PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

In Chapter 9 of the Printed Copy, the topic at Page number 10 - "Shares issued at a discount" is revised and being given hereunder. Students are advised to study this topic from here and not from printed copy of the study material.

Shares issued at a discount

According to Section 53 of the Companies Act, 2013,

(1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.

(2) any share issued by a company at a discounted price shall be void.

(2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

(3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

(i) the movement in share capital during the year and wherever there is any issue,

(ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.

(iii) Further, auditor should also verify that whether the company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

This topic has also been revised at page no. 10 of chapter 9 and students can refer at the link given below:

https://resource.cdn.icai.org/66605bos53774-cp9.pdf

PART – II: QUESTIONS AND ANSWERS

PART – II A: Multiple Choice Questions based on Case Scenarios

Case Scenario - 1

SaveLives Limited is a listed Company which deals in the manufacture of Sanitizers, floor cleaners, dish and fabric cleaners etc. In spite of spread of covid 19 in the country, the company's sales have been very high in the last financial year due to essential products it deals in. The Company is highly automated and is driven by IT systems and applications that are used in the preparation of the financial statements of the Company. The Company uses an integrated enterprise resource planning system since last five years.

KRAN & Associates has been appointed to conduct the statutory audit of the Company. The firm consists of eight partners, and CA N has been appointed as engagement partner for the audit of SaveLives Limited.

CA N briefed the team about the audit and also how IT would be relevant to the audit of SaveLives Limited. The team obtained an understanding of the entity and its automated environment which involved an understanding of how the IT department was organised, IT activities, IT dependence and the relevant risks and controls.

One of the team members wanted to understand the importance of different types of controls in an automated environment viz., General IT Controls, Application Controls and IT- Dependent Controls. Same was discussed in detail along with the relationship between different controls.

The Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls for a company. So, CA N decided to himself evaluate and validate the design and operating effectiveness of Internal Financial Controls over Financial Reporting (IFC-FR) of the company as at the Balance Sheet date. Internal Financial Controls (IFC) refers to the policies and procedures put in place by SaveLives Limited for ensuring adequacy and also the operating effectiveness of such controls.

The audit team decided to use the tools and techniques that auditors use in applying the principles of data analytics which are known as CAATs. Data analytics could also be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform various functions.

1.1 Under which situation is IT not relevant to an audit?

(a) Increased complexity of transactions

(b) Hi-tech nature of business

(c) Volume of transactions is low

(d) Company Policy (Compliance).

1.2 Which of the following is a risk that arises from the use of IT systems?

(a) Direct data changes (backend changes).

(b) Limited/Monitored access.

(c) Adequate segregation of duties.

(d) Authorized access to data.

1.3 The relationship between two controls is such that _____________ are needed to support the functioning of _______________, and both are needed to ensure complete and accurate information processing through IT systems.

(a) IT Dependent Controls, General Controls

(b) Application Controls, General Controls.

(c) General Controls, IT Dependent Controls.

(d) General IT Controls, Application Controls.

1.4 The term Internal Financial Controls (IFC) refers to the policies and procedures put in place by companies for ensuring which of the following:

(a) reliability of financial transactions.

(b) effectiveness and efficiency of operations.

(c) safeguarding of human resources.

(d) prevention and detection of errors.

1.5 Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialized audit tools viz., IDEA and ACL to perform which of the following:

(a) Evaluating impact of control deficiencies.

(b) Compliance with applicable laws and regulations.

(c) Authorized changes to system or programs.

(d) Providing latest information.

Case Scenario - 2

You are a partner in ABC & Company, a Chartered Accountant firm based in New Delhi. ABC & Company has been appointed as the statutory auditor of onetime Limited, a public limited company which manufactures and sells wall and table clocks and has many branches all over India. onetime Limited has been exporting the clocks since past two years. However, the domestic sales have contributed towards major source of revenue for the Company.

