necessity of such revision.

- (d) **Using the Work of Another Auditor:** When the accounts of the branch are audited by a person other than the company’s auditor, there is need for a clear understanding of the role of such auditor and the company’s auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, “Using the Work of another Auditor”**. It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor’s purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- (1) advise the other auditor of the use that is to be made of the other auditor’s work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the

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identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and

- (2) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

Further, SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel."

In the light of aforesaid, principal auditor was not within his right for asking for such sharing of working papers. It depends upon the discretion of auditor.

Question 2

- (a) As an Auditor give your comments for the following disclosures made by a Company which adopted Ind AS for compilation of Financial Statements:
- (i) In the Balance Sheet, the sub-head inventories contained an item "goods in transit" in which a consolidated amount aggregating the cost of raw materials in transit and loose tools billed on company but delivery not made to company had been specified.
 - (ii) Provision for doubtful debts of trade debtors was grouped in, "Provisions" under current liabilities.
 - (iii) In Statement of Profit and Loss, prior period income was shown under "Other Income".
 - (iv) Sale proceeds of scrap incidental to manufacture were included in "Other Income".
 - (v) Payment towards a one time voluntary retirement scheme introduced during the year was included in "Employee Benefit Expense".
- (b) ABC Ltd., is consistently following Accounting Standards as required under section 133 of the Companies Act, 2013. During your tax audit under section 44AB of the Income Tax Act, 1961, the Board of Directors informed you that profits of the Company is properly

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arrived at and the Accounting Standards applicable to it have been followed consistently and as such, there need not be any adjustments to be made as per Income Computation and Disclosure Standards notified under section 145 of Income Tax Act, 1961. Based on the requirements of Law in this regard, examine the validity of the stand of Management in this regard.

- (c) CA. Needle had been appointed as an Auditor of M/s Fabric Ltd. In the course of audit, it had been observed that inventory including work-in-process had been valued by Management by using experts hired by them. Analyse relevant factors to decide as to whether or not to accept the findings from the work of Management expert in valuation of inventories.
- (d) M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city, had great difficulty in regularly attending to the consultancy needs of his clients who are mostly located in an industrial cluster in a nearby outskirts which is situated at a distance of 26 kms from the office of the firm. To mitigate the difficulty and to have ease of business, a facilitation centre was opened in the industrial cluster. The proprietor managed, both the office and the facilitation centre, by himself. No intimation was made to the Institute of Chartered Accountants of India. Examine whether there, is any professional misconduct in this respect. **(5 x 4 = 20 Marks)**

Answer

- (a) (i) **Goods in Transits:** As per Division II of Schedule III of the Companies Act, 2013, cost of raw material in transit shall be disclosed as sub-head of raw material and loose tools billed on the company would be shown as separate sub-head of Loose tools under heading of Inventories i.e. part of Current Asset. Thus, disclosure of consolidated amount aggregating the cost of raw material in transit and loose tools is not correct.
- (ii) **Provision for Doubtful Debts of Trade Debtors was grouped in “Provisions” under current liabilities:** The term ‘doubtful debts’ is an adjustment to the carrying amounts of assets, hence no provision is created separately for it as per Ind-AS 37 “Provisions, Contingent Liabilities and Contingent Assets”. Thus, provision should be shown net in trade receivable.
- (iii) **In Statement of Profit and Loss, Prior Period Income was shown under Other Income:** As per Ind-AS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”, Prior Period Income should not be shown in statement of profit and loss. The entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.
- (iv) **Sale Proceeds of Scrap incidental to manufacture were included in “Other Income”:** As per Ind-AS 2 “Inventories”, sale proceeds of scrap incidental to

manufacture should be deducted from the cost of the main product. Thus, disclosure of sale proceeds of scrap as other income is not correct.

- (v) **Payment towards a one time VRS during the year included in Employee Benefit Expenses:** As per Ind-AS 19 "Employee Benefits", if the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognized, the entity shall apply the requirements for short-term employee benefits, in case it is not expected to be settled before twelve months the entity shall apply the requirements for long term employee benefits. In the instant case, it should be shown as short term employee benefits in place of Employee Benefit Expenses. Thus, treatment of such payment as employee benefit expenses is not correct.

- (b) **Income Computation and Disclosure Standards (ICDS):** Section 145 of the Income Tax Act, 1961 deals with the Method of Accounting: Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

Further, **Section 145(2)** empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessee or in respect of any class of income.

Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assesses (other than an individual or a HUF who is not required to get his accounts of one previous year audited in accordance with the provisions of section 44AB), following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources". from the A.Y. 2017-18.

In the instant case, ABC Ltd. is consistently following Accounting Standards in compliance with section 133 of the Companies Act, 2013 but not complying with the provisions of Income Computation and Disclosure Standards notified under section 145 of the Income Tax Act, 1961. Contention of the management that they are following Accounting Standards and need not to make any adjustments as per ICDS, is not correct. Thus, ABC Ltd. is required to adjust the profits in compliance with ICDS.

- (c) **Evaluating the Work of Management's Expert:** As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes-
- (1) Evaluate the competence, capabilities and objectivity of that expert;
 - (2) Obtain an understanding of the work of that expert; and

- (3) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert; discussions with that expert; discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert.

Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.

The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:

- (i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
 - (ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
 - (iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.
- (d) **Maintenance of Branch Office in the Same City:** As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 Kilometres from the municipal limits of a city, in which the first office is located. Further a member having two offices of the type referred to above, shall have to declare which of the two offices is his main office, which would constitute his professional address.

In the given case, M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city and had great difficulty in regularly attending to the consultancy needs of his clients. Therefore, a facilitation centre was opened in the industrial cluster and the proprietor is managing both the office and facilitation centre. Though distance between his office and facilitation centre i.e. sort of second office is within prescribed range i.e. 50 kilometres but M& Co., will be liable for misconduct as prescribed intimation about facilitation centre and main office should be sent to the Institute of Chartered Accountants of India.

Question 3

- (a) *H Co. Ltd., is a holding company with two subsidiaries R Co. Ltd., and S Co. Ltd. The H Co. Ltd., adopts straight line method of depreciation for its assets whereas S Co. Ltd., follows written down value or diminishing value method. Though R Co. Ltd., follows straight line method of depreciation, it does not give effect to component accounting of depreciation in respect of high value assets. While consolidating the financials of the R Co. Ltd., and S Co. Ltd., with those of H Co. Ltd., determine the possible issues that you have to ensure for compliance in the light of above facts.*
- (b) *Beneathminerals Limited is a Public Sector Company engaged in extraction of minerals from land. It has to pump out water in the first layer of the soil if the minerals are to be excavated. The Company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. The cost of construction of water course amounted to ₹5.25 crores and the Company had disclosed this amount as CSR expenses in the Statement of Profit and Loss. Comment.*
- (c) *A film artist who was going abroad for long shooting, deposited a sum of ₹20 lakhs with his tax consultant Mr. G, a practising Chartered Accountant for payment of Goods and Service Tax monthly when they were due, Mr. G duly remitted all but one instalments. He utilised the amount of instalment which he did not pay, to remit his own advance income tax. However, while filing return of GST of the film artist, he duly remitted on her behalf the tax payable with interest due for late payment of GST out of money lying with him. He also bore for himself the interest due to short fall in remittance of tax of his client. Comment on the above in the light of Code of Conduct.*
- (d) *KDK Bank Ltd., received an application from a pharmaceutical company for take over of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. KDK Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.* **(5 x 4 = 20 Marks)**

Answer

- (a) **When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework is Different than that of the Parent:** A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. Thus, using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group

accounting policies with the GAAP applicable to the parent's financial statements.

It may be noted that change in the selection of the method of depreciation is an accounting estimate and not an accounting policy as per Ind-AS 8. Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods for calculation of depreciation for its assets, if their expected pattern of consumption is different. The method once selected in the stand-alone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

In the given case, assets of R Co. Ltd. (subsidiary company) is depreciated using straight line method, assets of S Co. Ltd. (subsidiary company) are depreciated using written down value method and assets of parent company (H Co. Ltd.) are depreciated using straight line method, is in order. However, each part of an item of Property Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately under Component Method of Depreciation as per AS 10 on Property, Plant and Equipment. Thus, R Co. Ltd., though adopting straight line method but does not giving effect to component accounting of depreciation in respect of high value assets, is not in compliance with Ind AS 16/ Accounting Standard 10 Property Plan and Equipment.

