

MOCK TEST PAPER
FINAL NEW COURSE: GROUP – I
PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS
SUGGESTED ANSWERS/HINTS

1. (a) **Subsequent Events:** This case requires attention to SA 560 “Subsequent Events”, AS 4 “Contingencies and Events occurring after the Balance Sheet Date” and AS 29 “Provisions, Contingent liabilities and Contingent Assets”.

As per AS 4 “Contingencies and Events occurring after the Balance Sheet Date”, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. Similarly as per AS 29 “Provisions, Contingent liabilities and Contingent Assets”, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the will occur.

In the instant case, the amount of `1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. The facts have become known to the auditor before the date of issue of the Audit Report and Financial Statements.

The auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the financial statements i.e. 31-3-2017 to the date of Auditors Report i.e. 31-05-2017. It will be observed that as a result of long pending negotiations a sum of ` 1.50 cores representing arrears of salaries of the year 2015-16 and 2016-17 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29.

As per SA 560 “Subsequent Events”, the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

So the auditor should request the management to adjust the sum of ` 1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the audit report.

- (b) **Using the work of an Auditor’s Expert:** As per SA 620 “Using the Work of an Auditor’s Expert”, the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion

expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert.

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

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

In the instant case, Mr. A, Mr. B and Miss C, jointly appointed as an auditor of PRS Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. B's referred actuary has provided the gratuity valuation report, which later on found faulty. Further, Miss C being not agreed with Mr. B's report, submitted separate audit report specifically for such gratuity valuation.

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

Mr. A and Mr. B will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Miss C will not be held liable for the same due to separate opinion expressed by her.

- (c) **Disclaimer of Opinion:** We were engaged to audit the financial statements of ABC & Associates ("the entity"), which comprise the balance sheet as at March 31, 20XX, the statement of Profit and Loss, *(the statement of changes in equity)(where applicable)* and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

We do not express an opinion on the accompanying financial statements of the entity. Because of the significance of the matters described in the *Basis for Disclaimer of Opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after March 31, 20X1 and

thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 20X0 and 20X1, which are stated in the Balance Sheets at ` xxx and ` xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ` xxx as at March 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of Profit and Loss (*and statement of cash flows*)(*Where applicable*).

- (d) **Auditor's responsibilities in cases where audit report for an earlier year is qualified** is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements". As per SA 710, When the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

- (i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- (ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant Case, if P Ltd. does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

2. (a) **Sharing and Accepting of Part of Profits with an Advocate:** 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, 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 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" is included.

Therefore, Mr. Preet, an advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Ms. Preeti. Hence, Ms. Preeti, a practicing Chartered Accountant, will not be held guilty under any of the abovementioned clauses for paying and accepting part of profits from Mr. Preet.

(b) Turnover limit for the purpose of Tax Audit: The following points merit consideration as stated in the Guidance note on Tax Audit issued by the Institute of Chartered Accountants of India-

- (i) Price of goods returned should be deducted from the figure of turnover even if the return are from the sales made in the earlier years.
- (ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.
- (iii) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount.

Applying the above stated points to the given problem,

1. Total Turnover	124 Lacs
2. Less: (i) Goods Returned	20 Lacs
(ii) Special rebate allowed to customer in the nature of trade discount would be deducted	<u>5 Lacs</u>
Balance	<u>99 Lacs</u>

As the limit for tax audit is ` one crore, therefore, he would not be required to get his accounts audited under section 44AB of the Income Tax Act, 1961.

(c) Following Errors are noticed in presentation as per Schedule III:

- (i) Share Capital & Reserve & Surplus are to be reflected under the heading "Shareholders' funds", which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities yet it must be shown under head "shareholders' funds". The heading "Shareholders' funds" is missing in the balance sheet given in the question.
- (ii) Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head 'Surplus'. The balance of 'Reserves and Surplus', after adjusting negative balance of surplus shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.
- (iii) Schedule III requires that Employee Stock Option outstanding should be disclosed under the heading "Reserves and Surplus"
- (iv) Share application money refundable shall be shown under the sub-heading "Other Current Liabilities". As this is refundable and not pending for allotment, hence it is not a part of equity.
- (v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown.
- (vi) Under the main heading of Non-Current Assets, Fixed Assets are further classified as under:
 - (a) Tangible assets
 - (b) Intangible assets
 - (c) Capital work in Progress
 - (d) Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Fixed Assets as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading "Long term loans and advances" under the heading Non-Current Assets.

 - (e) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability.
- (d) As per **SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"**, the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:
 - (i) The requirements of the applicable financial reporting framework relevant to

the accounting estimates, including related disclosures.

- (ii) How Management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed, in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.
- (iii) The estimation making process adopted by the management including-
 - (1) The method, including where applicable the model, used in making the accounting estimates.
 - (2) Relevant controls.
 - (3) Whether management has used an expert?
 - (4) The assumption underlying the accounting estimates.
 - (5) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
 - (6) Whether and, if so, how the management has assessed the effect of estimation uncertainty.

3. (a) **Soliciting Clients:** As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re- appointed by the shareholders.