You being the engagement partner have started the audit for the year ended 31.03.2021 along with your five team members. One of the team members, CA B started verification of inventory. In addition to other procedures, he also checked that valuation of Inventory had been recognised in accordance with AS -2. During detailed checking, he noticed that the amount spent on salary of administrative employees and normal wastage on production of the clocks, had not been added to the valuation of Inventory. The contention of XYZ Limited was that since the cost was not directly related to the production cost and so not added to the cost of inventory.

CA B also noticed that one of the suppliers of onetime Limited, Mr AM had sent some raw material to the Company for storage in their warehouse in March 2021. Due to renovation going on at his warehouse, his stock could be damaged and so he had requested Onetime Limited to keep the same in their warehouse. onetime Limited contended that since the raw material was anyway billed to the Company the next month, so the same had been included in the valuation of stock, since physically the stock was present in the warehouse of Onetime Limited as on 31.03.2021.

The Company had issued shares at premium, and the premium received on the shares had been transferred to a "securities premium account". The same was then applied in writing off the expenses of selling the clocks, writing off the preliminary expenses of the Company and also writing off the commission paid to the sales agents. You have verified the same in detail.

While verifying debtors, team member C noticed that there were a few trade receivables pertaining to export sales mainly to England. Mr. C verified the same with respect to the invoices issued and other supporting documents. The amount booked as on 31.03.2021 was based on the exchange rate as on the date of the invoice.

Mr. T, another team member verified the fixed assets of the Company. onetime Limited had purchased few cars for its directors during the year of audit. The same were appearing in the fixed assets schedule of the Company. Mr T verified the same with respect to the invoices as well as physically verified the assets in the Company's premises. Since the cars were for the official use of the Directors, they were purchased in the name of the Directors of the Company. Mr. T verified the amount with the Invoice and checked the registration and insurance documents.

One of the article clerks was assigned the work of verification of "Provisions" appearing in the Balance sheet. He wanted to understand from you the circumstances in which a provision is recognised in the books of account. You explained him the situations in which an entity recognises Provisions in its books.

Onetime Limited has invested in the shares of other companies. One of the Companies has declared dividend on its shares. Onetime Limited has not recognised the same in the profit & loss account. Team Member R has asked you to look into the matter since she is unable to understand the reasons for the same.

The Company had spent a huge amount on repair and maintenance of the machinery used for the production of the clocks. The amount was accounted for in two parts: repairs were booked as a revenue expenditure and annual maintenance charges were capitalised and added to the machinery cost. Ms. R has verified the same in detail and raised her observations.

2.1 Is the raw material lying in the warehouse of onetime Limited accounted for correctly in its books of account?

(a) No, since the same belongs to Mr. AM and should appear in his books.

(b) Yes, since the same is in possession of onetime Limited and was billed to it the following month.

(c) It should be shown in the books of both onetime Limited and Mr. AM.

(d) It should not appear in the books of onetime Limited or Mr. AM and the raw material should be disclosed as a note in the final accounts of both the entities.

2.2 Which exchange rate is considered for accounting of foreign debtors at the year end?

(a) Exchange Rate on the date of the invoice.

(b) Exchange Rate on the last day of the financial year.

(c) Exchange Rate on the date of shipment of the products to the customer.

(d) Exchange Rate on the date of delivery of the products to the customer.

2.3 Which of the following assertions with respect to fixed assets has not been complied with by the Company?

(a) Existence

(b) Valuation

(c) Cut-Off

(d) Rights and Obligations

2.4 Which of the following condition is not required to be met for recognizing a provision?

(a) When a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

(b) When an entity has a present obligation (legal or constructive) as a result of a past event.

(c) A reliable estimate can be made of the amount of the obligation.

(d) When it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

2.5 Dividends are recognized in the statement of profit and loss only on fulfilment of which condition:

(a) the entity's right to receive payment of the dividend is established.

(b) it is probable that the economic benefits associated with the dividend will flow to the entity.

(c) the amount of the dividend can be measured reliably.

(d) All of the above

General MCQs

1. A type of super user access to information systems that enforces less or no limits on using that system is known as:

   (a) Super access.

   (b) Super user access.

