PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

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

*Answer any **four** out of remaining five*

Question 1

(a) *AP & Associates, Chartered Accountants, are Statutory Auditors of XP Limited for the last four years. XP Limited is engaged in the manufacture and marketing of FMCG Goods in India. During 2021-22, the Company has diversified and commenced providing software solutions in the area of "e-commerce" in India as well as in certain European countries. AP & Associates, while carrying out the audit for the current financial year, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise and infrastructure to carry out the audit of this diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.* ***(5 Marks)***

(b) *During the audit of Star Ltd. a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of ₹ 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation.* ***(5 Marks)***

(c) *TP Ltd. a government company engaged in providing tourism services, has failed to get its accounts audited by Statutory Auditor for the financial year 2021-22. You have been appointed as Tax Auditor for the same period and management provided the unaudited financial statements which have been adopted in the Annual General Meeting. Subsequently, the Statutory Auditor while auditing observed that there is a material misstatement in providing depreciation on fixed assets due to which financial statements have been revised. Now the company is requesting you to revise the tax audit report. You are required to state whether Tax Audit Report can be revised and if so, under what circumstances?* ***(4 Marks)***

Answer

(a) Acceptance and Continuance of Client Relationships and Specific Engagements: As per SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

In the given case, AP & Associates, Chartered Accountants, statutory auditors of XP Limited for the last four years, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise for the same, therefore, AP & Associates wish to withdraw from the engagement and client relationship. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship **address issues that include the following:**

- Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
- Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- Documenting significant issues, consultations, conclusions and the basis for the conclusions.

AP & Associates should address the above issues before deciding to withdraw.

(b) **External Confirmation:** As per SA 505, "External Confirmation", negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.

Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 20 lakh has not sent the confirmation on the credit balance. In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non-response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

(c) **Revision of Tax Audit Report:** The CBDT has, vide this notification, amended Rule 6G to provide that the audit report furnished may be revised by the person by getting revised report of audit from a chartered accountant, duly signed and verified by such chartered accountant, if there is payment by such person after furnishing of report which necessitates recalculation of disallowance under section 40 or section 43B. The said revised audit report has to be furnished before the end of the relevant assessment year for which the report pertains.

Further, when the accounts are revised in the following circumstances, the tax auditor may have to revise his tax audit report also.

(i) Revision of accounts of a company after its adoption in the annual general meeting.

(ii) Change in law with retrospective effect.

(iii) 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.

In the given case of TP Ltd., a government company failed to get its accounts audited by statutory auditor therefore, unaudited financial statements were provided for tax audit by the management which have been adopted in AGM. However, it was observed during statutory audit that there was a material misstatement in providing depreciation on fixed assets, accordingly, financial statements have been revised.

In view of above, tax auditor is required to revise his tax audit report as it is revision of accounts of a company after its adoption in the annual general meeting.

Question 2

(a) *CA. B was appointed as the auditor of SRT Limited for the financial year 2021-22. During the course of planning for the audit, CA. B intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to the factors that may affect the identification of an appropriate benchmark for this purpose.*

What benchmark should be adopted by CA. B, if SRT Limited is engaged in:

(i) *the manufacture and sale of air conditioners and is having regular profits.*

(ii) *the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic.* ***(5 Marks)***

(b) *ABC Limited holds 51% equity of BBB Limited, 63% equity of TTT Limited. There are different information and explanations which are disclosed by the respective companies in the notes to their financial statements. At the time of consolidation, management of ABC*

Limited has consolidated all the information and explanations disclosed in the notes as well. The principal auditor is of the view that only those information and explanations should form part of the notes to the consolidated financial statements which are relevant at group level. Please mention any five aspects which are given in the notes to the separate financial statements of the parent and the subsidiaries, need not be included in the consolidated financial statements. ***(5 Marks)***

(c) *You have been requested to carry out a forensic audit of a listed entity by the Board of Directors, based on a whistle blower complaint received. Before the commencement of the forensic audit, you and your team, are discussing the various aspects relating to the scope and the procedures to be carried out. What would be the items of discussion with respect to the differences between forensic audit and other audit?* ***(4 Marks)***

Answer

(a) Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole: As per SA 320, determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

In case if SRT Limited is engaged in manufacture and sale of air conditioner, and is having regular profits: CA. B, the auditor may consider profit before tax /Earnings.