- (b) **Corporate Social Responsibility Expenses:** Company (Corporate Social Responsibility Policy) Rules, 2014 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

In the instant case, Beneathminerals Limited is a public sector company which is engaged in extraction of mineral from land, for that it has to pump out water in the first layer of the soil if the minerals are to be excavated. The company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. Company has disclosed the cost of construction of water course as CSR expenses in the statement of Profit and Loss, which is not correct as this expenditure incurred for the construction of water course is included in the ordinary course of activities of business.

Therefore, the treatment done by showing the cost of construction of water course as CSR expense is not correct.

- (c) **Money of Clients to be Deposited in Separate Bank Account:** Clause (10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of

professional misconduct if “he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended”.

In the instant case, CA. G received sum of rupees 20 lakh from his client who is a film artist for monthly installment payment of Goods and Service Tax. This money should have been deposited in a separate bank account. CA. G utilized the amount of last installment for his own advance tax payment, though he paid the same along with interest and bore the interest due to short fall in remittance of tax of his client.

As per fact of the case CA. G has failed to keep the sum of rupees 20 lakh received on behalf of his client in a separate Bank Account and utilized the same for his own advance tax payment amounts to professional misconduct under Clause (10) of Part I of Second Schedule.

(d) **Over-Valued Assets:** In case of due diligence exercise, the area of analysis in order to ensure that the assets are not stated at over-valued amounts are:

- Uncollected/uncollectable receivables.
- Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- Litigated assets and property.
- Investments carried at cost though realizable value is much lower.
- Investments carrying a very low rate of income / return.
- Infertuous project expenditure/deferred revenue expenditure etc.
- Group Company balances not reconciled.
- Intangibles having no reliable value.

Question 4

- (a) *Mr. B, a Chartered Accountant in practice was invited to deliver a seminar on GST which was attended by professionals as well as by representatives of various Industries. One section of audience raised a particular issue unique to the industry to which it pertains. Mr. B enthusiastically explained the issue and elaborated how he actually solved this, for his client facing the same issue with worked out examples from the computer storage device using the actual data of one of his clients with full identification of client details being displayed to the group for the sake giving clarity on a topic in a real life situation. Comment his acts in the light of Code of Conduct.*

- (b) As an Auditor of TRP Ltd., you are suspicious that there might be non-compliance with laws and regulations to which the Company is subject to. Indicate the possible areas or aspects where you may have to look out for forming an opinion as to whether your suspicion has some basis to further inquire.
- (c) You are the Auditor of Good Luck General Insurance Company. You want to ensure that there exists good system that effectively serves the requirements of true and fair accounting of claim-related expenses and liabilities. Suggest how this can be ensured.
- (d) While evaluating the risks and controls at entity level, the Auditor should take cognizance of the prevalent direct and indirect entity level controls operating in the entity. Explain what they pertain to, with few examples.
- (e) The elements of skill, experience and independence of reviewers are ensured before initiating them in Peer Review process. In the above light, state few eligibility criteria fixed for a person to be empanelled and also for being appointed as a Peer Reviewer.

(4 x 5 = 20 Marks)

Answer

- (a) **Disclosure of Information to third Party:** Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force.

SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired during his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

In the instant case, Mr. B is a Chartered Accountant in practice and he was invited to deliver a seminar on GST which was attended by professional as well as by representatives of various industries. During his session, a query was raised on particular issue and Mr. B used the actual data of one of his clients with full identification of client details displayed to explain and elaborate such query. Applying the above provision, the auditor cannot disclose the information in his possession without specific permission of the client. Thus, CA. B will be liable for professional misconduct under clause 1 of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

- (b) **Indications of Non-Compliance with Laws and Regulations:** When the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations, possible areas or aspects to look out for forming an opinion are:
- Investigations by regulatory organisations and government departments or payment

of fines or penalties.

- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- Unusual payments towards legal and retainership fees.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorised transactions or improperly recorded transactions.
- Adverse media comment.

(c) **Verifications of Claims:** The auditor should satisfy himself that the estimated liability provided for by the management is adequate with reference to the relevant claim files/dockets, keeping in view the following:

- (i) that provision has been made for all unsettled claims as at the year-end on the basis of claims lodged/communicated by the parties against the company.
- (ii) Insurance companies normally have an 'initial provision' or 'default provision' based on a pre-determined formula or on a primary assessment of the damage by a surveyor. The auditor would need to review the pre-determined formula to ensure that initial reserving made is adequate.
- (iii) that provision has been made for only such claims for which the company is legally liable.
- (iv) that the provision made is normally not in excess of the amount insured except in some categories of claims where matters may be sub-judice in legal proceedings.
- (v) that in determining the amount of provision, events after the balance sheet date have been considered.
- (vi) that the claims status reports recommended to be prepared by the Divisional Manager on large claims outstanding at the year-end have been reviewed with the contents of relevant files or dockets for determining excess/short provisions.