   (c) Unlimited access.

   (d) Privileged access.

2. Which of the following is not an example of inflation of payments:

   (a) Making payments against fictitious vouchers.

   (b) Adjusting unauthorized or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them.

   (c) Making payments against vouchers, the amounts whereof have been inflated.

   (d) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.

3. _____requires firms to establish policies and procedures for the retention of________. The retention period for audit engagements ordinarily is no shorter than ______from the date of the auditor's report, or, if later, the date of the group auditor's report

   (a) SA 220, audit evidence, six years

   (b) SA 200, audit documentation, seven years

   (c) SQC 1, engagement documentation, seven years

   (d) SA 230, documentation, six years

4. ………….. is the threat which occurs when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised

   (a) Familiarity threat

(b) Advocacy threat

(c) Self Review threat

(d) Intimidation threat

5. _______refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

(a) Internal control assessment procedures

(b) Risk assessment procedures

(c) substantive procedures

(d) analytical procedures

PART II B – DESCRIPTIVE QUESTIONS

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

(i) No entry is passed for cheques received by the auditee on the last day of the year and not yet deposited with the Bank.

(ii) Written representation from management can be a substitute for other evidence that the auditor could expect to be reasonably available.

(iii) According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 5% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets

(iv) Communicating key audit matters in the auditor's report is a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern

(v) A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

(vi) It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the RBI and agreed upon by the concerned statutory auditors. Special consideration need not be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

(vii) The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971

(viii) Before holding inquiry by the Central Registrar thirty days' notice must be given to the Multi-State co-operative society.

Chapter 1 - Nature, Objective and Scope of Audit

2. (a) The IESBA Code establishes the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements. Discuss and also explain the meaning of ethics.

   (b) Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples.

3. The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. Explain those threats in detail giving examples.

Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

4. (a) Engagement Partner CA Hitesh Kapur of Kapur and Associates wanted to develop an audit plan of Sampurna Fabrics Ltd. Discuss the matters to be described in such an audit plan.

   (b) Without adequate knowledge of client's business, a proper audit is not possible. The auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. Explain giving examples.

5. You are being appointed as the auditor of Track Ltd. for the first time. You want to determine the materiality level and for that you have applied percentage to choose benchmark as a starting point in determining materiality for the financial statements as a whole. What are the factors that may affect the identification of an appropriate benchmark?

Chapter 3 - Audit Documentation and Audit Evidence

6. While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence.

7. (a) GPS & Co, Chartered Accountants, conducting the audit of Pratibha Ltd., a listed company for the year ended 31.03.2022 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GPS & Co wanted to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial

reporting framework. Guide GPS & Co with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.

(b) Pachranga International Ltd is manufacturer of pickles, ginger garlic paste, jams etc having its plant at Jaipur. Being in food industry, the company is facing many litigations in various courts across India. Auditors SPV & Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose.

8. TRS & Associates, Chartered Accountants, having completed the audit of Genuine Leathers Ltd has started the assembling of final audit file. TRS & Associates has established policies and procedures for the timely completion of the assembly of audit files. Explain the various aspects related to final audit file discussed in SA 230 giving specific reference to SQC 1, wherever required.

Chapter 4 - Risk Assessment and Internal Control

9. (a) Generally, IT benefits an entity's internal control by enabling an entity to enhance the timeliness, availability, and accuracy of information. Discuss explaining the other relevant points in the above context.

(b) While conducting the audit of Smart TV Ltd, engagement team of HTR& Co, has considered materiality and audit risk throughout the audit. Discuss explaining the meaning of audit risk.

10. Saburi Textile Ltd is an established player in the textile manufacturing sector. It has developed strong internal controls in almost every area. It has appointed you as an Internal Audit team head. Internal audit has a very strong relation with internal control of the company. Internal Audit analyses the effectiveness with which the internal control of the company is operating and also makes suggestions for improvement in that internal control. Explain stating clearly activities relating to Internal Control.

Chapter 5 - Fraud and Responsibilities of the Auditor in this Regard.