In case if SRT Limited is engaged in the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic: CA. B, the auditor may consider Revenue or Gross Profit as benchmarking. Alternatively, CA B, the auditor may consider the criteria relevant for audit of the entities doing public utility programs/ projects, Total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for that particular program/project activity. Where an entity has custody of the assets, assets may be an appropriate benchmark.

(b) The Ind AS 110 does not give a list of information which is part of the separate financial statement of the components but that need not be reported in the notes and other explanatory material of the consolidated financial statements, however, based on section 129(4) and circular issued by MCA, it can be construed that, even in consolidated financial statements under Ind AS, only those disclosures should be given which are relevant to consolidated financial statements.

Based on the above discussion, in case of companies, the information such as the following given in the notes to the separate financial statements of the parent and/or the subsidiary, need not be included in the consolidated financial statements.

(i) Source from which bonus shares are issued, e.g., capitalization of profits or reserves or from securities premium account.

(ii) Disclosure of all unutilized monies out of the issue indicating the form in which such unutilized funds have been invested.

(iii) Disclosure required under Micro, Small and Medium Enterprises Development Act, 2006.

(iv) A statement of investments (whether shown under "financial assets or non-financial assets as stock-in-trade) separately classifying trade investments and other investments, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate.

(v) Value of imports calculated on C.I.F. basis by the company during the financial year in respect of:

(a) raw materials;

(b) components and spare parts;

(c) capital goods.

(vi) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters.

(vii) Value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.

(viii) The amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.

(ix) Earnings in foreign exchange classified under the following heads, namely:

(a) export of goods calculated on F.O.B. basis;

(b) royalty, know-how, professional and consultation fees;

(c) interest and dividend;

(d) other income, indicating the nature thereof.

(c) Difference between forensic audit and other audit is as under:

Sr. No.	Particulars	Other Audits	Forensic Audit
1.	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually 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 realizable 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.

Question 3

(a) ABC Ltd. is engaged in the business of trading and manufacturing of readymade garments. The company has large balances of accounts receivables as on March 31, 2022, which has been assessed as the area of high risk in the audit planning stage. For the year ended March 31, 2022, in respect of the valuation of accounts receivables, the Statutory Auditor

has assigned the checking of the accuracy of the ageing of the accounts receivables and provision made towards doubtful receivables, to the internal auditor. Please advise the statutory auditor, the areas in which direct assistance from internal auditor cannot be taken. Also, comment in this scenario, whether statutory auditor can take internal auditor's assistance. ***(5 Marks)***

(b) CA. M is commencing the Statutory Audit of a limited company, which is engaged in trading software products and providing software solutions. CA. M was evaluating the controls environment and noted that the established internal controls are functioning in an automated environment. Enumerate any five focal points for the consideration of CA. M, when auditing in the automated environment, with respect to his audit approach during planning, execution and completion phases. ***(5 Marks)***

(c) Mt. P, a Chartered Accountant did not maintain books of account for his professional work on the ground that his income is assessed under Section 44ADA of the Income Tax Act, 1961. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. ***(4 Marks)***

Answer

(a) Direct Assistance from Internal Auditor: As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

(i) Involve making significant judgments in the audit;

(ii) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;

(iii) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or

(iv) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

Therefore, the amount of judgment involved, and the risk of material misstatement are also relevant in determining the work that may be assigned to internal auditors providing direct assistance.

In the given situation of ABC Ltd., in circumstances where the valuation of accounts receivable is assessed as an area of higher risk, the external auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance.

However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

(b) In a controls-based audit in an automated environment, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

Planning Phase:

- during risk assessment, the auditor should consider risk arising from the use of IT systems at the company;
- when obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered;

Execution Phase:

- while assessing the entity level controls the aspects related to IT governance need to be understood and reviewed;
- pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed;
- during testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
- when testing of reports and information produced by the entity (IPE) generated through IT systems and applications;

Completion Phase:

- at completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

(c) **Maintenance of Books of Account:** As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct.

Accordingly, it does not matter whether section 44ADA of the Income Tax Act, 1961 applies or not.

Conclusion: Hence, Mr. P is guilty of professional misconduct.