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- (vii) that in determining the amount of provision, the 'average clause' has been applied in case of under-insurance by parties.
- (viii) that the provision made is net of payments made 'on account' to the parties wherever such payments have been booked to claims.
- (ix) that in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability.
- (x) that wherever an unduly long time has elapsed after the filing of the claim and there has been no further communication and no litigation or arbitration dispute is involved, the reasons for carrying the provision have been ascertained.
- (xi) that wherever legal advice has been sought or the claim is under litigation, the provision is made according to the legal advisor's view.
- (xii) that in the case of amounts purely in the nature of deposits with courts or other authorities, adequate provision is made and deposits are stated separately as assets and provisions are not made net of such deposits.
- (xiii) that no contingent liability is carried in respect of any claim intimated in respect of policies issued.
- (xiv) that the claims are provided for net of estimated salvage, wherever applicable.
- (xv) that intimation of loss is received within a reasonable time and reasons for undue delay in intimation are looked into.
- (xvi) that provisions have been retained as at the year end in respect of guarantees given by company to various Courts for claims under litigation.
- (xvii) that due provision has been made in respect of claims lodged at any office of the company other than the one from where the policy was taken.

Claims Paid - The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows:

- (i) that in case of co-insurance arrangements, claims paid have been booked only in respect of company's share and the balance has been debited to other insurance companies.
- (ii) that in case of claims paid on the basis of advices from other insurance companies (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company.
- (iii) that the claims payments have been duly sanctioned by the authority concerned and the payments of the amounts are duly acknowledged by the claimants.

- (iv) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure.
 - (v) that the amounts of the nature of pure advances/deposits with Courts, etc., in matters under litigation/arbitration have not been treated as claims paid but are held as assets till final disposal of such claims.
 - (vi) that payment made against claims partially settled have been duly vouched.
 - (vii) that in case of final settlement of claims, the claimant has given an unqualified discharge note, not involving the company in any further liability in respect of the claim; and
 - (viii) that the figures of claims, wherever communicated for the year by the Division to the Head Office for purposes of reinsurance claims, have been reconciled with the trial balance-figure.
 - (ix) that payments have been made within 30 days of the receipt of the last document received.
- (d) **Entity Level Risks and Controls:** There are direct entity level controls and indirect entity level controls.
- (i) **Direct ELCs** operate at a level higher than business activity or transaction level such as a business process or sub-process level, account balance level, at a sufficient level of precision, to prevent, detect or correct a misstatement in a timely manner.
Examples include:
 - Business performance reviews;
 - Monitoring of effectiveness of controls activities by Internal Audit function;
 - (ii) **Indirect ELCs** do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements. However, they contribute indirectly to the effective operation of direct ELC and other control activities.
Examples include:
 - Company code of conduct and ethics policies;
 - Human resource policies;
 - Employee job roles & responsibilities.
- (e) **Eligibility to be a Reviewer :**
- (i) A Peer Reviewer shall: -
 - (a) Be a member with at least 10 years of experience in practice.

- (b) Is in Practice as per the Chartered Accountants Act, 1949.
 - (c) Should have undergone the requisite training as prescribed by the Board.
 - (d) Should furnish a declaration as prescribed by the Board, at the time of acceptance of Peer Review appointment.
 - (e) Should have signed the Declaration of Confidentiality as prescribed by the Board.
 - (f) Should have conducted audit of Level I Entities for at least 7 years to be eligible for conducting Peer Review of Level I Entities as referred to in Para II of this Statement.
- (ii) For being a Reviewer a member should not have: -
- (a) Disciplinary action / proceedings pending against him
 - (b) been found guilty by the Council or the Disciplinary Board or Committee at any time.
 - (c) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with transportation or imprisonment.
 - (d) any Obligation or conflict of interest in the Practice Unit or its Partners / Personnel.
- (iii) A Reviewer shall not accept any professional assignment from the Practice Unit for a period two years from the date of appointment.