11. CA Dev of D R Sanduja & Co., statutory auditor of company, Girija Fabs Ltd, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud to the tune of Rs 1.25 Crores has been committed in the company by its employees. CA Dev, the auditor wanted to report the matter to the Central Government as per Law. He refers to Rule 13 of the Companies (Audit and Auditors) Rules, 2014. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ **1 crore or above**, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

In the above context, explain the manner of reporting the matter to the Central Government.

12. While conducting audit of Always Best Company Ltd, auditor B of B L Kapur & Co. observes lot of intentional misstatements, e.g. fake invoices etc., and considers these encounters as exceptional circumstances and this brings into question his ability to continue performing the audit. Advise B as to what should he do?

Chapter 6 - Audit in an Automated Environment

13. With respect to audit in an automated environment, explain the following:
    (i) Applications
    (ii) Automated
    (iii) CAATs
    (iv) Data Processing
    (v) General (IT) Controls
14. Explain the meaning of Internal Financial Controls clearly stating reporting requirement (with reference to audit) on adequacy of internal financial controls. Also discuss about its (reporting requirement on adequacy of internal financial controls) applicability on various types of Companies.

Chapter 7- Audit Sampling

15. What are the advantages of Statistical sampling technique in auditing
16. Sampling risk can lead to two types of erroneous conclusions. Explain clearly stating the meaning of sampling risk

Chapter 8 - Analytical Procedures

17. If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, how would the auditor investigate such differences.
18. Discuss the matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated.

Chapter 9 - Audit of Items of Financial Statements

19. Explain how you will verify the items given while conducting an audit of an entity:
    (a) Recovery of Bad debts written off
    (b) Receipt of Insurance claims
    (c) Payment of Taxes
    (d) Sale proceeds of scrap material

20. While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss explaining clearly the provisions relating to discount on issue of shares and its verification by the auditor.

Chapter 10 - The Company Audit

21. Before appointment is made under **Section 139(1)** of the Companies Act, 2013, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor. Explain stating clearly provisions of Section 139(1) along with **Rule** 4 of The Companies (Audit and Auditors) Rules, 2014.

22. Harry Limited appointed CA Lakshman as an auditor of the company for a term of 5 years. Further, the company offered him the services of actuarial which were also approved by the board of directors. As an auditor, how would you deal with such situation?

23. Explain the Reporting requirements the auditor should ensure under CARO 2020 related to PPE and Intangible assets.

Chapter 11 - Audit Report

24. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. Explain stating clearly specific evaluations made by the auditor.

25. When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700. Explain

Chapter 12 - Bank Audit

26. There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets. Explain in detail.

27. Explain the following in the context of Bank audit:
    (a) For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses.
    (b) For audit of Provisions and contingencies, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.

Chapter 13- Audit of Different Types of Entities

28. (a) Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain.

(b) No inspection under Section 79 of Multi-State Co-operative Societies Act, 2002 shall be made unless a notice has been given to the multi-state co-operative society. Explain stating clearly when and how such inspection can be made. Also state the powers available with the Central Registrar in this regard along with provisions relating to communication of the inspection report under the said section.

SUGGESTED ANSWERS

Answer Key- Case Scenario - 1

Question No.	Answer	
1.1	**(c)**	Volume of transactions is low
1.2	**(a)**	Direct data changes (backend changes).
1.3	**(d)**	General IT Controls, Application Controls.
1.4	**(b)**	effectiveness and efficiency of operations.
1.5	**(a)**	Evaluating impact of control deficiencies.

Answer Key- Case Scenario - 2

Question No.	Answer	
2.1	**(a)**	No, since the same belongs to Mr. AM and should appear in his books.
2.2	**(b)**	Exchange Rate on the last day of the financial year.
2.3	**(d)**	Rights and Obligations
2.4	**(a)**	When a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
2.5	**(d)**	All of the above

Answer Key- General MCQ's

1. **(d)**
2. **(b)**
3. **(c)**
4. **(b)**
5. **(b)**

Descriptive Answers

1. (i) **Incorrect:** The person who is controlling the trade receivables should ensure that proper accounting entries have been passed by crediting respective trade receivables account. The balance of cheque in hand should be disclosed along with the cash and bank balances in the financial statements.