Question 4

(a) You have been appointed as an Auditor of LOC Bank, a nationalized bank. LOC Bank also deals in providing credit card facilities to its account holders. The bank is aware of the fact that there should be strict control over the storage and issuance of credit cards. How will you evaluate the internal control system in the area of credit card operations of the Bank?

(5 Marks)

(b) *The professional accountants need to observe certain fundamental principles, which are covered in the Code of Ethics of the Institute of Chartered Accountants of India. Briefly explain each of the five principles which needs to be complied by the Chartered Accountants?* ***(5 Marks)***

(c) *While evaluating the risks and control at the entity level, the Auditor should take cognizance of the prevalent direct and indirect entity level control operating in the entity. Explain, what are such controls with few examples.* ***(4 Marks)***

Answer

(a) Credit Card Operations System of Internal Control in Banks: The auditor should evaluate the internal control in the area of credit card operations of LOC Bank as under:

- There should be effective screening of applications with reasonably good credit assessments.
- There should be strict control over storage and issue of cards.
- There should be a system whereby a merchant confirms the status of unutilized limit of a credit-card holder from the bank before accepting the settlement, in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.
- All the reimbursement (gross of commission) should be immediately charged to the customer's account.
- There should be a system to ensure that statements are sent regularly and promptly to the customer.
- There should be a system to monitor and follow-up customers' payments.
- Payments overdue beyond a reasonable period should be identified and attended to carefully. For defaulting customers, credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

(b) Fundamental Principles: In order to achieve the objectives of the Accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles. The fundamental principles as discussed in Code of Ethics of ICAI, to be complied, are given below:

(i) Integrity – A professional accountant shall comply with the principle of integrity, **which requires an accountant to be straightforward and honest** in all professional and business relationships. Integrity implies fair dealing and truthfulness.

(ii) Objectivity – A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

(iii) Professional Competence and Due Care – A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:

(a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and

(b) act diligently in accordance with applicable technical and professional standards.

(iv) Confidentiality – A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships.

(v) Professional Behaviour – A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that accountant knows or should know might discredit the profession.

Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

(c) Entity Level 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.

Question 5

(a) CA. Uma is the Statutory Auditor of RJ Ltd. for the financial year 2021-22. The company is engaged in the production of electronic products. During the course of audit, CA. Uma obtained certain audit evidence of incorrect disclosure of related party transactions and structured finance deals which was not considered with the affirmation leading to misstatement in the financial statements. Discuss how CA Uma should deal with the situation in the auditor's report and the different options which can be considered?

(5 Marks)

(b) You are appointed as the Auditor of XMP Pvt. Ltd. for financial year 2021-22 after the resignation of RS & Co. Chartered Accountants, as statutory auditor of the company. RS & Co., had certain concerns on the accounting matters of the company, leading to change of auditors. All the compliances under Sections 139 and 140 are made by the company with regard to resignation and appointment.

During the course of audit, it came to your notice that a survey has been conducted on December 7, 2021 by the Income Tax Department and department has unearthed unrecorded sales of ₹ 5 lakhs which had been made in cash on different dates during the year 2020-21. XMP Pvt. Ltd. has purchased gold from such collections and these transactions are not recorded. Company surrendered and disclosed these transactions before the assessing officer and paid taxes thereon. However, company has not recorded those transactions in books of account even after surrender before Income Tax authorities.

You want to report the above matters in CARO, but the management requested you not to report them. Comment with respect to auditor's response to the management and his reporting requirements to the shareholders. ***(5 Marks)***

(c) NR Ltd., a leading manufacturer of kids garments has decided to acquire TP Ltd. TP Ltd. is currently engaged in the manufacture of ladies garments. NR Ltd, entrusted you to carry out the due diligence and value TP Ltd. The valuation of TP Ltd. is dependent on future maintainable sales of the company. Discuss the factors that you would consider in assessing the future maintainable sales of TP Ltd. ***(4 Marks)***

Answer

(a) Auditor's duties in case of inconsistency in Audit evidence: SA 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

The decision regarding which type of modified opinion is appropriate depends upon:

(a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and

(b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Further, the auditor shall modify the opinion in the auditor's report when the auditor concludes that based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement:

In the present case, during the course of the audit, CA Uma obtained certain audit evidence which was not consistent with the affirmation made in financial statements. Therefore CA Uma should modify his report in accordance with SA 705.