Thus, the incorporation as an independent professional, made by CA. Smart, while submitting representation under section 140(4)(iii) of the Companies Act, 2013 and indication of willingness to continue as an auditor if reappointed by shareholders, does not leads to solicitation.

Therefore, CA. Smart will not be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

these should be included in a schedule and attached to the report.

- (10) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

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

- (c) **Stock Exchange Membership Rights:** A Pvt. Ltd. has paid ` 110 lacs for acquiring membership of stock exchange. Such membership rights provide exclusive right to A Pvt. Ltd. for carrying out stock broking activities. Thus, Stock Exchange Membership Rights are controlled by A Pvt. Ltd. and provide the basis for generating economic benefits to it. All these criteria appear to meet the definition of intangible assets as laid down in AS 26, "Intangible Assets". The Standard requires an entity to recognize an intangible asset if it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably. In the instant case, membership rights of stock exchange acquired by A Pvt. Ltd. meet the criteria of identifiability, control and arising of future benefits as well as reliability of the amount of cost. Thus recognizing the membership rights as Fixed Assets is proper.

However, the fact that the company did not write-off any amount since it would enable the company to perpetually carry on its business is not proper since AS 26 requires that all Intangible Assets to be amortised. For this purpose, a rebuttable presumption of 10 years is to be considered. Hence in the instant case, the company should have amortised such rights over 10 years. Since the company has not amortised any amount, the auditor will have to qualify his report and state the fact of non-compliance with AS 26.

- (d) Accounting Standard 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future.

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

In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary is temporary, the auditor should verify that the intention of the parent, to dispose the subsidiary, in the near

future, existed at the time of acquisition of the subsidiary. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements.

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

However, as per section 129(3) of the Companies Act, 2013 where a company having subsidiary, which is not required to prepare consolidated financial statements under the applicable Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

Conclusion: In the given case, Parent Ltd. has acquired 51% shares of Child Ltd. during the year ending 31.03.2016 and sold 20% shares during the year 2016-17. Parent Ltd. did not consolidate the financial statements of Child Ltd. for the year ending 31.03.2016 and 31.03.2017.

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

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

4. (a) **Charging of Fees based on Percentage:** Clause (10) of Part I to First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.

However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed Regulation 192 which exempts debt recovery services where fees may be based on a percentage of the debt recovered.

In the given case, CA. Neha has charged fees based on percentage of the debt recovered (which is exempted under Regulation 192). Hence, CA. Neha will not be held guilty for professional misconduct.

- (b) **Fraud Committed by Managing Director:** The Managing Director of the company has committed a “Teeming and Lading” fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, “The Auditor’s responsibilities relating to Fraud in an Audit of Financial Statements”. First of all, as per SA 240, the auditor needs to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment. Secondly, the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. Thirdly, the auditor should communicate the matter to the Chairman and Board of Directors. Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management.

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

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

- (c) **1. Collection of Premium:**
- Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.
 - Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.
- 2. Calculation of Premium:**
- Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly.
 - Check that system employed as such is equipped to calculate all types of premium modes correctly.

3. Recognition of Income:

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

4. Accounting of 'Advance Premium':

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

5. Reporting of Premium figures to IRDA/ Management:

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

6. Other Areas:

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

(d) Application Controls are automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems. **Examples of automated applications include:**

- Edit checks and validation of input data;

- Sequence number checks;
- User limit checks;
- Reasonableness checks;
- Mandatory data fields.

(e) **Factors to be considered while planning the Performance Audit:** While planning a performance audit of Sugar Industry, the auditors should take care of certain factors which are listed below:

- (i) to consider significance and the needs of potential users of the audit report.
- (ii) to obtain an understanding of the program to be audited.
- (iii) to consider legal and regulatory requirements.
- (iv) to consider management controls.
- (v) to identify criteria needed to evaluate matters subject to audit.
- (vi) to identify significant findings and recommendations from previous audits that could affect the current audit objectives. Auditors should determine if management has corrected the conditions causing those findings and implemented those recommendations.
- (vii) to identify potential sources of data that could be used as audit evidence and consider the validity and reliability of these data, including data collected by the audited entity, data generated by the auditors, or data provided by third parties.
- (viii) to consider whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives.
- (ix) to provide sufficient staff and other resources to do the audit.
- (x) to prepare a written audit plan.

5. (a) **Specific Permission to be Obtained:** As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

In the instant case, CA. Aman took over as the executive chairman on 01.04.2016 and applied for permission later. Based on the given facts, he was engaged in other occupation, after 01.04.2016 and before the application for approval, without the permission of the Council. Therefore, CA. Aman is guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

- (b) **Scope of Operational Audit:** Operational auditing is a systematic process involving logical, structured and organized series of procedures. It concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvement in future.

The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems, and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects, and grasp technical matters.

In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues; he will have to get the assistance of norms and standards in every operating field to be able to objectively judge a situation. The norms and standards should be such as are generally acceptable or developed by the company itself.