   (ii) **Incorrect:** One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

   (iii) **Incorrect:** According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets

   (iv) **Incorrect:** Communicating key audit matters in the auditor's report is not a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern

   (v) **Incorrect:** A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.

   A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

   (vi) **Incorrect***:* It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

   (vii) **Incorrect** The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013

   (viii) **Incorrect:** Before holding inquiry by the Central Registrar fifteen days' notice must be given to the Multi-State co-operative society.

2. (a) The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements.

First, broadly understand what are ethics? "Ethics" are the principles of conduct governing an individual or group. Professions like law, medicine have their code of ethics. Auditing profession is no exception. Rather, in profession of auditing, importance of ethics is manifold.

The IESBA Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements. We shall understand broad meaning and intent of these fundamental principles as under:-

(a) Integrity

Integrity requires auditor to be straight forward and honest in all professional and business relationships. It implies fair dealing and truthfulness. It effectively means that he shall not be associated with reports, returns, communications or other information which he believes contains a materially false or misleading statement; contains statements or information provided recklessly or omits required information where such omission could be misleading.

(b) Objectivity

The principle of objectivity requires an auditor not to compromise professional judgment because of bias, conflict of interest or undue influence of others.

(c) Professional competence and due care

It requires that auditor attains and maintains professional knowledge and skill at the level required to render competent professional service based on current technical and professional standards and legislation and also to act diligently and in accordance with technical and professional standards. Diligence includes responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.

(d) Confidentiality

Confidentiality principle requires an auditor to respect the confidentiality of information acquired as a result of professional or business relationships.

and

(e) Professional behaviour

It requires an auditor to comply with relevant laws and regulations and avoid any conduct that he knows or should know might discredit the profession.

(b) It is to be understood that Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information". Remember that Standards on auditing apply in "audit" of historical financial information which is a reasonable assurance engagement whereas Standards on Review Engagements apply in "review" of historical financial information which is a limited assurance engagement only.

"Historical financial information means" information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Here, we have to broadly understand that "audit" and "review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement,

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are :

(i) SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

(ii) SA 230 Audit Documentation

(iii) SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment

(iv) SA 500 Audit Evidence

(v) Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

(i) SRE 2400 (Revised) Engagements to Review Historical Financial Statements

(ii) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

3. The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

1. Self-interest threats, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include (i) direct financial interest or materially significant indirect financial interest in a client, (ii) loan or guarantee to or from the concerned client, (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement, (iv) close business relationship with an audit client, (v) potential employment with the client, and (vi) contingent fees for the audit engagement. ***Like, in case an audit firm unduly relies on fees from a client, it may result in threat to self interest of auditor and he may not work objectively for the fear of losing client.***

2. **Self-review threats**, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.

3. **Advocacy threats,** which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. ***In such situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively. Remember that auditor has not only to be independent but also appear to be acting so.***

4. **Familiarity threats** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways: (i) close relative of the audit team working in a senior position in the client company, (ii) former partner of the audit firm being a director or senior employee of the client, (iii) long association between specific auditors and their specific client counterparts, and (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees. ***Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats. Such provisions prescribe that auditor is rotated after a certain number of years so that auditors do not become too familiar with their clients.***

5. **Intimidation threats,** which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees ***or being threatened with litigation. Such threats attempt to intimidate auditors to deter them from acting objectively.***

4. (a) **The auditor shall develop an audit plan that shall include a description of :**

(i) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material

Misstatement through Understanding the Entity and Its Environment".

(ii) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".

(iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

Example

Planning of the auditor's risk assessment procedures occurs early in the audit process.