Conclusion:

Since CA Uma has obtained audit evidence which is inconsistent with the affirmations made in the financial statements. CA Uma should modify his opinion as per the circumstances of the case.

- CA Uma shall express Qualified opinion when, having obtained sufficient appropriate audit evidence, he concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements.
- CA Uma shall express an Adverse opinion, where the auditor, having obtained sufficient appropriate evidence, concludes that misstatements, individually, or in the aggregate, are both material and pervasive to the financial statements.

(b) Clause (xviii) of Paragraph 3 of CARO, 2020:

In the given situation of XMP Pvt Ltd, the auditors RS & Co. resigned due to concerns on the accounting matters of the company. However, all the compliances regarding resignation and appointments discussed in section 139 and 140 of the Companies Act, 2013 are also being complied with. The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020 given hereunder:

Clause (xviii) of Paragraph 3 of CARO, 2020 requires the auditor to report whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

Clause (viii) of Paragraph 3 of CARO, 2020:

Further, the auditors noticed that a survey was conducted by the Income Tax Department and unrecorded sales of Rs 5 Lakhs were unearthed which had been made in cash on different dates during the year. XMP Pvt Ltd. has also purchased gold and the transactions remained unrecorded. Though Company surrendered and disclosed these transactions before the Assessing Officer and paid taxes thereon. The auditor would be required to report in CARO as per Clause (viii) of Paragraph 3 of CARO, 2020.

Clause (viii) of Paragraph 3 of CARO, 2020 requires the auditor to report -whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.

Since it is a statutory obligation on the part of the auditor to report in terms of CARO, 2020 as given above and consequently management's request to the auditor that not to report the above transactions is not tenable.

(c) In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

(i) **Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.

(ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.

(iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?

(iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

Question 6

(a) What is a Core Investment Company (CIC) under the Reserve Bank of India regulations? What are the specific reporting requirements to be considered by an auditor in respect of CIC under CARO 2020? ***(5 Marks)***

(b) AB & Co., Chartered Accountants, is a large firm based in Mumbai. AB & Co. is subject to peer review. For the peer review of the financial year ended March 31, 2021 the firm got an intimation on June 30, 2021. X & Co., Chartered Accountants, were appointed to undertake the peer review process. Upon completion of the peer review, X & Co., observed certain non-compliance with auditing standards. X & Co., did not share any of observations

with AB & Co. and submitted its final report to the Peer Review Board of the Institute of Chartered Accountants. Comment. ***(5 Marks)***

(c) CA. Raj is the auditor of a multiplex cinema house. He has observed during the course of the audit, that the existing venue has undergone renovation. The auditorium was split into smaller ones and additional auditoriums were constructed. CA. Raj, who finalised the audit plan and audit programme wanted to reconsider the same during the course of the audit. Discuss a few circumstances where the audit programme would have to be suitably altered by the auditor.

OR

Mr. X is a practising Chartered Accountant. Mr. Y is a practising advocate representing matters in the court of law. X and Y decided to help each other in matters involving their professional expertise. Accordingly, Mr. X recommends Mr. Y in all litigation matters in the court of law and Y consults X in all matters relating to finance and other related matters, which come to him in arguing various cases, consequently, they started sharing profits of their professional work. Is Mr. X liable for professional misconduct? ***(4 Marks)***

Answer

(a) Core Investment Companies: As per RBI Master Direction – Core Investment Companies (Reserve Bank) Directions, 2016, (Reference may be made to aforesaid Master Direction), these directions shall apply to every Core Investment Company (CIC), that is to say, a non-banking financial company carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited balance sheet:-

(i) it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

(ii) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trust only as sponsor constitute not less than 60% of its net assets as mentioned in clause (i) above;

Provided; that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.

(iii) it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

(iv) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the Reserve Bank of India Act, 1934 except

a. investment in
   (i) bank deposits,
   (ii) money market instruments, including money market mutual funds and liquid mutual funds
   (iii) government securities, and
   (iv) bonds or debentures issued by group companies,

b. granting of loans to group companies and

c. Issuing guarantees on behalf of group companies.