Question 5

- (a) *Mr. Dice, a practising Chartered Accountant was ordered to surrender his Certificate of Practice and he was suspended for one year on certain professional misconduct against him. During the period of suspension, Mr. Dice, designating himself as GST Consultant, did the work of filing GST returns and made appearance as a consultant before various related authorities. He contended that there is nothing wrong in it as he, like any other GST consultant, could take such work and his engagement as such in no way violates the order of suspension inflicted on him. Is he right in his contention?*
- (b) *The Auditor of M/s Quick Limited succumbed to the pressure of the management in certifying the financials with an over stated figure of turnover by not adhering to the cut-off principles of the time scale for the transactions of the year. On taking cognizance of this act of the auditor, the Tribunal under the Companies Act, 2013 initiated the proceedings against him. Briefly list the powers of the Tribunal in this respect including those relating to making orders against the Auditor found to be guilty.*
- (c) *M/s All-in-One Limited is a large-sized listed Indian Company with focus on design and delivery of custom made Information Technology applications for various business entities in India and abroad. The Management wants to know whether they are required to*

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constitute Risk Management Committee as per LODR, 2015 and if so, required, what should be its composition? Advise.

- (d) In the course of audit of Skip Bank Ltd., you found that the Bank had sold certain of its non-performing assets. Draft the points of audit check that are very relevant to this area of checking.
- (e) Neverpermit Limited refuses to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that at least outstanding above a threshold limit needs to be confirmed and reconciliation is to be carried out before finalising the audit. If the Company does not relent, how will you respond? **(4 x 5 = 20 Marks)**

Answer

- (a) **Filing of GST Returns and Appearance as GST Consultant:** A chartered accountant not holding certificate of practice cannot take up any other work in the capacity of Chartered Accountant in practice because it would amount to violation of the relevant provisions of the Chartered Accountants Act, 1949.

In case a member is suspended and is not holding Certificate of Practice, he cannot in any other capacity take up any practice separable from his capacity to practices as a member of the Institute. This is because once a member becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations.

In case he files GST returns and appears as a consultant before various related authorities in his capacity as a chartered accountant and a member of the Institute, having bound himself by the said Act and its Regulations made thereunder, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity. But if he is doing so in any other capacity such as GST Consultant wherein his capacity is not chartered accountant in practice, he will not be held guilty for misconduct.

In the instant case, Mr. Dice was a practicing chartered accountant and he was ordered to surrender his certificate of practice and was suspended for one year. Mr. Dice is doing the work of filing GST returns and has appeared as a consultant before various related authorities as GST Consultant which is not in capacity of a practicing chartered accountant rather in capacity of authorized representative. Any person who has been authorized to act as a GST Practitioner on behalf of the concerned registered person can become authorized representative. Thus, filing GST return and appearing as GST Consultant by Mr. Dice is not professional misconduct. Therefore, Mr. Dice will not be held guilty for misconduct.

- (b) **Power of Tribunal in case Auditor acted in a Fraudulent Manner:** As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is

satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

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

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

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

- (c) **Constitution of Risk Management Committee:** As per regulation 21 of LODR 2015, provision relating to constitution of risk management committee is applicable to top 100 listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year. In the instant case, All-in-One Limited, is a large sized listed Indian Company with focus on design and delivery of custom made IT applications for various business entities in India and abroad. As per fact of the case it is a large sized listed Indian company, assuming that it is included in top 100 listed entities, All – in – One Limited is required to constitute risk management committee.

Composition of Risk Management Committee:

- (i) The Board of Directors shall constitute a Risk Management Committee.
- (ii) The majority of members of Risk Management Committee shall consist of members of the Board of Directors.
- (iii) The Chairperson of the Risk Management Committee shall be a member of the Board of Directors and senior executives of the listed entity may be members of the committee.
- (iv) The Board of Directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. A majority of this Committee will be the members of the Board of Directors. Senior executives of the company may be

also be members of the Committee, but the Chairperson of the Committee shall be a member of the Board of Directors.