However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

(b) Knowledge of the client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

Example

1. If one of management's objectives is to grow the business, management may develop a strategy of steady but regular growth through specific marketing campaigns and development of new markets. Alternatively, management may develop a more aggressive, complex strategy of acquiring competitors. Each of these strategies gives rise to differing business risks and potentially differing risks of material misstatement.

2. Examples of potential business risks include:

    (i) Failure to keep up to date with new products, technologies or services.

    (ii) Excessive reliance on a key supplier, product or individual, such as the owner.

    (iii) Lack of personnel with expertise to react to changes in the industry.

    (iv) Insufficient or excessive production capacity caused by inaccurate estimation of demand.

- Loss of financing due to the entity's inability to meet financial covenants

5. **SA 320 "Materiality in Planning and Performing an Audit"** prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

   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:

   i. The **elements of the financial statements** (for example, assets, liabilities, equity, revenue, expenses);

   ii. 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);

   iii. 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.

   iv. 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

   v. The **relative volatility** of the bench.

6. **Inquiry: As per SA 500 Audit Evidence: -**

   (i) Inquiry consists of seeking information of knowledgeable persons, financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

   (ii) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

   (iii) Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

(iv) In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

7. (a) **The auditors, GPS & Co** wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

(i) Sales, transfers and charges between segments, and elimination of inter-segment amounts.

(ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.

(iii) The allocation of assets and costs among segments.

(iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

(b) The auditor SPV & Co. shall design and perform audit procedures in order to identify litigation and claims involving the entity (Pachranga International Ltd) which may give rise to a risk of material misstatement, including:

(i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.

(ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and

(iii) Reviewing legal expense accounts.

8. The auditor TRS & Associates, Chartered Accountants shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

(i) SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.

(ii) An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

(iii) Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.

Examples of such changes include:

(i) Deleting or discarding superseded documentation.

(ii) Sorting, collating and cross-referencing working papers.

(iii) Signing off on completion checklists relating to the file assembly process.

(iv) Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

(v) After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

(vi) SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

9. (a) Generally, IT benefits an entity's internal control by enabling an entity to:

(i) Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;

(ii) Enhance the timeliness, availability, and accuracy of information;

(iii) Facilitate the additional analysis of information;

(iv) Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;

(v) Reduce the risk that controls will be circumvented; and

(vi) Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

(b) Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

(a) Identifying and assessing the risks of material misstatement;

(b) Determining the nature, timing and extent of further audit procedures; and

(c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

10. The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the **activities Relating to Internal Control:**

(i) Evaluation of internal control: The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.

(ii) Examination of financial and operating information: The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.

(iii) Review of operating activities: The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.

(vi) Review of compliance with laws and regulations: The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Internal audit has a very strong relation with internal control of a company. Internal Audit analyzes the effectiveness with which the internal control of a company is operating and also makes suggestions for improvement in that internal control.

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

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

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

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the

Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

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

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

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

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

(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and

(c) If the auditor withdraws:

(i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

(ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

13. (i) Applications: These are computer software programs that provide a medium for recording, storage and retrieval of business operations or transactions in electronic format.

(ii) Automated: A task or activity that is routinely performed by a computer system and does not require manual effort

(iii) CAATs: Short form for Computer Assisted Audit Techniques, are a collection of computer-based tools and techniques that are used in an audit for analysing data in electronic form to obtain audit evidence.

(iv) Data Processing: Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.

(v) **General (IT) Controls:** Are a type of internal controls that help in mitigating risks that arise due to use of information technology and information systems in a business.

14. **Explanation given in Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls as,** "the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information."

    From the above definition, it is clear that **internal financial controls are** the policies and procedures adopted by the company for:

    1. ensuring the orderly and efficient conduct of its business, including adherence to company's policies,
    2. the safeguarding of its assets,
    3. the prevention and detection of frauds and errors,
    4. the accuracy and completeness of the accounting records, and
    5. the timely preparation of reliable financial information."

    Section 143(3)(i) of the Act requires an auditor to report whether the company has adequate internal financial controls ***with reference to financial statements*** in place and the operating effectiveness of such controls.