As per CARO 2020, the auditor is required to report that –

(i) Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria; [Paragraph 3(xvi) (c)]

(ii) Whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group; [Paragraph 3(xvi) (d)]

(b) (i) After completing the on-site Review, the Peer Reviewer, before making his Report to the Board, shall communicate his findings in the Preliminary Report to the Practice Unit if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification.

(ii) The Practice Unit shall within 5 days after the date of receipt of the findings, make any submissions or representations, in writing to the Reviewer. (i.e. Response to the Preliminary Report).

(iii) At the end of an on-site Review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

(iv) In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings (i.e. Preliminary Report), response by the Practice Unit (Response to Preliminary Report) and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

(v) In case of a modified report, The Board shall order for a “Follow On” Review after a period of one year from the date of issue of report as mentioned above. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report.

Conclusion: In the instant case, in view of X & Co. Peer Reviewer, systems and procedures in AB & Co. are deficient; therefore, Peer Reviewer should not submit the report directly to the Board.

Alternative Answer:

Eligibility to be a Reviewer: As per Peer Review Statement,

1. A Peer Reviewer shall: -
   (a) Shall be a member in practice with at least 7 years of audit experience.
   (b) In case a member has moved from industry to practice and is currently in practice he should have at least 10 years of audit experience in industry and at least 3 years audit experience in practice.
   (c) Should have undergone the requisite training and cleared the requisite test for Peer Review as prescribed by the Board.
2. A member on being appointed as a Reviewer shall be required to furnish-
   (a) a declaration as prescribed by the Board, at the time of Empanelment as a Peer Reviewer.
   (b) a Declaration of Confidentiality as per Annexure A to this Statement while giving consent for appointment as a Peer Reviewer.
3. A member shall not be eligible for being appointed as a Reviewer of a Practice Unit, if -
   (i) any disciplinary action / proceeding is pending against him;
   (ii) he has been found guilty of professional or other misconduct by the Council or the Board of Discipline or the Disciplinary Committee at any time
   (iii) he has been convicted by a competent court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment,
   (iv) he or his partners have any obligation or conflict of interest in the Practice Unit.
   (v) He has undergone training/articleship under any of the partner of Practice Unit.
4. A Reviewer shall not accept any professional assignment from the Practice Unit for a period of next two years from the date of appointment. Further, he should not have accepted any professional assignment from the Practice Unit for a period of two years before the date of appointment as reviewer of that Practice Unit.

In the current scenario, X & Co., Chartered Accountants, were appointed to undertake the peer review process. X & Co. is a firm not an individual member a. Hence, as per the above eligibility criteria, only an individual can be appointed as a peer reviewer and not a firm. Therefore, appointment of X & Co. as Peer Reviewer is not in order.

(c) In the given case of multiplex cinema house, CA Raj observed that existing venue undergone renovation, being split into smaller ones and additional auditoriums were constructed. Since CA Raj developed the audit program keeping in view a multiplex cinema house but during the audit, circumstances have changed significantly and hence CA Raj should suitably alter the audit program.

Given below are a few circumstances where in the audit programme would have to be suitably altered:

(1) If the audit procedures were designed for a certain volume of turnover and subsequently the volume have substantially increased. Also, when there have been significant changes in the accounting organisation, procedures and personnel subsequent to the audit procedures.

(2) Where during the course of an audit, it has been discovered that internal control procedures were not as effective as assumed at the time the audit programme was framed.

(3) Where there has been an extraordinary increase in the amount of book debts or that in the value of stocks as compared to that in the previous year.

(4) When a suspicion has aroused during the course of audit or information has been received that assets of the company have been misappropriated.

It may be noted that the audit plan and related programme should be reconsidered as the audit progresses. Such re-consideration is based on the auditor's review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures.

Or

(c) According to Clause (2) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Furthermore, Clause (3) of Part I of the First Schedule to the said Act states that a

Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute.

However, a practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as prescribed by the Council under Regulation 53-A of the Chartered Accountants Regulations, 1988. Under the said regulation, the member of "Bar Council of India" (Advocate) is included.

Therefore, Mr. Y, a practicing advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Mr. X. Hence, Mr. X, a practicing Chartered Accountant, will not be held guilty under any of the above-mentioned clauses for paying and accepting part of profits to/from Mr. Y.