To a traditional internal auditor, a loss of ₹ 1,000 caused by a wrong totaling of invoice is important and this is that he looks for. But for an auditor engaged in the review of operations, carrying out of a proper maintenance programme of the machines is of greater importance because considerable production loss due to machine breaks down can thus be prevented. In both the cases, the auditor's objective is to see that the business and its profitability do not suffer from avoidable loss, but, nevertheless, there is a distinct difference in approach. But it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls.

Hence, contention of operational auditor that totaling error in invoice of ₹ 1,000 is out of scope is not correct as operational audit is being carried out to ensure that all the management functions like planning, organizing, staffing, directing and controlling are working effectively and efficiently. Such kind of error is very much in scope because such an existence of error indicates that control system (controlling function) is not sound.

- (c) **Energy Audit** is defined as "the verification, monitoring and analysis of use of energy including submission of technical report containing recommendations for improving energy efficiency with cost benefit analysis and an action plan to reduce energy consumption.

The following are some of the key functions of the energy auditor:

- (i) Quantify energy costs and quantities.
 - (ii) Correlate trends of production or activity to energy costs.
 - (iii) Devise energy database formats to ensure they depict the correct picture – by product, department, consumer, etc.
 - (iv) Advise and check the compliance of the organisation for policy and regulation aspects.
 - (v) Highlight areas that need attention for detailed investigations.
 - (vi) Conduct preliminary and detailed energy audits which should include the following:
 - (a) Data collection and analysis.
 - (b) Measurements, mass and energy balances.
 - (c) Reviewing energy procurement practices.
 - (d) Identification of energy efficiency projects and techno-economic evaluation.
 - (e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.
 - (f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.
- (d) **Disclosure of Information to the Shareholders relating to Director's Appointment:** As per Regulation 36 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, in case of the appointment of a new director or re-appointment of a director, the shareholders must be provided with the following information-
- (i) A brief resume of the director;
 - (ii) Nature of his expertise in specific functional areas;
 - (iii) Disclosure of relationships between directors inter-se;
 - (iv) Names of listed entities in which the person also holds the directorship and the membership of Committees of the Board; and
 - (v) Shareholding of non-executive directors.

The auditor should ascertain from the communications sent, whether in the case of appointment of a new director or re-appointment of a director, the shareholders have been provided with the information stipulated above.

- (e) **Basic system of Control:** Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof.

In the given case of New Life Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.

The general condition pertaining to the internal check system may be summarized as under-

- (i) No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iii) Every member of the staff should be encouraged to go on leave at least once a year.
- (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
- (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
- (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
- (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
- (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
- (x) Procedures should be laid down for periodical verification and testing of

different sections of accounting records to ensure that they are accurate.

6. (a) **As per SRS 4410 “Compilation Engagements”, the engagement partner shall take responsibility for-**

- (i) The overall quality of each compilation engagement to which that partner is assigned; and
- (ii) The engagement being performed in accordance with the firm's quality control policies and procedures, by:
 - (1) Following appropriate procedures regarding the acceptance and continuance of client relationships and engagements;
 - (2) Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the compilation engagement;
 - (3) Being alert for indications of non-compliance by members of the engagement team with relevant ethical requirements, and determining the appropriate action if matters come to the engagement partner's attention indicating that members of the engagement team have not complied with relevant ethical requirements;
 - (4) Directing, supervising and performing the engagement in compliance with professional standards and applicable legal and regulatory requirements; and
 - (5) Taking responsibility for appropriate engagement documentation being maintained.

(b) The circumstances in which an auditor can be prosecuted under the Companies Act, and the penalties to which he may be subjected are briefly stated below:

- (i) **Criminal liability for Misstatement in Prospectus** - As per Section 34 of the Companies Act, 2013, where a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.

This section shall not apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

- (ii) **Punishment for false statement** - According to Section 448 of the Companies Act, 2013 if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a

statement —

- (a) which is false in any material particulars, knowing it to be false; or
- (b) which omits any material fact, knowing it to be material,

he shall be liable under section 447.

Punishment for Fraud- As per Section 447 of the Companies Act, 2013, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

It may be noted that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

- (c) **Considerations for Planning and Performing Audit in case of Special Purpose Framework:** As per SA 800 “Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks”, financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

- (i) To obtain an understanding of the entity’s selection and application of accounting policies. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.
- (ii) Compliance of all SAs relevant to audit, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.
- (iii) Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.
- (iv) In the case of special purpose financial statements, such as those prepared in

accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

- (v) Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility.
- (d) The bank is a consortium member of cash credit facilities of ₹ 50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹ 1.75 crores towards interest, the credits in X Ltd's account are to the tune of ₹ 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.
- (e) **Consequence in case QRB notices non-compliance of Standards:**
 - Referring the case to the Director (Discipline) of the Institute for necessary action under the Chartered Accountants Act, 1949;
 - Informing the details of the non-compliance to the regulatory bod(y)/ies relevant to the enterprise;
 - Intimating the concerned auditor as to the findings of the Report as well as action initiated under (a) and/or (b) above;
 - Consider the matter complete and inform the audit firm/auditor accordingly.