    However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall **not** be applicable to a private company which is a–

    (i) One person company; or

    (ii) Small company; or

    (iii) Company having turnover less than ₹ 50 crore as per latest audited financial statement and having aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than ₹ 25 crore.

15. **Advantages of Statistical Sampling in Auditing: The advantages of statistical sampling may be summarized as follows -**

    (i) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.

    (ii) The sample selection is more objective and thereby more defensible.

    (iii) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.

    (iv) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) *i.e.* the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.

(v) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

16. Sampling Risk. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. This risk will always be in existence when auditor uses sampling technique in conducting his audit.

Sampling risk can lead to two types of erroneous conclusions:

(i) In the case of a **test of controls**, that controls are more effective than they actually are, or in the case of a **test of details**, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. This is because of over reliance on the internal controls.

(ii) In the case of a **test of controls**, that controls are less effective than they actually are, or in the case of a **test of details**, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect. This is because of under reliance on the test of controls and detailed substantive procedures performed by the auditor. Here risk of giving wrong opinion is minimum but it will lead to more detailed checking which is time consuming.

17. If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses: Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

(ii) Performing other audit procedures as necessary in the circumstances: The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

18. Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include:

(i) The accuracy with which the expected results of substantive analytical procedures can be predicted.

For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.

(ii) The degree to which information can be disaggregated.

For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.

(iii) The availability of the information, both financial and non-financial.

For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.

19. (a) Recovery of Bad Debts written off: Recovery of bad debts written off is verified with reference to relevant correspondence and proper authorisation.

(i) Ascertain the total amount lying as bad debts and verify the relevant correspondence with the trade receivables whose accounts were written off as bad debt.

(ii) Ensure that all recoveries of bad debts have been properly recorded in the books of account.

(iii) Examine notification from the Court or from bankruptcy trustee. Letters from collecting agencies or from account receivables should also be seen.

(iv) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.

(v) Vouch acknowledgement receipts issued to account receivables or trustees.

(vi) Review the internal control system regarding writing off and recovery of bad debts

(b) Receipt of Insurance Claims: Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims-

(i) The auditor should examine a copy of the insurance claim lodged with the insurance company correspondence with the insurance company and with the insurance agent should also be seen. Counterfoils of the receipts issued to the insurance company should also be seen.

(ii) The auditor should also determine the adjustment of the amount received in excess or short of the value of the actual loss as per the insurance policy.

(iii) The copy of certificate/report containing full particulars of the amount of loss should also be verified.

(iv) The accounting treatment of the amount received should be seen particularly to ensure that revenue is credited with the appropriate amount and that in respect of claim against asset, the Statement of Profit and Loss is debited with the short fall of the claim admitted against book value, if the claim was lodged in the previous year but no entries were passed, entries in the Statement of Profit and Loss should be appropriately described.

(c) Payment of Taxes:

(i) Obtain the computation of taxes prepared by the auditee and verify whether it is as per the Income Tax Act/GST Act/ Rules/ Notifications/ Circulars etc.

(ii) Examine relevant records and documents pertaining to payment of advance income tax and self assessment tax.

(iii) Payment on account of income-tax and other taxes like GST consequent upon a regular assessment should be verified by reference to the copy of the assessment order, notice of demand and the receipted challan acknowledging the amount paid.

(iv) The penal interest charged for non-payment should be debited to the interest account.

(v) Nowadays, electronic payment of taxes is also in trend. Such electronic payment of taxes by way of internet banking facility or credit or debit cards shall also be verified.

(vi) The assessee can make electronic payment of taxes also from the account of any other person. Therefore, it should be verified that the challan for making such payment is clearly indicating the PAN No./TAN No./TIN No./GSTIN etc. of the assessee on whose behalf the payment is made.

(d) Sale Proceeds of Scrap Material:

(i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.

(ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.

(iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.

(iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.

(v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.

(vi) See that scrap materials sold have been billed and check the calculations on the invoices.

(vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it and sold as scrap

(viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

20. Shares issued at a discount

According to Section 53 of the Companies Act, 2013,

(1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.