(d) Sale of Non-Performing Assets: In case of Sale of NPA by Bank, the auditor should examine :

- the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers.
- that only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- the assets have been sold/ purchased “without recourse” only.
- subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- the NPA has been sold at cash basis only.
- the bank has not purchased an NPA which it had originally sold.
- that on the sale of the NPA, the same has been removed from the books of the account.
- that the short fall in the net book value has been charged to the profit and loss account.
- that where the sale is for a value higher than the NBV, no profit is recognised and the excess provision has not been reversed but retained to meet the shortfall/ loss because sale of other non-performing financial assets.

(e) SA 505 “External Confirmations”, establishes standards on the auditor’s use of external confirmation as a means of obtaining audit evidence. If the management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (i) Inquire as to Management’s reasons for the refusal, and seek audit evidence as to their validity and reasonableness,
- (ii) Evaluate the implications of management’s refusal on the auditor’s assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and
- (iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management’s refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those in charge of governance in accordance with SA 260 “Communication with Those Charged with Governance” and also determine its implication for the audit and his opinion in accordance with SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”.

A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Question 6

- (a) Explain how a Forensic Audit differs from an Assurance Engagement.
- (b) Tee & Co., a firm of Chartered Accountants had been appointed by C & AG to conduct statutory audit of M/s Rare Airlines Limited, a Public Sector Company. They would like to check certain mandatory propriety points as required under section 143(1) of the Companies Act, 2013. List the areas of check to meet these requirements.
- (c) Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.
- (d) Distinguish
 - (i) Self-interest threat from self-review threat in an Assurance Engagement.

OR

- (ii) Reasonable Assurance Engagement from Limited Assurance Engagement.
- (e) The Operational Audit is carried out effectively when the Operational Auditor responds with positive traits in a scenario which is blended with behavioural issues. Explain few positive traits that help to conclude an Operational Audit, a success. **(4 x 5 = 20 Marks)**

Answer

(a) Difference between Forensic Audit and Assurance Engagement:

| Sr. No. | Particulars | Assurance Engagement | Forensic Audit |
|---------|-------------|--|---|
| 1. | Objectives | Express an opinion as to 'True & Fair presentation | Whether fraud has taken place in books |
| 2. | Techniques | Substantive & Compliance. Sample based | Investigative, substantive or in depth checking |
| 3. | Period | Normally for a particulars accounting period. | No such limitations |

| | | | |
|----|--|---|--|
| 4. | Verification of stock, Estimation realisable value of assets, provisions, liability etc. | Relies on the management certificate/Management Representation | Independent / verification of suspected/selected items where misappropriation in suspected |
| 5. | Off balance sheet items (like contracts etc.) | Used to vouch the arithmetic accuracy & compliance with procedures. | Regulatory & propriety of these transactions/contracts are examined. |
| 6. | Adverse findings if any | Negative opinion or qualified opinion expressed with/without quantification | Legal determination of fraud impact and identification of perpetrators depending on scope. |

(b) **Mandatory Propriety Points under section 143 (1) of the Companies Act, 2013:** The requirement of the provisions of section 143(1) is essentially propriety-oriented as much as some specific dubious practices are required to be looked into by the auditor. Areas of propriety audit under the provisions of Section 143(1) may be following:

- (i) **Whether the terms on which secured loans and secured advances have been made are prejudicial to the interests of the company or its members”:** It may be appreciated that the terms of loans include such matters as security, interest, repayment period and other business considerations. The auditor has to inquire whether the terms are such that they can be adjudged as prejudicial to the legitimate interest of the company or of its shareholders. This is a process of judging a situation by reference to certain objective standards or reasonableness whether the terms entered into are prejudicial or not, not only to the company but also to the shareholders.
- (ii) **Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company:** This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards. It is also possible that some transactions may not adversely affect the interests of the company. The auditor has to judiciously consider what does and does not constitute the interest of the company.
- (iii) **Whether investment of companies, other than a banking or an investment company, in the form of shares, debentures and other securities have been sold at a price lower than the cost:** Apparently, this is a matter of verification by the auditor. The intention, however, is not known whether loss has occurred due to the sale. The auditor is required to inquire into circumstances of sale of investments that resulted in loss. Obviously, the duty cast on him is propriety based, i.e., reasonableness of the decision to sell at a loss. It involves exercise of judgment

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having regard to the circumstances in which the company was placed at the time of making the sale.

- (iv) **Whether loans and advances made by the company have been shown as deposits. Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made:**
 - (v) **Whether personal expenses have been charged to revenue:** It is an accepted principle that expenses which are not business expenses should not be charged to revenue. The effect of charging personal expenses to the business is to distort the profitability of the company and to secure a personal gain at the cost of the company. Obviously, propriety is involved in this; charging personal expenses to business account is highly improper and abusive hence this provision.
 - (vi) **In case it is stated in the books and papers of the company that shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash actually received, whether the position in books of account and balance sheet so stated is correct, regular and not misleading:** A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.
- (c) **Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance:** SA 610 'Using the work of Internal Auditor' Deals about the concept of direct assistance of internal auditor. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:
- (1) The amount of judgment involved in:
 - (i) Planning and performing relevant audit procedures; and
 - (ii) Evaluating the audit evidence gathered;
 - (2) The assessed risk of material misstatement; and
 - (3) The external auditor's evaluation of the existence and significance of threats to the objectivity and level of competence of the internal auditors who will be providing such assistance.

If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.

The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and

relationships that may create a threat to their objectivity.

(d) (i) **Self Interest Threat and Self Review Threat in an Assurance Engagement**

Self Interest Threat: Self-interest threats, which may occur as a result of the financial or other interests of a professional accountant or of a relative:

Circumstances that may create self-interest threats

- A financial interest in a client or jointly holding a financial interest with a client.
- Undue dependence on total fees from a client.
- Having a close business relationship with a client.
- Concern about the possibility of losing a client.
- Potential employment with a client.
- Contingent fees relating to an assurance engagement.

Self-Review Threat: Self-review threats, which may occur when a previous judgment needs to be re- evaluated by the professional accountant responsible for that judgment;

Examples of circumstances that may create self-review threats

1. The discovery of a **significant error during a re-evaluation** of the work of the professional accountant in public practice.
2. Reporting on the **operation of financial systems** after being involved in their design or implementation.
3. Having prepared the **original data** used to generate records that are the subject matter of the engagement.
4. A member of the **assurance team** being, or having recently been, a **director or officer** of that client.
5. A member of the assurance team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement.
6. Performing a service for a client that **directly affects** the subject matter of the assurance engagement.

OR

(ii) **Reasonable Assurance Engagement and Limited Assurance Engagement :**

| | Limited Assurance | Reasonable Assurance |
|---|---|--|
| 1 | The practitioner should designing and perform procedures to address the subject matter and to | The practitioner should designing and perform procedures to address the subject matter and to obtain limited |

| | | |
|----|---|---|
| | obtain limited assurance to support and to obtain limited assurance to support the practitioner's conclusion. | assurance to support and obtain limited assurance to support the practitioner's conclusion. |
| 2 | In obtaining an understanding of the underlying subject matter and other engagement circumstances, the practitioner should consider the process used to prepare the subject matter information. | In obtaining an understanding of the underlying subject matter and other engagement circumstances, the practitioner should obtain an understanding of internal control over the preparation of the subject matter information relevant to the engagement. |
| 3. | <p>Based on the practitioner's understanding, the practitioner should:</p> <p>(a) Identify areas where a material misstatement of the subject matter information is likely to arise;</p> <p>(b) Design and perform procedures to address the areas and to obtain limited assurance to support the practitioner's conclusion.</p> | <p>Based on the practitioner's understanding the practitioner should:</p> <p>(a) Identify and assess the risks of material misstatement in the subject matter information; and</p> <p>(b) Design and perform procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's opinion.</p> |

(e) **Positive Traits that help to conclude an Operation Audit A success:** The operational auditor should possess some very essential personal qualities to be effective in his work:

In areas beyond accounting and finance, his knowledge ordinarily would be rather scanty and this is a reason which should make him even more inquisitive.

He should ask the who, why, how of everything. He should try to visualise whether simpler alternative means are available to do a particular work.

He should try to see everything as to whether that properly fits in the business frame and organisational policy. He should be persistent and should possess an attitude of scepticism.

He should not give up or feel satisfied easily. He should imbibe a constructive approach rather than a fault-finding approach and should give a feeling that his efforts are to help attaining an improved operation and not merely fault finding.

If the auditor succeeds in giving a feeling of help and assistance through constructive criticism, he will be able to obtain co-operation of the persons who are involved in the operations. This will itself be a tremendous achievement of the operational auditor. He should try to develop a team comprised of people of different backgrounds. Involvement of technical people in operational auditing is generally helpful.

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