(2) any share issued by a company at a discounted price shall be void.

(2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

(3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

(i) the movement in share capital during the year and wherever there is any issue,

(ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.

(iii) Further, auditor should also verify that in case a company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

In the given case of Air Space Ltd, it is clear that it can issue shares to its creditors when its debt is converted into shares in accordance with approved restructuring scheme.

21. **Section 139(1)** of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The following points need to be noted in this regard-

(i) Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

(ii) **Under Rule** 4 of The Companies (Audit and Auditors) Rules, 2014, the said certificate shall state the following:-

(a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

(b) the proposed appointment is as per the term provided under the Act;

(c) the proposed appointment is within the limits laid down by or under the authority of the Act;

(d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(iii) The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

22. Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

(i) accounting and book keeping services;

(ii) internal audit;

(iii) design and implementation of any financial information system;

(iv) actuarial services*;

(v) investment advisory services;

(vi) investment banking services;

(vii) rendering of outsourced financial services;

(viii) management services; and

(ix) any other kind of services as may be prescribed.

*Actuarial services broadly pertain to services relating to evaluation of financial impact of risks using range of mathematical and statistical methods

In the given situation, CA. Lakshman was appointed as an auditor of Harry Ltd for a term of 5 years. He was offered additional services of actuarial which was also approved by the Board of Directors. CA. Lakshman is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

23. Reporting for PPE and Intangible assets - Clause (i) of Para 3 of CARO ,2020, requires the auditor to include a statement in the auditor's report on the following matters, namely-

(i) (a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;

(B) whether the company is maintaining proper records showing full particulars of intangible assets;

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

(c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held –indicate range, where appropriate	Reason for not being held in name of company*
					*also indicate if in dispute

(d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

(e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

24. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements.

In particular, the auditor shall evaluate whether:

(a) The financial statements adequately disclose the significant accounting policies selected and applied;

(b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

(c) The accounting estimates made by management are reasonable;

(d) The information presented in the financial statements is relevant, reliable, comparable, and understandable;

(e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and

(f) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Further, when the financial statements are prepared in accordance with a fair presentation framework, the evaluation mentioned above shall also include an evaluation by the auditor as to whether the financial statements achieve fair presentation which shall include consideration of:

(a) The overall presentation, structure and content of the financial statements; and

(b) Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

25. When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

(a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;

(b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and

(c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

26. Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets which are given below:

Categories of Non-Performing Assets:	Provision required
(i) **Substandard Assets:** Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
(ii) **Doubtful Assets:** Would be one, which has remained in the substandard category for a period of 12 months.	Secured+ Unsecured
(i) **<u>Sub-categories</u>**:	
Doubtful up to 1 Year (D1)	25% + 100%
Doubtful 1 to 3 Years (D2)	40% + 100%
Doubtful more than 3 Years (D3)	100% + 100%
(ii) **Loss Assets:** Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%

27. (a) **For audit of operating expenses**, the auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures. The auditor should examine whether there are any divergent trends in respect of major items of expenses. The auditor should perform substantive analytical procedures in respect of these expenses. e.g. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years. The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

(b) **For audit of Provisions and contingencies**, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.

The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation. The other provisions for expenses should be examined vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

28. (a) Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations.

The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.

The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

(b) Inspection of Multi-State Co-operative societies under Section 79

1. **When:** The Central Registrar may, on a request from
   (i) federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or
   (ii) not less than one-third of the members of the board or
   (iii) not less than one-fifth of the total number of members of a Multi-State co-operative society
2. **How:** By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing in this behalf to make an inspection into the constitution, working and financial condition of a Multi-State co-operative society.
3. **Opportunity of Being heard:** No inspection shall be made unless a notice of not less than fifteen days has been given to the multi-state co-operative society.
4. **Powers available:** The Central Registrar or the person authorized by him shall have the following powers:
   (a) He shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of that society and may, in the event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.
   (b) Every officer or member of a Multi-State Co-operative society shall furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.
5. **Inspection Report:** A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection.