Edition

2025

CA FINAL

Advanced Auditing

Question Bank

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ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

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Total = 621

- **Covered 100% ICAI SM illustrations, TYK from Nov 2024 Edition [Applicable from Sep 2025 Exams onwards]**
- **Covered Past Exam Questions from May 2022 to May 2025 Exams**
- **Covered MTP & RTP from May 2022 to May 2025**
- **6 Model Test Papers are Covered**

Test Your Understanding from ICAI SM

Test Your Understanding 1.

ABC & Associates, Chartered Accountants, has a policy to accept the clients wherein the risk evaluation is conducted with respect to the Company and the promoter. XYZ Limited approached ABC & Associates. The promoter of XYZ Limited is a close associate and family friend of Mr. A, Managing Partner of ABC & Associates. XYZ Limited has been in the news in the previous year for certain inquiries from the regulatory authorities in relation to certain matters. The existing auditor of XYZ Limited has resigned and has created a casual vacancy. XYZ Limited is ready to offer 25% more than the existing fees and has approached ABC & Associates for appointment as Auditor. Mr. A has a strong recommendation to the Firm to accept the audit. What is your understanding of the functioning of the tone at the top of the firm ABC & Associates, Chartered Accountants.? What are the considerations one should exercise to uphold Quality of the Firm?

Answer:

The given situation indicates that proposed client is a new one whose promoter is close associate and family friend of managing partner of M/s ABC & Associates. However, the previous auditor of proposed client has resigned and company is offering hike in audit fees in comparison to audit fees paid to previous auditor. Besides, there are also regulatory inquires against the company. In spite of all this, managing partner of firm Mr. A has recommended for acceptance of offered audit of the company.

It reflects poorly regarding functioning at the top of the firm as regards quality control. SQC 1 requires that the firm establish a system of quality control designed to provide it with reasonable assurance that firm and its personnel comply with professional standards, legal and regulatory requirements. It further requires that the firm's business strategy is subject to overriding the requirement of firm to achieve quality in all engagements. However, in the given situation, commercial considerations seem to be an overriding factor.

The managing partner of firm is close associate and family friend of promoter. The matter should have been brought to knowledge of firm in accordance with requirements of SQC 1 as it involves issue of independence of managing partner of the firm with respect to proposed audit engagement. Further, matters of inquiries from regulators and resignation of previous auditor raise question about integrity of the proposed client. SQC 1 further requires firm to consider before acceptance of an engagement that client does not lack integrity. All these factors need to be taken into consideration before accepting engagement.

Overall, such a situation reflects lack of proper establishment of quality control framework at top of the firm. Following considerations should be taken into account while upholding quality of firm: -

i. The firm assigns its management responsibilities so that commercial considerations do not override quality of work performed

ii. The firm's policies and procedures in relation to its personnel are designed to demonstrate its overriding commitment to quality.

iii. The firm devotes sufficient resources for development and documentation of its quality control policies and procedures

iv. A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about integrity of Client, promoters and key managerial personnel, competence (including capabilities, time and resources) to perform engagement and compliance with ethical requirements.

Test Your Understanding 2.

MNP & Co., a firm of auditors, is appointed by a bank to conduct stock audit of a borrower. It deputes one of its paid Chartered accountant employees, Sudhanshu, to conduct above said stock audit. He leverages it as an opportunity to prevail upon the client to get the accounts audited from their firm. He also assures the client of a clean stock audit report without adverse comments as a quid pro quo. Is approach of Sudhanshu proper? How does it reflect upon the quality control system of firm?

Answer:

Approach of Sudhanshu is not proper. Such practices clearly violate Code of Ethics and its spirit. It reflects poorly upon the quality control system of firm envisaged in SQC 1 which requires that quality control policies and procedures should be documented and communicated to the firm's personnel. It shows that firm's personnel are not properly sensitized regarding requirements of SQC 1.

Test Your Understanding 3.

CA M is introduced to a prospective client in a social function. He assures to visit office of CA M very soon in relation to professional work. During discussions over a cup of coffee next week, it transpires that there was a search by the Enforcement Directorate in his premises about a month back resulting in recovery of huge sum of cash. The income tax department had also searched his premises in relation to bogus capital gains on penny stocks. Complaining about the poor quality of services provided by his present auditor, he offers appointment as tax auditor of his five family-owned firms to CA M in lieu of handsome fees. What are the factors to be evaluated by CA M if he wants to take up the engagement?

Answer:

As per SQC 1, before accepting a new engagement, integrity of client should be considered including matters that indicate involvement in money laundering or criminal activities. There has been search of ED on the said party leading to recovery of huge amount of cash. The above coupled with actions of income tax department relating to bogus capital gains on penny stocks indicates that client might be involved in money laundering activities. Therefore, offer should not be accepted.

Test Your Understanding 4.

GVN & Associates are auditors of a listed company involved in "fin-tech" sector. The engagement team is stuck up with some issues pertaining to a particular Ind AS applicable to the company. They have framed a query and sent to ICAI for expert opinion on the matter. The issue was resolved upon receipt of expert opinion. Since expert opinion was provided by ICAI, engagement team was of the view that appointment of engagement quality control reviewer has lost its relevance. Do you agree?

Answer:

Engagement quality control review in listed entities is a mandatory requirement. Expert opinion of ICAI pertains to the issue of interpretation. The appointment of reviewer is a separate and mandatory requirement in audits of listed companies.

Test Your Understanding 5.

RST & Co., a firm of Chartered accountants, are auditors of a listed company engaged in manufacturing of heavy machinery components. The audit report for the year 2023-24 also included reports on matters listed in CARO, 2020. While reporting under clause vii(a) of the said order relating to regularity of undisputed statutory dues by the company, the auditors have commented that company is "generally regular" in depositing statutory dues to appropriate authorities. Is the above reporting qualitative and in line with the requirements of SA 220?

Answer:

Such type of reporting is not qualitative. It is not in accordance with SA 220. One of the objectives of the auditor, as per SA 220, is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that the audit complies with professional standards and regulatory and legal requirements. The reporting under CARO, 2020 is not proper. Hence, the audit does not comply with regulatory and legal requirements.

Test Your Knowledge

Question 1

PQR & Associates are statutory auditors of a listed company. There arose an issue during the course of audit relating to related party transactions. The engagement partner wants to consult an engagement quality control reviewer on this matter during the course of audit process itself. Can he consult with engagement quality control reviewer? Discuss.

Answer:

It is necessary to maintain objectivity of reviewer. Therefore, participation in engagement or making decisions for engagement team is to be avoided at all costs. However, engagement partner may consult engagement quality control reviewer during the engagement so as not to compromise his objectivity and eligibility to perform the role.

Question 2

Beta Private Limited has approached a firm of Chartered accountants to assist them in preparation of financial statements and issue a compilation report in this regard. Does CA firm have responsibility in relation to quality control for above said engagement? Discuss with reasons.

Answer:

Such kind of services fall in category of "related services". SQC 1 is applicable to all type of engagements including engagement pertaining to "related services".

Question 3

Ramanujan, a CA final student, feels that engagement file in audit engagement should be ready prior to issue of audit report. Discuss whether Ramanujan's view is in order.

Answer:

The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. Engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements. Thus, view of Ramanujan is not in order.

Question 4

BNE & Co. are in midst of audit process of a listed company. During the audit, an issue arose relating to revenues from contracts with customers in terms of Ind AS 115. The engagement partner took a certain stand. However, engagement quality control reviewer recommended otherwise after review. The engagement partner is not willing to accept recommendations of reviewer. How can this conflict be resolved?

Answer:

In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body. The audit report should be issued only after resolution of the matter.

Question 5

MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1.

Answer:

As per SQC 1, the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

With regard to the integrity of a client, matters that the firm considers include, for example:

- ✓ The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- ✓ The nature of the client's operations, including its business practices.
- ✓ Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- ✓ Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- ✓ Indications of an inappropriate limitation in the scope of work.
- ✓ Indications that the client might be involved in money laundering or other criminal activities.
- ✓ The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

Question 6 Exceptional **(Newly Added)**

SPS & Associates, Chartered Accountants, are statutory auditors of Grec Limited for the last two years. Grec Limited is engaged in the manufacturing and marketing of pharmaceutical goods in India. During the year 2023-24, the company has diversified and commenced providing software solutions in "e-commerce" in India as well as in certain African countries. SPS & Associates, while carrying out the audit, noticed that the company has expanded its operations into a new segment as well as in a new country. SPS & Associates does not possess the necessary expertise and infrastructure to carry out the audit of these diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.

Answer:

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

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

Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.

If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with governance withdrawal from the engagement or from both the engagement and the client relationship and the reasons for the withdrawal.

Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.

Documenting significant issues, consultations, conclusions, and the basis for the conclusions.

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

Question 7 Exceptional **(Newly Added)**

PQR Associates are the statutory auditors of a large un-listed company, which is engaged in manufacturing of auto components. Subsequent to reappointment of auditors in the Annual General Meeting, the Company shared the appointment letter with PQR Associates, seeking acknowledgement and acceptance letter. CA R is the engagement partner and is planning to issue the acceptance letter. During the current financial year, there was a search by the Income-tax Authorities on the company, and certain accounting records were seized for verification. Based on the information available on social media, CA R noted that the promoters' brother is contemplating to contest in the ensuing elections, under the banner of a political party. One of the current senior engagement team manager, who has been doing the audit engagement till last year, has left PQR Associates and is planning to provide some accounting services to one of the associate companies. PQR Associates are yet to recruit another senior manager having adequate experience in the audits of clients engaged in the automotive sector. Elaborate the matters to be considered by PQR Associates with respect to acceptance & continuance of client relationships considering the above issues.

Answer:

Acceptance and Continuance of Client Relationships: As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," a firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about: -

- ✓ Integrity of Client, promoters, and key managerial personnel.
- ✓ Competence (including capabilities, time, and resources) to perform engagement.
- ✓ Compliance with ethical requirements.

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

Further, as per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence.

In view of the above, PQR Associates should:

- ✓ follow their firm's policies and procedures for client acceptance and continuance. This includes evaluating the integrity of the client, assessing potential risks associated with the engagement, and ensuring the firm has the necessary resources and expertise to perform the engagement effectively. The engagement team, should assess, whether the company is involved in any funding activities, to the political parties, and if so enquire and assess the risks related to such transactions.
- ✓ communicate clearly with the client regarding the scope of the engagement, the responsibilities of both parties and any limitations on the services to be provided. This helps manage expectations and ensures alignment between the firm and the client.
- ✓ independence and objectivity throughout the engagement. Any potential threats to independence, such as relationships with the client's affiliates or involvement in political activities by related parties, should be evaluated and mitigated appropriately. Since the senior manager who was on this engagement is providing certain accounting services, to one of the group companies, the engagement partner, should assess, whether it would have any impact on the audit and examine the relevant ethical/independence requirements.
- ✓ continually monitor the client relationship for any changes or developments that may impact the firm's ability to provide services effectively. This includes staying informed about significant events such as the income-tax search, changes in client management, or potential conflicts of interest. Since there was an income-tax raid on the organisation, the engagement partner should evaluate the risks of material misstatements and non-disclosure of tax disputes and liabilities.
- ✓ ensure that their engagement team possesses the necessary competence and capabilities to perform the audit effectively. The departure of a senior manager and the need to recruit a replacement with specific industry experience should be addressed promptly to maintain audit quality. Since one of the senior engagement team members has left PQR Associates, the engagement partner should assess, whether he would be in a position to devote adequate time on the engagement or whether to recruit another resource, before commencement of the audit.

Question 8 **(Newly Added)**

CA Giri is a senior partner of M/s TSV Associates. M/s TSV Associates is a reputed firm of Chartered Accountants which has been in practice for more than five decades. The firm undertakes statutory audits of large listed companies across various industry sectors and has more than fifty qualified experienced professionals. CA Giri has been assigned as an Engagement Quality Control Reviewer for an audit engagement of a listed company. What are the aspects which would be looked into by CA Giri as an EQCR in relation to the engagement?

Upon completion of the review, CA Giri has identified certain issues with respect to revenue recognition and adequacy of provisions relating to onerous contracts. The views of CA Giri are not accepted by the Engagement Partner. Suggest ways of resolving the differences of opinion between CA Giri and the engagement partner.

Answer:

As per SA 220, "Quality Control for an Audit of Financial Statements", for audits of financial statements of listed entities, CA Giri, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

i. The engagement team's evaluation of the firm's independence in relation to the audit engagement;
ii. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations;

iii. Whether audit documentation selected for review reflects the work performed in relation to the significant judgments made and supports the conclusions reached.

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements,", there might be difference of opinion within engagement team, with those consulted and between engagement partner and engagement quality control reviewer. The report should only be issued after resolution of such differences. In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

In the given situation, under completion of review, CA Giri, Engagement Quality Control Reviewer has identified certain issues. However, the view of CA Giri, the EQCR are not accepted by the Engagement Partner. This difference of opinion among the CA Giri and Engagement Partner should be resolved with abovementioned manner as per SQC 1.

Question 9 Exceptional **(Newly Added)**

TPX & Co., Chartered Accountants, is a large audit firm. It maintains audit documentation both electronically and in physical form (hard files). The physical files are neither scanned and incorporated into electronic files nor cross-referenced to the electronic files. Further, there are many instances where audit working papers do not contain details as to whether information was obtained from client or prepared by engagement team. How do you view the above situation from the point of view of quality control system in audit firm? Analyse.

Answer:

In accordance with SQC 1," Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements" the firm should establish policies and procedures designed to maintain confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.

In the given situation, the physical files are neither scanned and incorporated in the electronic files nor cross-referenced to the electronic files. Inability to do so shows that firm has not established policies and procedures to maintain integrity of engagement documentation. Lack of ensuring the same makes it difficult to demonstrate completeness of audit files and whether these were assembled within 60 days timeframe stipulated in SQC 1.

Where engagement documentation is in paper, electronic, or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. One of the reasons for designing and implementing appropriate controls for engagement documentation in this regard is the protection of the integrity of information at all stages of engagement.

For the practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In that case, the firm implements appropriate procedures requiring engagement teams to:

a. Generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;
b. Integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and
c. Enable the scanned copies to be retrieved and printed as necessary.

It has also been stated that there are many instances where audit working papers do not contain details as to whether information was obtained from the client or prepared by the engagement team. It is important to identify the source of the document and the information used as audit evidence to ensure its reliability. It could have potential risks of non-compliance with Standards on Auditing.

Question 10 Exceptional **(Newly Added)**

Pine & Associates is the statutory auditor of BB Ltd., a listed company and started its operations 6 years ago. The fieldwork during the audit of the financial statements of the company for the year ended 31st March, 2024 was completed on 1st May, 2024. The auditor's report was dated 15th May, 2024. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on 18th May, 2024. The engagement partner had completed his reviews in entirety by 12th May, 2024. Comment.

Answer:

As per SA 220, "Quality Control for an Audit of Financial Statement", the engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

For audits of financial statements of listed entities, the engagement partner shall:

- ✓ Determine that an engagement quality control reviewer has been appointed;
- ✓ Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- ✓ Not date the auditor's report until the completion of the engagement quality control review.

Further, SA 700," Forming an Opinion and Reporting on Financial Statements", requires the auditor's report to be dated not earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

In this case, the audit of BB Ltd. for the year ending on 31st March 2024 was conducted by Pine & Associates and was completed on 1st May, 2024. Subsequently, the engagement partner reviewed the audit by 12th May, 2024. The audit report issued by Pine and Associates was dated 15th May, 2024. However, the engagement quality control review was finalized on 18th May, 2024, which is later than the date of the audit report. In view of above, the date of auditors' report before the completion of the engagement quality control review, is not correct.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

SPS & Associates, Chartered Accountants, are statutory auditors of Grec Limited for the last two years. Grec Limited is engaged in the manufacturing and marketing of pharmaceutical goods in India. During the year 2023-24, the company has diversified and commenced providing software solutions in "e-commerce" in India as well as in certain African countries. SPS & Associates, while carrying out the audit, noticed that the company has expanded its operations into a new segment as well as in a new country. SPS & Associates does not possess the necessary expertise and infrastructure to carry out the audit of these diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.

Answer: Already covered in TYK Qn

Question 2 **(MTP 1 May '24 5M)**

TPX & Co., Chartered Accountants is a large audit firm. It maintains audit documentation both electronically and in physical form (hard files). The physical files are neither scanned and incorporated into electronic files nor cross-referenced to the electronic files. Further, there are many instances where audit working papers do not contain details as to whether information was obtained from client or prepared by engagement team. How do you view above situation from point of view of quality control system in audit firm? Analyse.

Answer: Already covered in TYK Qn

Question 3 **(MTP 2 May '24 4M)**

Pine & Associates is the statutory auditor of BB Ltd., a listed company and started its operations 6 years ago. The fieldwork during the audit of the financial statements of the company for the year ended 31st March, 2023 was completed on 1st May, 2023. The auditor's report was dated 15th May, 2023. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on 18th May, 2023. The engagement partner had completed his reviews in entirety by 12th May, 2023. Comment

Answer: Already covered in TYK Qn

Question 4 **(PYP May '24 5M)**

PQR Associates are the statutory auditors of a large un-listed company, which is engaged in manufacturing of auto components. Subsequent to re-appointment of auditors in the Annual General Meeting, the Company shared the appointment letter with PQR Associates, seeking acknowledgement and acceptance letter. CA. R is the engagement partner and is planning to issue the acceptance letter. During the current financial year, there was a search by the Income-tax Authorities on the company, and certain accounting records were seized for verification. Based on the information available on social media, CA. R noted that the promoters' brother, is contemplating to contest in the ensuing elections, under the banner of a political party. One of the current senior engagement team manager, who has been doing the audit engagement till last year, has left PQR Associates and is planning to provide some accounting services to one of the associate companies. PQR Associates are yet to recruit another senior manager having adequate experience in the audits of clients engaged in automotive sector.

Elaborate the matters to be considered by PQR Associates with respect to acceptance & continuance of client relationships considering the above issues.

Answer: Already covered in TYK Qn

Question 5 **(PYP May '24 5M)**

CA Giri is a senior partner of M/s TSV Associates. M/s TSV Associates is a reputed firm of Chartered Accountants which has been in practice for more than five decades. The firm undertakes statutory audits of large listed companies across various industry sectors and has more than fifty qualified experienced professionals. CA Giri has been assigned as an Engagement Quality Control Reviewer for an audit engagement of a listed company. What are the aspects, which would be looked into by CA Giri as an EQCR in relation to the engagement?

Upon completion of the review, CA Giri has identified certain issues, with respect to revenue recognition and adequacy of provisions relating to onerous contracts. The views of CA Giri are not accepted by the Engagement Partner. Suggest the ways of resolving the differences of opinion between CA Giri and the engagement partner.

Answer: Already covered in TYK Qn

Question 6 Exceptional **(PYP Nov '24 5M)**

STA and Associates, Chartered Accountants, is an upcoming firm and its good professional services are hired by diverse clients for assurance services. With a standing of seven years in practice, the firm has clients in various industries like health care, education, hospitality, manufacturing and many more. With the increasing assignments, changes in regulatory compliances and appointment of new personnel, the senior partner CA T is concerned with the proper functioning of the system of Quality control within the firm. He wants to ensure that policies and procedures relating to the system of quality control of the firm are complied with properly. CA T suggests that a proper monitoring of quality control will be the right approach. Discuss the factors that are to be considered by CA T for monitoring the quality control of engagements to ensure that they comply with SQC.

Answer:

Factors considered for Monitoring Quality Control Engagements: As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," factors to be considered by CA T for monitoring the quality control of engagements to ensure that they comply with SQC:

- ✓ Deciding whether the quality control system of the firm has been appropriately designed and effectively implemented.
- ✓ Examining whether new developments in the professional standards, legal, and regulatory requirements have been reflected in the quality control policies.
- ✓ Conducting monitoring by entrusting responsibility of monitoring process to a partner or other persons with sufficient and appropriate experience and authority in the firm.
- ✓ Dealing with complaints and allegations against the firm or any employees of it of noncompliance with professional standards or appropriate regulatory requirements by a person within or outside the firm.
- ✓ Taking appropriate remedial actions against the personnel who did not conform to quality control policies.
- ✓ Taking action when deficiencies in the design or operation of the firm's quality control policies and procedures or non-compliance with the firm's system of quality control are identified.

Question 7 **(MTP M25 S1 5M)**

Rajni Ltd., a listed company, has appointed M/s Amit & Co. as its statutory auditor. CA Sunil, who recently joined the firm, has been appointed as the engagement partner for the first time. While preparing for the audit, he realises the importance of ensuring the audit team's independence, as required by standard audit practices. However, when reviewing the firm's framework, he is unable to find any documented policies or procedures addressing independence compliance.

What steps should CA Sunil take to ensure compliance with independence requirements for the audit engagement? Why is it necessary for an audit firm to have well-documented policies and procedures to maintain independence? Discuss with reference to the relevant Standards on Auditing.

Answer:

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," the firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code. Such policies and procedures should enable the firm to:

(i) Communicate its independence requirements to its personnel and, where applicable, to others subject to them; and

(ii) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

Further, as per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement.

In doing so, the engagement partner shall:

(i) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

(ii) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and

(iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Question 8 **(MTP M25 S2 5M)**

Sun & Associates are the statutory auditors of a large un-listed company, which is engaged in manufacturing of auto components. Subsequent to re-appointment of auditors in the Annual General Meeting, the company shared the appointment letter with Sun & Associates, seeking acknowledgement and acceptance letter. CA S is the engagement partner and is planning to issue the acceptance letter. During the current financial year, there was a search by the Income-tax Authorities on the company, and certain accounting records were seized for verification. Based on the information available on social media, CA S noted that the promoters' brother, is contemplating to contest in the ensuing elections, under the banner of a political party. One of the current senior engagement team manager, who has been doing the audit engagement till last year, has left Sun & Associates and is planning to provide some

accounting services to one of the associate companies. Sun & Associates are yet to recruit another senior manager having adequate experience in the audits of clients engaged in automotive sector.
Elaborate the matters to be considered by Sun & Associates with respect to acceptance & continuance of client relationships considering the above issues.
Answer: Already covered in TYK Qn

Question 9 **(PYP May '25 5M)**

XYZ and Associates, Chartered Accountants, is an audit firm, giving services to the various types of clients in the field of auditing, taxation and management consultancy. It has been doing statutory audit of B Ltd, a listed entity since last seven years. CA X who has been the engagement partner for the company since beginning has a complete idea about the strengths and weaknesses of the internal controls of the company. He maintains good relations with the management and those charged with the governance. Every year audit is completed in a cordial and healthy manner. During current year the quality control reviewer insisted to change the engagement partner for the company saying that continuation of same engagement partner poses certain audit risk and threats to the organization and advises to review the firm's policies and procedures in relation to the engagement partner. The management of the company does not wish to change the engagement partner. How do you view the above situation from the viewpoint of quality control system in audit firm in terms of requirements of SQC 1? Guide the firm in establishing the policies and procedures in respect of an engagement partner.

Answer:

Quality control system in an audit firm (SQC 1): SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," lays special emphasis on familiarity threat. Using the same senior personnel on assurance engagements over a prolonged period may impair the quality of performance of the engagement.
Therefore, the firm should establish criteria for determining the need for safeguards to address this threat. In determining appropriate criteria, the firm considers such matters as
(i) the nature of the engagement, including the extent to which it involves a matter of public interest, and
(ii) the length of service of the senior personnel on the engagement.

- The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre-defined period, normally not more than seven years (except in cases where audit of listed entities is conducted by a sole practitioner). However, to ensure quality control exists in such firms and appropriate reports are issued, there is a process for mandatory peer review of such firms.

  In the given situation, XYZ and Associates, Chartered Accountants, has been conducting the statutory audit of B Ltd., a listed company, for the past seven years. CA X served as the engagement partner throughout this period. CA X has developed an in-depth understanding of the company's internal controls and maintains a strong, cordial relationship with the management and those charged with governance. However, during the current year, the firm's quality control reviewer raised concerns about the continued involvement of CA X, citing the continuation of the same engagement partner poses certain audit risk and threats to the organisation, and advised reviewing the firm's policies regarding engagement partner rotation.

  In view of SQC 1, the continued involvement of the same engagement partner, CA. X with a listed entity for an extended period, i.e., more than 7 years, poses a familiarity threat, potentially impairing audit quality and independence. Therefore, the firm should implement a policy of mandatory partner rotation and review its quality control procedures to ensure compliance with professional standards and maintain the integrity of the audit process.

The firm should establish policies and procedures requiring that:

I. The identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance;

II. The engagement partner has the appropriate capabilities, competence, authority, and time to perform the role; and

III. The responsibilities of the engagement partner are clearly defined and communicated to that partner.

Exceptional Questions

SA 220

Question 1 Exceptional **(RTP - May '19 | MAY '22)**

During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.

Answer:

As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

1. Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence.
2. Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and
3. Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.
4. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is NOT RIGHT. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

Question 2 **(PYP Nov '22)**

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

Answer: Already covered above in SPS & Associates Qn

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

My Décor Limited, presently engaged in manufacturing of fabrics, wants to set up a new plant for manufacturing of special kind of fabric providing an altogether different texture and feel. This kind of fabric has become a hit with retail customers. The company needs to set up plant for manufacturing the above kind of fabric involving huge capital outlays to stay competitive in the market. You are auditor of the company and find that company's revenue has increased in financial year 2023-24 toRs.1000 crore fromRs.750 crore in last year. By the time, you started the audit, there was no change in plant capacity and information regarding need to set up new plant has become known to you during inquiry of company's personnel. Discuss, how you should proceed to deal with above situation, as auditor of the company, paying special attention to risk of material misstatement due to fraudulent financial reporting?

Answer:

The given situation highlights need for the company to set up new plant for manufacturing of special kind of fabric to stay competitive in the market. Setting up of such plant involves huge capital outlays which could entail financing arrangements. Therefore, excessive pressure exists for management to be involved in fraudulent financial reporting. In such a situation, management may be tempted to inflate its revenues to show rosy picture. It is a fraud risk factor and needs to be evaluated by the auditor.

The revenues of the company have jumped from Rs.750 crore in last year to Rs.1000 crore in year 2023-24 without any change in plant capacity. The auditor may consider above said fraud risk factor for assessing risk of material misstatement due to fraud.

In case of auditor assessing risk of material misstatement due to fraudulent financial reporting, audit procedures to address such risk like performing substantive analytical procedures relating to revenue, use of computer assisted audit techniques to identify unusual revenue transactions and testing controls pertaining to revenue transactions need to be performed.

Test Your Understanding 2. Exceptional

CA Ridhima, internal auditor of Track Store Limited, has pointed out following deficiencies in internal control of the company, in her reports: -

i. Receivables are not reconciled at stipulated intervals.

ii. Customers are provided a credit limit based upon their track record. However, no review of customer credit limits is undertaken at required intervals. The statutory auditor of the company finds that no action has been taken by the company on the said deficiencies pointed out in reports of internal auditor. What does above situation indicate to statutory auditor of company?

Answer:

Management failing to remedy known significant deficiencies in internal control on a timely basis is a fraud risk factor for misstatements arising from fraudulent financial reporting.

When management does not correct significant deficiencies in internal control on a timely basis, it reflects an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act.

Failure to rectify known control deficiencies pertaining to reconciliation of receivables and review of customer credit limits has the potential to fraud. Lack of timely reconciliation of receivables may lead to intentional misstatements. Further, non-reviewing customer limit may lead to grant of credit beyond creditworthiness of customers. It may result in intentional tying up of company's funds with risky customers due to collusion.

The above situation is a fraud risk factor for fraudulent financial reporting.

Test Your Understanding 3. Exceptional

FAS Insurance Brokers Limited is a leading online insurance intermediary. During the year, Director General of GST Intelligence (DGGI) has issued notice to the company for allegedly creating fictitious invoices for "marketing and sales services" amounting to Rs.50 crores in favour of non-life insurance companies. The premises of company were also searched during the year by DGGI officials. The matter was also informed to IRDAI by DGGI for violation of norms and regulations in this regard. Does above situation has any bearing on your responsibilities as statutory auditor of the company? Outline briefly in context of possible non-compliance with laws by the company.

Answer:

When the auditor becomes aware of the existence of or has information about investigations by government departments and regulatory organizations, it may be an indication of non-compliance with laws and regulations.

In the instant case, notice has been served upon the company by DGGI for allegedly creating fictitious invoices in guise of providing "marketing and sales services" for Rs.50 crores. Issuing an invoice without supply of services is a serious offence under GST laws and it could involve penalties and imprisonment. Such suspected non-compliance may have a direct effect on financial statements.

The matter has also been informed to regulator i.e. IRDAI. Violation of IRDAI regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.

If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain: -

(a) An understanding of the nature of the act and the circumstances in which it has occurred and

(b) Further information to evaluate the possible effect on the financial statements.

If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.

If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

Test Your Understanding 4. Exceptional

CA Vallabh Sundar is auditor of a leading private sector bank. "IT Systems and controls" is under his consideration to be reported as "Key audit matter" in audit report of the bank due to high level of automation and complexity of the IT architecture and its impact on the financial reporting system. At what time he should communicate such identified "Key audit matter"? What are relevant considerations in this regard and their usefulness?

Answer:

SA 260 requires the auditor to communicate with those charged with governance on a timely basis.

SA 701 states that the appropriate timing for communications about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit, and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance.

Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report, and provides them with an opportunity to obtain further clarification where necessary. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion.

Communication with those charged with governance recognizes their important role in overseeing the financial reporting process, and provides the opportunity for those charged with governance to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

Test Your Understanding 5.

Four audit firms viz. GPR & Co., MKS & Co., CY & Associates and DES & Associates have been appointed for conducting statutory audit of KNB Bank, a public sector bank in accordance with regulatory guidelines. The professional work was divided by audit firms on the basis of zones of bank. However, work relating to "IT Systems and controls" was not allocated by them due to its very nature. While planning for the above common work area, it was decided to test IT general controls, application controls and IT dependent manual controls. Planned key audit procedures relating to this common area also included testing design and operating effectiveness of controls over "computer operations including back-up, batch-processing and data centre security". The actual audit procedures pertaining to "testing controls over batch processing" were performed by team of DES & Associates. In case work in relation to above audit procedures is not performed professionally by DES & Associates, discuss where responsibility for such lapses would lie in line with SA 299?

Answer:

In respect of common areas, the joint auditors are only responsible for appropriateness of nature, timing and extent of planned audit procedures agreed among them. The responsibility of individual execution lies with concerned joint auditor.

In the instant case, audit procedures relating to testing design and operating effectiveness of controls over computer operations including back-up, batch-processing and data center security have been planned jointly as it is a common area.

However, audit procedures relating to testing controls over batch processing were actually performed by team of DES & Associates although these were planned jointly. In case of any lapses in performing such procedures, DES & Associates would be responsible.

Test Your Knowledge

Question 1

A, B and C are joint auditors of a company. B is of the opinion that there are material misstatements in financial statements of a company which, if accounted for, would turn profit reflected in financial statements for Rs.25 crore to a loss of Rs.5 crore. He, therefore, wants an adverse opinion to be expressed in audit report. However, A and B do not concur with his views and are inclined to accept management's version. Is B required to go by majority opinion of 2-1?

Answer:

Where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. Therefore, B is not required to go by majority opinion of 2-1.

In such circumstances, the audit report issued by the joint auditors shall make a reference to the separate audit report issued by the other joint auditor. Further, separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading "Other Matter Paragraph" as per SA 706.

Question 2

Exceptional

CA Shelly Goel is offered appointment as auditor of Rute Limited, a listed company. The audit committee of the company wants her to justify independence in relation to company through proper communication. Although she has ensured that there are no threats to her independence, she feels requirement of audit committee to be beyond its purview. What is your opinion in this regard?

Answer:

As required in SA 260, in the case of listed entities, the auditor shall communicate with those charged with governance: -

a. A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence and

b.
   i. All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor and
   ii. The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

Further, as per the Companies Act, 2013 requires audit committee to review and monitor auditor's independence. Therefore, audit committee requiring auditor to justify her independence is well within its purview.

Question 3 Exceptional

You are auditor of a social media company. Of late, government has tightened noose around companies operating in this segment by bringing in a maze of regulatory legislations to protect interests of users. How you can proceed to verify that company is compliant with new regulatory requirements? Besides, what does above situation underscore to you as an auditor?

Answer:

It needs to be verified that the company has put in place systems and procedures to meet with new regulatory requirements. The same can be verified by examining policies and procedures developed by company in this regard like devising appropriate system of internal control, sensitizing employees regarding new rules, engaging legal advisors etc.

Further, financial stability of the company may be threatened due to new regulatory requirements. The management may be under pressure. It is also a fraud risk factor and may need to be evaluated by auditor.

Question 4

Discuss why the potential effects of inherent limitations of an auditor's ability to detect material misstatements described in SA 200 are far greater in respect of non-compliance with laws and regulations?

Answer:

In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following: -

There are many laws and regulations, relating principally to the operating aspects of an entity that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.

Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.

Whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law.

Question 5

MN & Associates are the statutory auditors of ABC Ltd. for the FY 2023-24. During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. How should the audit team deal with the situation?

Answer:

During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. In such a situation the audit team should:

(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 from the engagement is legally permitted; 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.

Question 6

CA Anand is the engagement partner for the audit assignment of NHT Ltd. engaged in manufacture of Iron and Steel bars. The company has its plants in the state of Sikkim. While verifying the wages record of the company, CA Anand found that maximum of the labour employed in the plants of the company was child labour. He questioned the management of the company about the same to which the management replied that looking into the compliance of such law is outside his scope of financial audit. Give your comments with respect to such situation.

Answer:

As per SA 250 "Considerations of Laws and Regulations in an Audit of Financial Statements", the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

For the compliance with provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements, the auditor's responsibility is to obtain sufficient appropriate audit evidence about compliance with the provisions of those laws and regulations.

For other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but compliance with which may be fundamental to the operating aspects of the business, the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.

In the instant case, maximum of the labour employed in the plants of the company was child labour. When CA Anand questioned the management of the company about the same, the management replied that looking into the compliance of such law is outside his scope of financial audit. Such reply by the management is not acceptable as such situation may have a material effect on the financial statements. Therefore, CA Anand should ensure as to whether any penal provisions will be there for non- compliance of such law and also whether the same has been duly disclosed by the company. If CA Anand concludes that such non- compliance has a material effect on the financial statements and the same has not been adequately reflected in the financial statements by the company, he shall express an adverse or a qualified opinion on the financial statements.

Question 7

Magnet Interiors Ltd. is a listed company engaged in the manufacture of office furniture. The company has its activities divided into four geographic regions. The company has appointed two joint auditors, namely, AB & Co. and CD & Co. to conduct the joint audit of the financial statements of the company for the year ending 31-03-2024. The engagement partners from both the firms, CA Amar and CA Chetanya along with their audit teams had a meeting to discuss the areas of the work to be divided and their respective responsibilities. Explain the responsibilities of the joint auditors with respect to such joint audit.

Answer:

As per SA 299 "Joint Audit of Financial Statements", in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures. In cases where specific divisions, zones or units are allocated to different joint auditors, it is the separate and specific responsibility of each joint auditor to obtain information and explanations from the management in respect of such divisions/zones/units and to evaluate the information and explanations so obtained by said joint auditor. The joint auditors shall have proper coordination and rationality wherever required.

All the joint auditors shall be jointly and severally responsible for: -

a. the audit work which is not divided among the joint auditors and is carried out by all joint auditors
b. decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors.
c. matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors
d. examining that the financial statements of the entity comply with the requirements of the relevant statutes
e. presentation and disclosure of the financial statements as required by the AFRFW.
f. ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.

Where, in the course of the audit, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

It shall be the responsibility of each joint auditor to determine the nature, timing and extent of audit procedures to be applied in relation to the areas of work allocated to said joint auditor. It is the individual responsibility of each joint auditor to study and evaluate the prevailing system of internal control and assessment of risk relating to the areas of work allocated to said joint auditor.

As regards decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors, all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing and extent of the audit procedures agreed upon among them, proper execution of these audit procedures is the individual responsibility of the joint auditor concerned.

Question 8

MNO Ltd. gets its accounting data processed by a service organisation. CA Riya is the statutory auditor of MNO Ltd. CA Riya wants to obtain an understanding as to how MNO Ltd. is using the services of the service organisation. What all understanding should she obtain?

Answer:

When obtaining an understanding of MNO Ltd. (user entity) in accordance with SA 315, CA Riya shall obtain an understanding of how MNO Ltd. uses the services of a service organisation in its operations, including: -

(a) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control. Information on nature of services provided by a user organization may be available from sources such as user manuals, contract between the user entity and service organization, reports by service auditors etc.

(b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation. In certain situations, the transactions processed and the accounts affected by the service organisation may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of those controls is necessary in the circumstances.

(c) The degree of interaction between the activities of the service organisation and those of the user entity. The degree of interaction refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organisation. For example, a high degree of interaction exists between the activities of the user entity and those at the service organisation when the user entity authorises transactions and the service organisation processes and does the accounting for those transactions

(d) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

Question 9 Exceptional

UVW & Associates are the statutory auditors of Moon Ltd., a listed company, for the financial year 2023-24. CA Udhav is the engagement partner for the audit assignment. He was of the understanding that as per the requirement of one of the SAs he has a responsibility to communicate following matters to those charged with governance:

(a) The auditor's responsibilities in relation to the financial statement audit.

(b) Planned scope and timing of the audit.

(c) Auditor independence

Which of the matters is not included in the list prepared by CA Udhav. Discuss such matters in detail.

Answer:

SA 260 "Communication with Those Charged with Governance" deals with auditor's responsibility to communicate with those charged with governance in relation to an audit of financial statements. Among various matters as included by CA Udhav in his list, one of the matters that is not mentioned in the list is Significant findings from the audit. With respect to such matter, the auditor shall communicate with those charged with governance: -

(a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;

(b) Significant difficulties, if any, encountered during the audit;

(c) Unless all of those charged with governance are involved in managing the entity: -

 (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management;

 (ii) Written representations the auditor is requesting

(d) Circumstances that affect the form and content of the auditor's report, if any and
(e) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.

The communication of findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.

Question 10 Exceptional **(Newly Added)**

Studio Ltd. appointed RST & Associates and XYZ & Co. as joint auditors for conducting the audit for the year ending on 31st March 2024. During the audit, it was observed that there is a significant understatement in the value of trade receivables. The trade receivable valuation work was looked after by RST & Associates, however, there was no documentation outlining the division of the work between the joint auditors. Comment on the above situation with respect to the allocation of responsibilities among joint auditors as per relevant Standards on Auditing.

Answer:

Responsibility and Co-ordination among Joint Auditors: As per SA 299, "Joint Audit of Financial Statements", where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of the work would usually be in terms of audit identifiable units or specified area. In some cases, due to the nature of the business entity under audit, such a division of the work may not be possible. In such situations, the division of the work may be with reference to items of assets or liabilities or income or expenditure or with reference to period of time. The division of the work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

In respect of the audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate audit of the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible –

(i) The audit work which is not divided among the joint auditors and is carried out by all joint auditors;
(ii) Decisions taken by all the joint auditors under audit planning phase concerning the nature, timing and extant of the audit procedure to be performed by each of the auditor;
(iii) Matters which are bought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
(iv) Examining that the financial statements of the entity comply with the requirements of the relevant statute;
(v) Presentation and disclosure of financial statements as required by the applicable financial reporting framework;
(vi) Ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI;

The joint auditors shall also discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas of audit to be performed by each of the joint auditors and the same shall be communicated to those charged with governance. After identification and allocation of work among the joint auditors, the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.

Hence, in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures.

In the instant case, Studio Ltd. appointed two CA Firms RST & Associates and XYZ & Co. as joint auditors for conducting audit. As observed during the course of audit that there is a significant understatement in the value of trade receivable and valuation of trade receivable work was looked after by RST & Associates.

In view of SA 299, RST & Associate will be held responsible for the same as trade receivable valuation work was looked after by RST & Associates only. Further, there is violation of SA 299 as the division of work has not been documented.

Question 11 **(Newly Added)**

During the audit of Indo limited, CA Harish observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Indo Limited used a service organisation to record transactions and process related data. What factors should CA Harish consider regarding the nature and extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk. Discuss with reference to the relevant Standards on Auditing.

Answer:

As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", when obtaining an understanding of the user entity in accordance with SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

(i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;

(ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;

(iii) The degree of interaction between the activities of the service organisation and those of the user entity; and

(iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organization.

Based on above, while conducting the audit, CA Harish will assess the effect on the audit risk and take necessary steps.

Question 12 **(Newly Added)**

Happy Hospital is a very renowned hospital for Orthopedic Surgeries in Mumbai having sophisticated infrastructure. Happy Hospital has started using a novice system which includes complete record of Indoor Patient i.e. their diagnosis, their treatment, their medications, their billings, and receipts thereon which is developed and managed by CT Contractors. CA Z is a statutory auditor of Happy Hospital. CA Z came to know about this system while auditing. CA Z is concerned whether the controls at CT Contractors Associates are operating effectively or not. For this purpose, CA Z demanded from CT Contractors, an assurance report from a practicing chartered accountant about their opinion on the description of CT Contractor's system, and the effectiveness of the control. Which type of report should be obtained by CA Z in terms of relevant Standard on Auditing? What aspects are to be considered by CA Z in using such assurance report as audit evidence that controls at CT Contractors are operating effectively?

Answer:

In the given scenario, CA Z, as the statutory auditor of Happy Hospital, is concerned about the effectiveness of controls at the service organization, specifically the system managed by CT Contractors. To address this concern, CT Contractors should provide a Type 2 assurance report from a practicing-chartered accountant as per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation". This report will offer an opinion on the description of the system in use at Happy Hospital, as well as evaluate the effectiveness of the controls implemented by CT Contractors.

Using a Type 2 report as audit evidence that controls at the service organisation are operating effectively: If, the user auditor plans to use a Type 2 report as audit evidence that controls at the service organisation are operating effectively, the user auditor shall determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by:

(a) Evaluating whether the description, design, and operating effectiveness of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;

(b) Determining whether complementary user entity controls identified by the service organisation are relevant to the user entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;

(c) Evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and

(d) Evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment.

Question 13 Exceptional **(Newly Added)**

FAB Limited is availing the services of Atiya Private Limited for its payroll operations. Payroll cost accounts for 63% of total cost for FAB Limited. Atiya Limited has provided the type 2 report as specified under SA 402 for its description, design, and operating effectiveness of control.

Atiya Private Limited has also outsourced a material part of payroll operation M/s RST & Associates in such a way that M/s RST & Associates is sub-service organization to FAB Limited. The Type 2 report which was provided by Atiya Private Limited was based on carve-out method as specified under SA 402. CA Akram while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA Akram hence asked his assistant to remove such reference and modify report accordingly.

Comment whether CA Akram is correct in removing the reference of the work done by service auditor?

Answer:

Reporting by the User Auditor: As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation", the user auditor shall modify the opinion in the user auditor's report in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organisation relevant to the audit of the user entity's financial statements.

The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion.

Thus, in view of the above, contention of CA Akram in removing reference of the work done by service auditor is in order as in case of unmodified audit report, user auditor cannot refer to the work done by service auditor.

Question 14 Exceptional **(Newly Added)**

Arihant Ltd. was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2023-24. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to Rs.43 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings. In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement.

Answer:

As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

In accordance with SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and SA 330, "The Auditor's Responses to Assessed Risks" the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level and assertion level.

The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property. However, when there is a complex revenue structure or when there is lack of controls on revenue recognition, then there is a high probability of fraud risk in revenue recognition.

Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.

In the current scenario, the company was earning revenue from multiple streams. Also, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. During the year it was identified that the management did not account for revenue from corporate hotel bookings amounting to ₹ 43 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

Therefore, the auditor while performing the risk assessment procedures should consider the complexity and nature of the revenue for determining the fraud risks in revenue recognition. Also, there were no adequate controls addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk. Moreover, the audit team should have recognised fraud risk by identifying the deficiencies of internal control over the revenue recognition process and should have treated the risk of improper revenue recognition as a significant risk. Also, as per Section 143(12), the auditor is required to report all the frauds identified during the course of the audit involving amounts above ₹ 1 crore within the prescribed time frame to the Central Government.

(Note: Content of SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing; SA 210 Agreeing the Terms of Audit Engagements and SA 230 Audit Documentation is covered in depth at Intermediate level. Thus, application part of above SAs may be discussed in the form of Case Study at Final level.)

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 4M)**

During the audit of Indo limited, CA Harish observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Indo Limited used a service organisation to record transactions and process related data. What factors should CA Harish consider regarding the nature and extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk.

Discuss with reference to the relevant Standards on Auditing.

Answer: Already covered in TYK Qn

Question 2 **(MTP 2 Nov '24 5M)**

Studio Ltd. appointed AB & Associates and CD & Co. as joint auditors for conducting the audit for the year ending on 31st March 2024.

During the audit, it was observed that there is a significant understatement in the value of trade receivables. The trade receivable valuation work was looked after by AB & Associates, however, there was no documentation outlining the division of the work between the joint auditors.

Comment on the above situation with respect to the allocation of responsibilities among joint auditors as per relevant Standards on Auditing.

Answer: Already covered in TYK Qn

Question 3 **(MTP 1 May '24 4M)**

FAB Limited is availing the services of Atiya Private Limited for its payroll operations. Payroll cost accounts for 63% of total cost for FAB Limited. Atiya Limited has provided the type 2 report as specified under SA 402 for its description, design, and operating effectiveness of control.

Atiya Private Limited has also outsourced a material part of payroll operation M/s RST & Associates in such a way that M/s RST & Associates is sub-service organization to FAB Limited. The Type 2 report which was provided by Atiya Private Limited was based on carve-out method as specified under SA 402. CA. Akram while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA. Akram hence asked his assistant to remove such reference and modify report accordingly.

Comment whether CA. Akram is correct in removing the reference of the work done by service auditor?

Answer: Already covered in TYK Qn.

Question 4 Exceptional **(MTP 2 May '24 5M)**

Nandini Ltd. a chemical manufacturing company, having its factory located at Kanawali Village, for the year 2022-23 appointed Vasu & Co. as their statutory auditors. During the course of the audit, Vasu & Co. identified that Nandini Ltd. received a show cause notice from National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Nandini Ltd. was dumping toxic solid waste, without treating it, on the nearby grounds, and because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation performed by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 and a lot of damage has been done to the environment by Nandini Ltd. A show cause notice was already issued to Nandini Ltd. by the National Green Tribunal for levying the penalty of an amount of ₹700 crore. The unaudited profit for the financial year 2022-23 of Nandini Ltd. was ₹ 49 crore and the unaudited turnover was ` 120 crore. Upon inquiry it was identified that Nandini Ltd. has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

"The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws and the company's legal department has assessed and found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices."

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter.

Answer:

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor is required to obtain an understanding and need to evaluate the impact of other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:

(a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and

(b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities

As per section 143(3)(j) read with Rule 11(a), the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

As per SA 570, "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

(i) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and

(ii) Disclose clearly that there is material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall (a) Express a Qualified opinion or Adverse opinion, as appropriate, in accordance with SA 705; and (b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

In the current scenario, Nandini Ltd. has received a show cause notice from the National Green Tribunal of an amount which is more than the net profit and the turnover of the company for the year. In the event of an unfavourable order for Nandini Ltd., there will be an impact on Nandini Ltd.'s ability to continue as a going concern.

As a result, appropriate disclosure should be provided by management for such events, which cast significant doubt on the entity's ability to continue as a going concern. As no appropriate disclosure has been provided by Nandini Ltd. for such show cause notice, Vasu & Co. should report this matter in their audit report under "Going Concern Para" as per SA 570 and under clause (j) of section 143(3) of the Companies Act, 2013. Also, the auditor is required to issue an Adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

Question 5 **(MTP 2 May '24 5M)**

Aditya Ltd. was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Sanjay & Co. as its statutory auditor for the financial year 2022-23. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to ` 43 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account.

The amounts received in the bank account of the company were disclosed as advances received against the future bookings.

In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement.

Answer: Already covered in TYK

Question 6 **(PYP May '24 5M)**

Happy Hospital is a very renowned hospital for Orthopedic Surgeries in Mumbai having sophisticated infrastructure. Happy Hospital has started using a novice system which includes complete record of Indoor Patient i.e. their diagnosis, their treatment, their medications, their billings, and receipts thereon which is developed and managed by CT Contractors. CA Z is a statutory auditor of Happy Hospital. CA Z came to know about this system while auditing. CA Z is concerned whether the controls at CT Contractors Associates are operating effectively or not. For this purpose, CA Z demanded from CT Contractors, an assurance report from a practicing chartered accountant about their opinion on the description of CT Contractor's system, and the effectiveness of the control. Which type of report should be obtained by CA Z in terms of relevant Standard on Auditing? What aspects are to be considered by CA Z in using such assurance report as audit evidence that controls at CT Contractors are operating effectively?

Answer: Already covered in TYK Qn

Question 7 **(PYP May '24 4M)**

TP Limited is a listed company engaged in the business of manufacturing of kids garments under the brand name of MM. M/s R & Associates, firm of chartered accountants, are appointed as a Statutory Auditor of the Company for the year 2023-24. CA R is looking after the audit of the Company. During audit, CA R observed that there are number of notices received from GST Department and Income-tax Department for various issues. Further during plant visit, CA R observed that few child labourers are engaged in some of the activity. In response to the observation made, CA R followed the procedure as envisaged in SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements". According to CA R, the provisions of SA 250 and the provisions of NOCLAR (Non-Compliance with Laws and Regulations) under Revised Code of Ethics are one and the same. Do you agree? If not, give your comments.

Answer:

In the given situation, CA R is looking after the audit of the TP Limited, a listed company. During audit, CA R observed that there are number of notices received from GST Department and Income-tax Department for various issues. Further during plant visit, CA R observed that few child labourers are engaged in some of the activity. In response to the observation made, CA R followed the procedure as envisaged in SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements". assuming the provisions of SA 250 and the provisions of NOCLAR (Non-Compliance with Laws and Regulations) under Revised Code of Ethics are one and the same. However, following points indicates that the provisions of SA 250 and NOCLAR (Non-Compliance with Laws and Regulations) under the Revised Code of Ethics are not one and same:

i. SA 250 is applicable only on Audit, and not on other Assurance engagements. However, NOCLAR is applicable on professional accountants in service, and in practice.
ii. SA 250 talks of auditor's responsibilities for laws having direct effect on the determination of material amounts and disclosures in the financial statements (such as tax and labour laws); and other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business. NOCLAR, while being alike to SA 250 till this point, is further ahead of it in that it takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.
iii. SA 250 does not define stakeholders. NOCLAR is related to affect of non-compliance on investors, creditors, employees as also the general public.
iv. As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted. This provision is not existent in SA 250.

Question 8 **(MTP M25 S1 5M)**

Joseph Retail Pvt. Ltd. is a well-known luxury fashion retailer in Delhi, recognised for its premium collection of designer clothing and accessories. The company has recently implemented an advanced inventory management system, which tracks product availability, pricing, sales, and customer transactions in real time. This system has been developed and is managed by RealTrend Solutions, a third-party IT service provider.

CA Z, the statutory auditor of Joseph Retail Pvt. Ltd., became aware of this system while conducting the audit. Concerned about whether the internal controls at TrendTech Solutions are operating effectively, CA Z requests an assurance report from a practicing Chartered Accountant regarding the

description of TrendTech Solutions' system and the effectiveness of its controls.
Which type of report should CA Z obtain in accordance with the relevant Standard on Auditing?
What aspects should CA Z consider while using such an assurance report as audit evidence to determine whether controls at TrendTech Solutions are operating effectively?

Answer: Already covered in TYK Qn

Question 9 **(PYP May 25 5M)**

Alpha Manufacturing Ltd. (AML) is engaged in the production of speciality machinery for the automotive industry. The company operates in a competitive market and is under pressure to meet aggressive revenue and profitability targets to secure additional funding from the investors. The audit firm BETA LLP has been engaged to conduct AML's statutory audit for the financial year 2024-25. BETA LLP performed risk assessment procedures and related activities towards obtaining information in identifying risk of material misstatement due to fraud and also evaluated whether there is an indication that one or more fraud risk factors are present. Analytical procedures reveal unexpected relationships potentially indicating fraudulent activities, such as sales inflation by management to meet earnings targets. Management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery.
Guide BETA LLP to decide the course of action in determining overall responses to address the assessed risks of material misstatement due to fraud at the (i) Financial Statement Level and (ii) Assertion Level.

Answer:

(I) Responses to the Assessed Risks of Material Misstatement due to Fraud at the Financial Statement Level: In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:

(a) Assign and supervise personnel taking account of the knowledge, skill, and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement;

(b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and

(c) Incorporate an element of unpredictability in the selection of the nature, timing, and extent of audit procedures.

(II) Audit Procedures Responsive to Assessed Risks of Material Misstatement due to Fraud at the Assertion Level:

(a) The auditor shall design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. In doing so, the auditor may change the nature, timing, and extent of audit procedures to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information.

(b) If the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery.

(i) In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms.

(ii) In addition, the auditor might find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

Question 10 **(PYP May 25 5M)**

Key Ventures Limited is availing the services of Chipmetric Limited for processing of its accounting data including payroll operations. Payroll costs account for 75% of the total costs of Key Ventures Limited. CA Tej, the auditor of Key Ventures Limited wants to obtain an understanding of the nature and significance of the services provided by Chipmetric Limited and their effect on the user entity's internal control to identify and assess the risks of material misstatement. In this regard, he wants to use Type 1 or Type 2 report.

What shall be the considerations of CA Tej in determining the sufficiency and appropriateness of the audit evidence? Suggest the procedures if he plans to use a Type 1 or Type 2 report as audit evidence to support the understanding about the design and implementation of controls at Chipmetric Limited as per relevant Standard on Auditing.

Answer:

Using A Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organisation:

As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation", in determining the sufficiency and appropriateness of the audit evidence provided by a Type 1 or Type 2 report, CA Tez, the user auditor shall be satisfied as to: -

(i) The service auditor's professional competence (except where the service auditor is a member of the Institute of Chartered Accountants of India) and independence from the service organisation; and

(ii) The adequacy of the standards under which the Type 1 or Type 2 report was issued.

If the user auditor plans to use a Type 1 or Type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organisation Chipmetric Ltd., CA Tez, the user auditor shall:

(i) Evaluate whether the description and design of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;

(ii) Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's internal control relevant to the audit; and

(iii) Determine whether the complementary user entity controls identified by the service organisation are relevant to the user entity and, if so, obtain an understanding of whether the user entity has designed and implemented such controls.

Exceptional Questions

Question 1 **[PYP May '19]**

Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March, 2019.

In the course of audit, it has been observed that there is a major understatement in the value of inventory. The inventory valuation work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors.

Comment on the above situation with regard to responsibilities among joint auditors.

Answer:

Responsibility and Co-ordination among Joint Auditors: As per SA 299, "Joint Audit of Financial Statements"

RESPONSIBILITY OF JOINT AUDITOR:

1. Individual / Separate Responsibilities: Where work is divided among the joint auditors on a suitable basis then each joint auditor is responsible only for the work performed by them. Generally, the work will be divided based on the following basis.
   a) Items of Assets or liabilities
   b) Income or Expenditure
   c) Geographical areas
   d) Identified units
   e) Period of Financial statements
2. Joint / Combined Responsibility: In the following areas all the joint auditors will have indivisible or combined responsibility.
   a) In respect of audit work not divided among themselves
   b) In respect of decisions taken by all the joint auditors
   c) In respect of matters brought to the notice of all joint auditors
   d) For verifying disclosure requirements of financial statements; and
   e) For ensuring that the audit report complies with relevant statute.

Further the division of work among Joint auditors shall be Documented.

ANALYSIS AND CONCLUSION:

In the instant case. Dice Ltd. appointed two CA Firms MN & Associates and PQ & Co. as joint auditor for conducting audit. As observed during the course of audit that there is a major understatement in the value of inventory and the inventory valuation work was looked after by MN & Associates.

In view of SA 299 MN & Associate will be held responsible for the same as inventory valuation work was looked after by MN & Associates only. Further, there is violation of SA 299 as the division of work has not been documented.

Question 2 Exceptional

What are the objectives of joint auditors?

Answer:

Objectives of the auditor SA 299

- To lay down broad principles for the joint auditors in conducting the joint audit.
- To provide a uniform approach to the process of joint audit.
- To identify the distinct areas of work and coverage thereof by each joint auditor.
- To identify individual responsibility and joint responsibility of the joint auditors in relation to audit.

Question 3 Exceptional

Four audit firms viz. GPR & Co., MKS & Co., CY & Associates and DES & Associates have been appointed for conducting statutory audit of KNB Bank, a public sector bank in accordance with regulatory guidelines. The professional work was divided by audit firms on the basis of zones of bank. However, work relating to "IT Systems and controls" was not allocated by them due to its very nature.

While planning for the above common work area, it was decided to test IT general controls, application controls and IT dependent manual controls. Planned key audit procedures relating to this common area also included testing design and operating effectiveness of controls over "computer operations including back-up, batch-processing and data center security".

The actual audit procedures pertaining to "testing controls over batch processing" were performed by team of DES & Associates. In case work in relation to above audit procedures is not performed professionally by DES & Associates, discuss where responsibility for such lapses would lie in line with SA 299?]

Answer: Already covered in TYK Qn

Question 4 **(MTP 2 Nov 24 5M)**

Studio Ltd. appointed AB & Associates and CD & Co. as joint auditors for conducting the audit for the year ending on 31st March 2024.

During the audit, it was observed that there is a significant understatement in the value of trade receivables. The trade receivable valuation work was looked after by AB & Associates, however, there was no documentation outlining the division of the work between the joint auditors.

Comment on the above situation with respect to the allocation of responsibilities among joint auditors as per relevant Standards on Auditing.

Answer: Already covered in TYK Qn

SA 240

Question 5 **(PYP NOV '20)**

In the course of audit of Quick Ltd, you suspect that the management has made misstatements in the financial statements intentionally to deceive the users and to succumb to pressures to meet market expectations. Elucidate how the fraudulent financial reporting may be accomplished and also discuss the techniques of committing fraud by management overriding controls.

Answer:

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" Fraudulent financial reporting may be accomplished by the following:

1. Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
2. Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.
3. Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

1. Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
2. Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
3. Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
4. Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
5. Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
6. Altering records and terms related to significant and unusual transactions.

Question 6 Exceptional **(RTP Nov '18)**

M/s Innocent Limited has entered into a transaction on 25th February, 2018, near year-end, whereby it has agreed to pay Rs.5 lakhs per month to Mr. Yuvraj as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but Rs.60 lakhs is provided in books of account as on March 31, 2018.

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

Answer:

RESPONSIBILITY UNDER SA 240:

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

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

Accordingly, the auditor would adopt the following approach:

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

1. 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;
2. Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
3. If the auditor withdraws:
   a. 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
   b. 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.

COMPANIES ACT 2013 RESPONSIBILITY:

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 Rs.1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than Rs.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 has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

SA 250

Question 7 **(QP Nov '20)**

PQ Limited, a listed entity, is in the business of manufacturing of specialty chemicals. The company has appointed CA Jazz as CFO of the company. CA Jazz is concerned about compliance with the provisions of laws and regulations that determine the reported amounts and disclosure in financial statements of PQ Limited. Accordingly, CA Jazz wants to implement such policies and procedures that can assist him in the prevention and detection of non-compliance with laws and regulations. Help CA Jazz by citing examples of such policies and procedures. [SA 250]

Answer:

In PQ Ltd, listed entity, CA Jazz has been appointed as CFO. PQ Ltd is in the business of manufacturing of specialty chemicals. CA Jazz is concerned about compliance with the provisions of Laws and regulations and wants to implement such policies and procedures that would assist him in prevention and detection of non-compliance with laws and regulations.

CA Jazz is specifically wanting examples of types of policies and procedures that PQ Ltd may implement so that relevant laws and regulations are properly complied with. Such examples of policies and procedures are given in SA 250.

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements",

The following are examples of the types of policies and procedures PQ Ltd. may implement to assist in the prevention and detection of non-compliance with laws and regulations:

1. Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
2. Instituting and operating appropriate systems of internal control.
3. Developing, publicizing and following a code of conduct.

4. Ensuring employees are properly trained and understand the code of conduct.
5. Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
6. Engaging legal advisors to assist in monitoring legal requirements.
7. Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

Question 8 **(RTP May '22)**

CA Abhinanadan is an auditor of KM Private Limited. During the course of audit, CA Abhinanadan becomes aware of information concerning an instance of non- compliance or suspected non-compliance with laws and regulations. Being a senior partner of CA. Abhinanadan, guide him regarding audit procedures to be followed when non-compliance is identified or suspected.

Answer:

1. As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", if the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:
   - An understanding of the nature of the act and the circumstances in which it has occurred; and
   - Further information to evaluate the possible effect on the financial statements.
2. If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance.
3. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.
4. If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.
5. The auditor shall evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.

Question 9 **(RTP - Nov '22)**

Abhinandan Limited a chemical manufacturing company, having its factory located at Nanded Village, for the year 2021-22 appointed Subahu & Co. as their statutory auditors. During the course of the audit, Subahu & Co. identified that Abhinandan Limited received a show cause notice from National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Abhinandan Limited was dumping toxic solid waste, without treating it, on the nearby grounds, and because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation performed by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 and a lot of damage has been done to the environment by Abhinandan Limited. A show cause notice was already issued to Abhinandan Limited by the National Green Tribunal for levying the penalty of an amount of Rs.500 crore. The unaudited profit for the financial year 2021 -22 of Abhinandan Limited was Rs.35 crore and the unaudited turnover was Rs.100 crore. Upon inquiry it was identified that Abhinandan Limited has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

"The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws and the company's legal department has assessed and found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices."

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter. [SA 250 AND 705]

Answer:

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements",

a) The auditor is not responsible for preventing non-compliance and cannot be expected to detect all non-compliance with all laws and regulations.
b) Further This standard divides the responsibility of auditor in relation to Consideration of laws and regulations into two types:

Type 1 - Those laws and regulations which have a direct effect on the determination of material amounts and disclosures in the financial statements.

Type 2 - Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to continue its business, or to avoid material penalties and therefore non-compliance with such laws and regulations may have a material impact on the financial statements.

The objectives of the auditor are:

a) To obtain sufficient appropriate audit evidence regarding compliance with Type 1 laws and regulations;
b) To perform Limited audit procedures to help identify instances of non-compliance with Type 2; and
c) To report appropriately to identified non-compliance with laws and regulations

The auditor shall perform the following Limited audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:

a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
b) Inquiring and Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.
c) Inquiring Entity's Legal counsel to know the details of pending litigations and resultantly estimate the possible non compliances.

As per Section 143(3)(j) read with Rule 11(a), the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

As per SA 570, "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine adequacy of disclosures in the financial statements:

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall

(a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 and

(b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

ANALYSIS AND CONCLUSION:

In the current scenario, Abhinandan Limited has received a show cause notice from the National Green Tribunal of an amount which is more than the net profit and the turnover of the company for the year.

In the event of an unfavorable order for Abhinandan Limited, there will be an impact on Abhinandan Limited's ability to continue as a going concern.

As a result, appropriate disclosure should be provided by management for such events which cast significant doubt on the entity's ability to continue as a going concern. As NO appropriate disclosure has been provided by Abhinandan Limited for such show cause notice, Subahu & Co. should report this matter in their audit report under "Going Concern Para" as per SA 570 and under clause (j) of Section 143(3) of the Companies Act, 2013.

Also, the auditor is required to issue an ADVERSE OPINION as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

Question 10 Exceptional **(PYP May '18)**

As an Auditor of TRP Ltd., you are suspicious that there might be non-compliance with laws and regulations to which the Company is subject to. Indicate the possible areas or aspects where you may have to look out for forming an opinion as to whether your suspicion has some basis to further inquire.

Answer:

The following are few indicators of Non compliances with various laws and regulation. This list is only illustrative and not exhaustive.

Further an indicator doesn't mean that there is a severe Non-compliance. It only provides the auditor the guidance to identify non compliances if any exists.

i) Investigations by regulatory organisations and government departments.
ii) Payment of fines or penalties.
iii) Payments for unspecified services or loans to consultants, related parties, employees or government employees.
iv) Purchasing at prices significantly above or below market price.
v) Unusual payments in cash or payments in form of bearer cheques,
vi) Unusual payments towards legal and retainership fees.
vii) Unusual transactions with companies registered in tax havens.
viii) Unauthorised transactions or improperly recorded transactions.
ix) Adverse media comment.

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

XWL Limited was engaged in dealing in commodity futures trading based in Surat. CA P, based at Delhi, was auditor of the company. The auditor did not even once visit the office of the company and failed to understand the nature of business of the company. All the papers and account books were received on emails and audit was concluded.

There were also included in his working papers checklists which had a requirement of test checking of cost of raw material consumed & cost of stores and spares. There was nothing in his working papers showing understanding of the nature of business of company. What does it reflect upon planning of audit by CA P?

Answer:

SA 300 requires the auditor to plan the audit in such a manner that it is performed effectively. It also requires auditor to establish overall audit strategy including identifying the characteristics of the engagement, facilitating him to define its scope and planning of nature, timing and extent of audit procedures required to be performed to achieve the objective of audit.

SA 300 further requires the auditor to document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to such plans.

In the given situation, auditor didn't even once visit the company and failed to understand about business of the company. Therefore, he has flouted requirement of SA 300 to plan the audit in such a manner that it is performed effectively. The auditor has to plan the audit commensurate to the nature and complexity of the business of the entity and identify and assess the risk of material misstatement.

Further, working papers of auditor also do not show his understanding of nature of business which is again a blatant violation of requirement of SA 300 which requires the auditor to document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to such plans.

Inclusion of a checklist in working papers having requirement of test checking of cost of raw material consumed & cost of stores and spares shows that it was a general checklist and specifics of business were never understood and audit was not planned to be conducted in an effective manner in accordance with requirements of SA 300.

Test Your Understanding 2.

CA Pradyuman is planning for audit of a listed company headquartered in Noida. While doing this exercise, he has made a list of various procedures intended to be performed by him during the course of audit. He has further made up his mind to decide about sample size at time of performing various planned procedures. Is the above approach of CA Pradyuman proper?

Answer:

SA 300 states that audit plan shall include description about nature, timing and extent of audit procedures. The extent of audit procedures also includes deciding about sample sizes to be tested for performing audit procedures. Therefore, the said approach is not proper. Various procedures planned to be undertaken should also include considerations relating to sample sizes to be tested.

Test Your Understanding 3.

CA Nikita is conducting audit of a leading society engaged in promoting awareness regarding usefulness of internet among the disadvantaged sections of society through easily understandable means and methods. The society is also registered under FCRA, 2010 for receipt of foreign contributions. During the course of audit, she embarked upon extensive procedures relating to verification of receipt of foreign contributions to rule out "round-tripping" in comparison to procedures originally thought of. She is documenting various procedures performed by her including relevant audit findings. However, she doesn't not feel need for putting into writing about how she planned the whole exercise. Does she require refreshening of her knowledge?

Answer:

SA 300 requires auditor to document audit plan and significant changes made during the audit engagement to the audit plan. It also requires auditor to document reasons for such changes.

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.

Further, changes to audit plan along with reasons thereof due to embarking upon extensive procedures related to verification of foreign contributions in comparison to what was originally envisaged need to be documented.

Failure to document audit plan could entail risk of not conducting audit according to professional standards in a qualitative manner.

Test Your Understanding 4.

CA Sourabh, an engagement partner, is conducting statutory audit of BBI Bank for SBT & Associates. The bank has 1034 branches spread all over the country which are audited by branch auditors. In respect of one large branch audited by a branch auditor, there were errors in NPA classification of many advances which were not pointed out by branch auditor in his report through memorandum of changes and NIL memorandum of changes was reported electronically. During overall review of financial statements of bank by statutory auditor, the above said errors did not come into light. The statutory auditor had also called soft copies of internal inspection report and concurrent audit reports of above branch as part of overall review procedures. However, these reports did not point towards any irregularities in such accounts. Would the statutory auditor of bank be liable for above lapses? What precautions have to be taken by him while expressing opinion considering possibilities of such situations?

Answer:

SA 600 states that the principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by the other auditors. When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

In the given situation, nothing has come to light of statutory auditor which would arouse his suspicion about reliability of work performed by branch auditor. Therefore, he would not be responsible for work performed by branch auditor.

Further, it should be clearly stated in the report that 1034 branches of bank have been audited by branch auditors.

Test Your Understanding 5.

CA Keshavraj is conducting statutory audit of a listed company "Live with Nature Limited". The company is engaged in producing environment-friendly niche products for new-born babies. There is also a well-functioning internal audit department in the company. On perusal of internal audit reports, he finds that not only verification of inventories was attended by internal auditor at regular intervals during the year, workings were also made in respect of inventory valuation as at year end. He has also attended inventory count at end of financial year and no prima facie adverse inferences were drawn by him. However, ongoing through inventory reports, he gathers that inventories are being held for considerably long period before being sold. The internal audit reports have not taken this aspect into consideration. Should he choose to rely upon inventory valuation work performed by internal auditor?

Answer:

For a particular account balance, class of transaction or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In such circumstances, the external auditor will need to perform more procedures directly and accordingly, make less use of the work of the internal audit function in obtaining sufficient appropriate audit evidence. Furthermore, as explained in SA 200, the higher the assessed risks of material misstatement, the more persuasive the audit evidence required by the external auditor will need to be, and, therefore, the external auditor will need to perform more of the work directly.

In the given situation, inventories are being held for considerably long period before being sold. As company is dealing in niche products for new-born babies, there is a risk of inventory obsolescence due to changes in customer preferences. It carries a significant risk of material misstatement and requires more judgment on part of statutory auditor in planning and performing procedures.

In such circumstances, statutory auditor needs to perform procedures directly like comparing net realizable value of products with costs to verify completeness of provisions, recomputing of provisions for obsolete stocks etc.

Therefore, in the given situation, he should perform procedures directly in accordance with SA 610.

Illustrations from ICAI SM

Illustration 1:

CA Amboj, a practicing-chartered accountant, has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA Kishore, the statutory auditor of the Company, for his view and reporting. Can CA Kishore rely on such report?

Using the Work of Internal Auditor: As per SA 610 "Using the Work of Internal Auditors", while determining whether the work of the internal auditors can be used for the purpose of the audit, the external auditor shall evaluate-

a. The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;
b. The level of competence of the internal audit function; and
c. Whether the internal audit function applies a systematic and disciplined approach, including quality control.

Further, the external auditor shall not use the work of the internal audit function if the external auditor determines that:

a. The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
b. The function lacks sufficient competence; or
c. The function does not apply a systematic and disciplined approach, including quality control.

In the instant case, CA. Kishore should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible, he should also test check few items and he can also observe the procedures performed by the internal auditors.

If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.

Illustration 2:

While doing audit, Ram, the Auditor requires reports from experts for the purpose of Audit evidence. What types of reports/opinions he can obtain and to what extent he can rely upon the same?

Using the Work of an Auditor's Expert: As per SA 620, "Using the Work of an Auditor's Expert", during the audit, the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert. While doing audit, Ram, the auditor can obtain the following types of reports, or options or statements of an expert for the purpose of audit evidence:

i. The valuation of complex financial instruments, land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.
ii. The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
iii. The estimation of oil and gas reserves.
iv. The valuation of environmental liabilities, and site clean-up costs.
v. The interpretation of contracts, laws and regulations.
vi. The analysis of complex or unusual tax compliance issues.

When the auditor intends to use the work of an expert, he shall evaluate the adequacy of the auditor's expert's work, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence; if that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and if that expert's work involves the use of source data that is significant to his work, the relevance, completeness, and accuracy of that source data. If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, he shall agree with that expert on the nature and extent of further work to be performed by that expert; or perform further audit procedures appropriate to the circumstances.

Test Your Knowledge

Question 1

While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?

Answer:

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.

Question 2

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct audit for the financial year 2023-24. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuarial reports. However, Mr. X agreed to Mr. Y's actuary report, though Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in a dilemma. Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later, was found faulty.

Answer:

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

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

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

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

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

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

Question 3

A & Co. was appointed as auditor of Great Airways Ltd. As the audit partner what factors shall be considered in the development of overall audit plan?

Answer:

Development of an overall plan - Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:

i. Terms of his engagement and any statutory responsibilities.
ii. Nature and timing of reports or other communications.
iii. Applicable Legal or Statutory requirements.
iv. Accounting policies adopted by the clients and changes, if any, in those policies.
v. The effects of new accounting and auditing pronouncement on the audit.
vi. Identification of significant audit areas.
vii. Setting of materiality levels for the audit purpose.
viii. Conditions requiring special attention such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
ix. Degree of reliance to be placed on the accounting system and internal control.
x. Possible rotation of emphasis on specific audit areas.
xi. Nature and extent of audit evidence to be obtained.

xii. Work of the internal auditors and the extent of reliance on their work, if any in the audit.
xiii. Involvement of other auditors in the audit of subsidiaries or branches of the client and involvement of experts.
xiv. Allocation of works to be undertaken between joint auditors and the procedures for its control and review.
xv. Establishing and coordinating staffing requirements.

Question 4 Exceptional

As an auditor of a garment manufacturing company for the last five years, you have observed that new venture of online shopping has been added by the company during current year. What factors would be considered by you in formulating the audit strategy of the company?

Answer:

Formulation of Audit Strategy: While formulating the audit strategy for a company, following factors may be considered -

General Factors: Refer Para 2.1.

Specific Factors for Online Shopping:

The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:

i. The classes of transactions in the entity's operations that are significant to the financial statements;
ii. The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
iii. The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
iv. How the information system captures events and conditions, other than transactions, that are significant to the financial statements;
v. Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

Question 5

During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.

Answer:

As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

✓ Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

- ✓ Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- ✓ Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

Question 6 Exceptional

AKJ Ltd is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and have their corporate office in Delhi. Recently the company appointed new firm of Chartered Accountants as their statutory auditors.

The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter?

Answer:

As per SA 210 'Agreeing the Terms of Audit Engagements', the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

i. The objective and scope of the audit of the financial statements;

ii. The responsibilities of the auditor;

iii. The responsibilities of management;

iv. Identification of the applicable financial reporting framework for the preparation of the financial statements; and

v. Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Question 7

A private company is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs

considered for percentage completion etc) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.
The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.

Answer:

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- ✓ Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.
- ✓ Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.
- ✓ Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.

However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.

In the given case, the management is not correct in refusing the relevant information to the auditor.

Question 8

X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. The auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise.

Answer:

As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In certain situations, the need for a detailed agreement in writing is required like -

- ✓ The auditor's expert will have access to sensitive or confidential entity information.
- ✓ The matter to which the auditor's expert's work relates is highly complex.
- ✓ The auditor has not previously used work performed by that expert.
- ✓ The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.

Question 9 Exceptional

Cineplex, a movie theatre complex, is the foremost theatre located in Delhi. Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe, shops, pubs etc. located in the complex. Its other income includes advertisements exhibited within/outside the premises such as hoardings, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises.

Cineplex appointed your firm as the auditor of the entity. Being the head of the audit team, you are, therefore, required to draw an audit programme initially in respect of its revenue and expenditure considering the above mentioned facts along with other relevant points relating to such complex.

Answer:

Audit Programme of Movie Theatre Complex:

i. Peruse the Memorandum of Association and Articles of Association of the entity.

ii. Ensure the object clause permits the entity to engage in this type of business.

iii. In the case of income from sale of tickets:

1. Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly and accurately accounted.
2. Verify the system relating to online booking of various shows and the system of realization of money.
3. Check that there is overall system of reconciliation of collections with the number of seats available for different shows in a day.

iv. Verify the internal control system and its effectiveness relating to the income from café, shops, pubs, game zone etc., located within the multiplex.

v. Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.

vi. Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.

vii. In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement, any payment of advance made to the distributor is also adjusted against the amount due.

viii. Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.

ix. Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.

x. Verify the insurance premium paid and ensure it covers the entire assets.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India. The Auditors are duly appointed for all the subsidiaries and branches. What should be the considerations of CA H regarding determination of materiality during the audit of consolidated financial statements? How he should deal in his report if there are observations (for instance modification and/or emphasis of matter paragraph in accordance with SA 705/706) made by component auditors?

Answer:

CA H should consider the requirement of SA 600, "Using the Work of Another Auditor", if he decides to use the work of another auditor in relation to the audit of consolidated financial statements and he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

(i) The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.

(ii) The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.

(iii) The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS.

(iv) The principal auditor also obtains certain confirmations from component auditors like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 need to be considered i.e. CA H (the parent auditor) should comply with the requirements of SA 600, "Using the Work of Another Auditor".

Question 2 **(MTP 1 May '24 4M)**

Jagdish Pvt. Ltd. is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc.) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Comment

Answer: Already covered in TYK Qn.

Question 3 **(MTP 2 May '24 5M)**

Naveen Ltd. is a chair manufacturing company having its corporate office in Maharashtra. The company is in the process of expansion and has acquired five companies during the year. Soni & Co. is the principal auditor of the company while the audit of all the companies acquired during the year is being conducted

by Rahul K & Associates.
During the course of audit, CA. Soni, the engagement partner asked the management of Naveen Ltd. at the corporate office that in order to conduct the audit of the consolidated financial statements, his audit firm is required to conduct audit of the financial statements of all the components also (Companies acquired during the year). To this, the management asked CA. Soni to consider the audit reports of the component auditor already provided to his audit team and to communicate with the component auditor for any discussion they wish to have. CA. Soni contended that for the purpose of audit of consolidated financial statements either his firm is required to conduct an audit of all the component's financial statements, or he needs the working papers of the component auditors. Is the contention of CA. Soni correct?

Answer:

As per SA 600, "Using the work of Another auditor", the principal auditor is normally entitled to rely upon the work of component auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent (NTE) of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

The principal auditor should consider the significant findings of the other auditor.

The principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor.

Accordingly, CA. Soni, can perform the above-mentioned audit procedures. However, the audit of the component's financial statements by the principal auditor is not required.

So, the contention of CA. Soni that for the purpose of audit of consolidated financial statements he is required to conduct an audit of the components financial statements is not correct.

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

Accordingly, it is the discretion of the component auditor as the working papers with respect to the components examined by the component auditor are the property of the component auditor.

So, the contention of CA. Soni is not correct.

Question 4 **(MTP 2 May '24 5M)**

STU & Associates have been the statutory auditors of the listed company "First and Last Ltd.," operating in the petrochemical industry, for the past three years. CA. K, the engagement partner, had designed certain substantive procedures on some selected assertions in response to the assessed risk of material misstatements for the year under audit. These particular assertions were not examined by him in previous years due to materiality or risk considerations.

Mr. X leads the internal audit department of the company and reports to the company's audit committee. During the course of audit, a senior member of the engagement team decides to engage Mr. X for providing direct assistance in performing the above substantive procedures. Comment with respect to

the relevant Standards on Auditing.
Also, indicate the activities to be performed by the statutory auditor prior to using internal auditor for providing direct assistance.

Answer:

SA 610, "Using the Work of Internal Auditor" states that in determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned. Examples of activities and tasks that would not be appropriate to use internal auditors to provide direct assistance include the discussion of fraud risks, determination of unannounced audit procedures as addressed in SA 240 etc.

In the above case, engagement partner had designed certain substantive procedures on some selected assertions in response to assessed risk of material misstatements in year under audit. Such assertions were not tested by him in the previous years due to materiality or risk considerations. It is being done now for incorporating an element of unpredictability in audit procedures to be performed as individuals within the company who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting.

Therefore, in such matters, using an internal auditor to provide direct assistance could prove to be counter-productive and defeat the very purpose of designing such substantive procedures. Hence, decision of senior engagement team member to use Mr. X to provide direct assistance on above said matters is not in accordance with SA 610 and is not proper.

Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall: -

a. Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
b. Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

Question 5 **(PYP Nov '24 5M)**

UV Limited is a large multinational company with a global outreach. Due to the voluminous business, it has an in-house internal audit function to monitor the day-to-day operations of the company. LK and associates, Chartered Accountants have been engaged to conduct the statutory audit for the financial year 2023-24. Since the company has large scale operations and there is a limited time to perform statutory audit, CA L, the engagement partner decides to take direct assistance from the internal auditors for certain areas of audit. CA L assigns the audit documentation part to one of his audit assistants and instructs him to do the requisite documentation of working papers. Further, he tells his audit assistant not to document the working papers prepared by the internal auditors who directly assisted them, as it does not form part of statutory audit.

Is CA L right in excluding the working papers prepared by internal auditor from the audit documentation? Guide him as to the matters to be included in the Audit Documentation in this scenario.

Answer:

As per SA 610, Using the Work of an Internal Auditor, if the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:

(i) The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance.
(ii) The basis for the decision regarding the nature and extent of the work performed by the internal auditors.

(iii) Who reviewed the work performed and the date and extent of that review in accordance with SA 230 Audit Documentation.
(iv) The written agreements obtained from an authorized representative of the entity and the internal auditors and
(v) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

In the given situation, CA L the engagement partner decided to take direct assistance from the internal auditor for certain areas of audit and he assigned his audit assistant to do the requisite documentation of working papers. However, he instructed them not to document the working papers prepared by the internal auditors who directly assisted them as those documents do not form part of statutory audit.

In view of the above, the auditor is required to document the working papers prepared by the internal auditor in case of direct assistance, thus, contention of CA. L in excluding the working papers prepared by internal auditor from the audit documentation is not correct.

Question 6 **(PYP Nov '24 5M)**

MK Electronics Limited is a listed company with eight subsidiaries spread across various states. The financial statements of MK Electronics Ltd. are audited by CA Amar, the principal auditor. CA Amar relies on the work of other auditors for auditing the financial statements of subsidiaries. You are required to:

(i) Explain the procedures that CA Amar will perform to obtain sufficient appropriate audit evidence to ensure that the work of other auditors is adequate for his purpose.
(ii) Explain how he will document the working papers with respect to the subsidiaries audited by other auditors. What matters need to be documented if the other auditor's report is modified?

Answer:

(i) The principal auditor CA. Amar should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate for the principal auditor's purposes. When using the work of another auditor, CA. Amar the principal auditor should ordinarily perform the procedures given below:

(1) advise the other auditor regarding use of his (other auditor) work and report and make sufficient arrangements for co-ordination at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit;

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

(ii) CA Amar should document in his working papers, the components whose financial information audited by other auditors. CA Amar should also document the procedures performed and the conclusions reached. For example, the auditor would document the results of discussions with the other auditor and review of the written summary of the other auditor's procedures.

Where the other auditor's report is other than unmodified, the principal auditor should also document how he has dealt with the qualifications or adverse remarks contained in the other auditor's report in framing his own report.

Question 7 **(MTP M25 S1 4M)**

CA Raj has been appointed as the auditor of MARCO Pvt. Ltd., a private real estate company. During the audit, he requested information from the management to review the outcome of accounting estimates—such as estimated costs considered for percentage completion—used in the prior period financial statements. His objective was to assess their subsequent re-estimation for the current period. However, the management refused to provide the requested information, arguing that the auditor should not review prior period estimates. Please advise how should Raj deal with this situation?

Answer: Already covered in TYK Qn

Question 8 **(MTP M25 S1 4M)**

Rajveer & Associates have been the statutory auditors of Ish and Vish Ltd., a listed company. CA Vishav, the engagement partner, had designed certain substantive procedures on some selected assertions in response to the assessed risk of material misstatements for the year under audit. These assertions were not examined by him in previous years due to materiality or risk considerations.

Mr. Yug leads the internal audit department of the company and reports to the company's audit committee. During the audit, a senior member of the engagement team decides to engage Mr. Yug to provide direct assistance in performing the above substantive procedures. Comment with respect to the relevant Standards on Auditing.

Also, indicate the activities to be performed by the statutory auditor prior to using internal auditor for providing direct assistance.

Answer:

As per SA 610, "Using the Work of Internal Auditors", prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:

(i) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and

(ii) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

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

(a) There are significant threats to the objectivity of the internal auditor; or

(b) The internal auditor lacks sufficient competence to perform the proposed work.

In the current scenario, Rajveer & Associates are the statutory auditors of Ish and Vish Ltd., a listed company. CA. Vishav, the engagement partner, designed certain substantive procedures on some selected assertions in response to the assessed risks of material misstatements for the year, which were not previously examined. Mr. Yug, head of the internal audit department, reports to the audit committee. A senior audit team member decides to involve Mr. Yug in performing these substantive procedures.

As a result, the Rajveer & Associates is required to obtain written agreements from both the entity and the internal auditors regarding their cooperation and confidentiality. Further, using an internal auditor to provide direct assistance could prove to be counter-productive and defeat the very purpose of designing such substantive procedures. Hence, the decision of senior engagement team member to use Mr. Yug to provide direct assistance on above said matters is not in order as it is not in accordance with SA 610.

Question 9 **(MTP M25 S2 4M)**

Surya Pvt. Ltd., engaged in the business of real estate, appointed CA Amit as the auditor for F.Y. 2023-24. During the audit, CA Amit requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc.) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.

Answer: Already covered in TYK Qn

Question 10 **(PYP May 25 5M)**

CA A has been appointed as an auditor of Datacom Ltd. to conduct statutory audit. The company has various derivative contracts - options, forward contracts, interest rate swaps etc. which were required to be fairly valued for which company got the fair valuation done through an external third party. CA A involved a registered valuer Mr. S as an auditor's expert to do the valuation of derivatives in order to obtain sufficient appropriate audit evidence. CA A and Mr. S are new to each other and they were working for the first time. Mr. S performed his work and submitted the report. CA A, while evaluating the adequacy of the work of Mr. S, observed that expert's work involved use of significant assumptions and methods. Consequently he wants to test the relevance and reasonableness of those assumptions and methods in the applicable circumstances. Guide CA A in this regard as per relevant Standard on Auditing.

Answer:

Testing the relevance and reasonableness of assumptions and methods used by the auditor's expert: As per SA 620, "Using the Work of an Auditor's Expert", when an auditor uses the work of an expert, they must evaluate whether the expert's work is adequate for the auditor's purposes. In the given case, CA A, statutory auditor of Datacom Ltd., is using the valuation report of Mr. S, a registered valuer, for auditing derivative instruments. CA A also observed that an expert's work involves the use of significant assumptions and methods. Accordingly, he must assess the relevance and reasonableness of the expert's assumptions, methods, and findings in the circumstances as per SA 620.

SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures", discusses the assumptions and methods used by management in making accounting estimates, including the use in some cases of highly specialised, entity-developed models. Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management's assumptions and methods, it may also assist the auditor when evaluating an auditor's expert's assumptions and methods.

When an auditor's expert's work involves the use of significant assumptions and methods, factors relevant to the auditor's evaluation of those assumptions and methods include whether they are:

- ✓ Generally accepted within the auditor's expert's field;
- ✓ Consistent with the requirements of the applicable financial reporting framework;
- ✓ Dependent on the use of specialised models; and
- ✓ Consistent with those of management, and if not, the reason for, and effects of, the differences.

Exceptional questions

SA 450

Question 1 Exceptional **(RTP Nov '18 | May '22)**

In audit plan for TELCO Ltd, as the audit partner you want to highlight the sources of misstatements arising from other than fraud to your audit team and caution them.
Identify the sources of misstatements.

Answer:

According to SA 450 "Evaluation of Misstatements identified during the Audit", the following are the sources of misstatements arising from other than fraud:

a. An inaccuracy in gathering or processing data from which the financial statements are prepared.
b. An omission of an amount or disclosure.
c. An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and
d. Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

Question 2 Exceptional **(MTP 2 Nov '24 5M)**

While assessing the impact of uncorrected misstatements in the audit of MINI Builders Private Limited, Mr. Gautam encountered a significant issue related to the calculation of materiality on revenue. The initial materiality calculation was based on estimated figures provided by the management. Management, to estimate full-year revenue, extrapolated the sales for 11 months to arrive at a figure for 12 months. However, given the nature of MINI Builders as a company in the construction sector, where monthly sales exhibit substantial variations, a unique challenge emerged.
The actual sales for the last month deviated significantly from the estimated sales due to an unexpected slowdown in project completions. As a result, the last month's actual sales represented only 30% of the estimated sales. Now, Mr. Gautam is confronted with a dilemma regarding the appropriate approach to evaluate uncorrected misstatements using the previously calculated materiality. Kindly Guide Mr. Gautam in the light of relevant Standards on Auditing.

Answer:

As per SA 450, "Evaluation of Misstatements Identified during the Audit", the auditor is required to reassess materiality, in accordance with SA 320 "Materiality in Planning and Performing an Audit", before evaluating the impact of uncorrected misstatements. This reassessment is crucial to confirm the ongoing appropriateness of materiality in light of the entity's actual financial results.
The determination of materiality under SA 320 often relies on estimates of the entity's financial results, given that the actual results may not be known during the early stages of the audit. Therefore, before the auditor proceeds to assess the effect of uncorrected misstatements, it becomes necessary to adjust the materiality calculated under SA 320 based on the now available actual financial results.
SA 320 outlines that, as the audit progresses, materiality may be revised for the financial statements as a whole or for specific classes of transactions, account balances, or disclosures. This revision is prompted by the auditor's awareness of information that would have led to a different initial determination. Typically, significant revisions occur before the evaluation of uncorrected misstatements. However, if the reassessment of materiality under SA 320 results in a lower amount, the auditor must reconsider performance materiality and the appropriateness of the audit procedures' nature, timing, and extent. This is crucial for obtaining sufficient and appropriate audit evidence on which to base the audit opinion.

In the present case involving MINI Builders Private Limited, it has been identified that the materiality calculated at the beginning of the audit for revenue was based on estimates provided by the management. The management extrapolated sales for the full year using the actual amount of 11 months, but since the company experiences significant monthly variations in sales, the actual sales for the last month were only 30% of the estimated figure. This discrepancy arose due to an unexpected slowdown in project completions.

In this audit scenario, Mr. Gautam, the auditor, must review and re-assess the materiality initially determined under SA 320 to ensure its continued validity in light of the actual financial results. If the re-assessed materiality is lower than the previously calculated amount, Mr. Gautam must reconsider performance materiality and the appropriateness of the nature, timing, and extent of further audit procedures. This meticulous approach is essential to gather sufficient and appropriate audit evidence, enabling Mr. Gautam to form an independent and objective opinion on the financial statements of MINI Builders Private Limited.

SA 520

Question 3 **(PYP Nov '18)**

In audit of DEF Limited, the Auditor had made use of certain analytical procedures with regard to certain key data in the Statement of Profit and Loss. The results obtained showed inconsistencies with other relevant information. State the course of action that the Auditor should take to ensure that the risk of material misstatement would be contained to a low level fixed as per materiality level.

Answer:

Investigating Results of Analytical Procedures: As per SA 520, "Analytical Procedures", if analytical procedures performed in accordance with this SA 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; and

(ii) Performing other audit procedures as necessary in the circumstances.

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.

The need to perform other audit procedures may arise when 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.

SA 540

Question 4 **(PYP Jan '21)**

M/s. HK & Co. was appointed as an auditor of GSB Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, GSB Limited is required to pay certain percentage of its annual revenue as license fee. GSB Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues and not only on core business revenues. Matter was disputed and went to court of law. On prudence basis, GSB Limited made a provision on estimated business in its books of accounts of agreed percentage on non-core business receipts also. The amount of provision was of such huge amount that the GSB Limited's profit and loss account for that quarter reflected loss due to that provision. How you as an auditor can evaluate this accounting estimate which involves significant risk and what if Management has not addressed the effects of estimation uncertainty on provision made?

Answer:

The given case, HK & Co. was appointed as an auditor of GSB Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that GSB Ltd.'s profit and loss account reflected a loss due to that provision.

For accounting estimates that give rise to significant risks, in + the reasonableness of the accounting estimate.

Question 5 Exceptional **(PYP Nov '19)**

Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing.

Answer:

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

SA 580, "Written Representations" discusses the use of written representations. Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

1. About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.
2. That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
3. That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.
4. That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

SA 610

Question 6 **(RTP - May '18)**

Mr. Anand is appointed as statutory auditor of Xerox Ltd. Xerox Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhanu as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhanu, internal auditor as stated above in view of auditing standards.

Answer:

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

Involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following:

- Assessing the risks of material misstatement;
- Evaluating the sufficiency of tests performed;
- Evaluating the appropriateness of management's use of the going concern assumption;
- Evaluating significant accounting estimates; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

SA 620

Question 7 Exceptional **(RTP Nov '18)**

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

Answer: Already covered in TYK Qn

Question 8 Exceptional **(MTP 2 Nov '24 5M)**

While assessing the impact of uncorrected misstatements in the audit of MINI Builders Private Limited, Mr. Gautam encountered a significant issue related to the calculation of materiality on revenue. The initial materiality calculation was based on estimated figures provided by the management. Management, to estimate full-year revenue, extrapolated the sales for 11 months to arrive at a figure for 12 months. However, given the nature of MINI Builders as a company in the construction sector, where monthly sales exhibit substantial variations, a unique challenge emerged.

The actual sales for the last month deviated significantly from the estimated sales due to an unexpected slowdown in project completions. As a result, the last month's actual sales represented only 30% of the estimated sales. Now, Mr. Gautam is confronted with a dilemma regarding the appropriate approach to evaluate uncorrected misstatements using the previously calculated materiality. Kindly Guide Mr. Gautam in the light of relevant Standards on Auditing.

Answer: Already covered in Execeptional Qn

Question 9 Exceptional **(MTP 2 Nov '24 5M)**

Mr. Atharv, while conducting the audit of Black Mountain Mining Ltd., which is involved in phosphate mining, decided to engage an auditor's expert to assess environmental liabilities and site clean-up costs. Black Mountain Mining Ltd. re-appointed Mr. Aman as an independent expert for this task. For the past five years, the management has consistently re-appointed Mr. Aman. He calculated the environmental liabilities for both completed mining sites and sites scheduled for closure in the near future, including provisions for clean-up costs. Management accepted his assessment.

Mr. Atharv, after performing the inquiries with management, was of the opinion that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. Hence, there is no need to raise a question on the objectivity of Mr. Aman or on his work performed for the company. However, the audit partner was of the opinion that the audit team needs to evaluate the objectivity of an expert engaged by the entity, irrespective of the fact that he was appointed as an independent expert.

Guide the audit partner and Mr. Atharv with respect to requirements pertaining to evaluating the objectivity of the management expert.

Answer:

As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, have regard to the significance of that expert's work for the auditor's purposes evaluate the competence, capabilities and objectivity of that expert.

A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the management's expert's profession, legislation or regulation), or by the management's expert's work environment (for example, quality control policies and procedures). Although safeguards cannot eliminate all threats to a management expert's objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert's objectivity and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:

- ✓ Financial interests.
- ✓ Business and personal relationships.
- ✓ Provision of other services.

In the current case, Black Mountain Mining Ltd. re-appointed Mr. Aman for this engagement as an independent expert. The audit team was of the view that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. However, the audit partner had a contrary view.

Hence, the audit team should evaluate the objectivity of an expert engaged by the entity as the threat to objectivity, created by being an employee of the entity, will always be present. An expert appointed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity. As a result, audit partner Atharva is correct in his view.

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

CA R is conducting statutory audit of a Divisional office (DO) of a public sector insurance company. On going through delegation of powers laid down by company's head office, it is noticed that surveyors in claims under property insurance policies beyond estimated amounts of ` 30 lac are to be appointed by Divisional Claims Committee (DCC). However, ongoing through surveyor appointment details of 10 such claims during the year, 5 instances have come to his notice where above delegation of powers has not been followed and appointments were made by Divisional manager in place of DCC. In the beginning, the auditor had assessed risks of material misstatement to be low. Describe why the above finding would change auditor's assessment in relation to above.

Answer:

Evaluation of Internal Controls influences auditor's assessment of risks of material misstatement. Risks of material misstatement also consists of control risk.

In the given situation of statutory audit of a Divisional office of a public sector insurance company, it is noticed that procedure relating to delegation of powers has not been followed and surveyor appointments have been made in violation of laid down procedures. It is a serious violation and shows that controls are not operating effectively as laid down by company management.

Such deviations from established controls may lead auditor to conclude that control risk needs to be revised. Revision of control risk assessment is likely to lead to revision in risks of material misstatement. It may also result in modification of nature, timing and extent of planned substantive procedures.

Test Your Understanding 2. Exceptional

You have recently been appointed as an auditor of NGO working in the field of "upholding democracy" for the first time. The last year accounts of NGO were unaudited and its activities were limited at a small scale. However, it is only in the current year that NGO has received substantial donations including foreign funds. The said NGO is also crowdfunding its donations. The government has now legislative power to cancel FCRA certificate of NGO. Since it is working in a field which encompasses political and social fields, accusations and counter-accusations are flying thick and fast. What factors you may consider for assessing audit risk?

Answer:

For assessing audit risk, auditor shall consider all components of audit risk. The said NGO is working in a political-cum-social field which can make its activities inherently risky. Crowd funding donations may have to be seen in relation to the constitution of NGO which may make these risky. Since the NGO is in receipt of foreign funds, it may make transactions inherently risky. The credibility and integrity of persons behind NGO is important. Shady NGOs can be involved in money laundering activities and may be involved in mis utilizing funds from donors. Since last year's accounts were unaudited, it also increases the inherent risk due to the probable effect of misstatements, if any, of last year. Non-compliance with strict laws has the potential to make activities of NGO inherently risky.

Since NGO has received substantial donations in the current year and its activities were on a relatively small scale during last year, formal controls may not be in place. Lack of formal controls may lead to non-compliance with laws. Non-compliance with FCRA can have serious consequences including cancelling such certificate of NGO. Therefore, control risk could be high.

Further, audit for NGO has been accepted for the first time. There may be a lack of understanding of activities of NGO. It may lead to higher detection risk due to inappropriate sampling procedures or faulty application of audit procedures.

Test Your Understanding 3. Exceptional

RK Living Limited is engaged in manufacturing and processing of textile fabrics. It purchases its raw material from a company based in Silvassa taxable @ 12%. It takes about 3-4 days for raw materials to reach the company's plant. Recently, the company has revamped its internal control system for recording its transactions. You have also assumed charge as head of the internal audit department of the company a few days before. It is noticed that the information system requires booking of purchases in purchase ledger and stock records from date of purchase invoice only. How would you deal with the above matter as internal auditor of the company?

Answer:

Internal audit involves continuous and critical appraisal of functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity including its strategic risk management and internal control system. Internal audit also involves evaluation of internal control to provide assurance to management regarding design, implementation and operating effectiveness of control.

In the given situation, the information system requires booking of purchases in purchase ledger and stock records from date of invoice. Such a control system is likely to present a distorted picture of stocks of the company. It would show stocks of raw material as received whereas these goods could be in transit. Therefore, the design of the control itself is faulty, which allows booking from date of purchase invoice only. Further, such a system can have implications with respect to GST laws.

The internal auditor should report on the above matter asking management for corrective action.

Test Your Understanding 4. Exceptional

A company as part of its internal control set up has a system under which quarterly budgeted targets in respect of sales are analysed with respect to actual performance achieved. It also involves fixing responsibilities of different product departmental heads and taking timely correction. In case of product departmental heads not achieving quarterly budgeted targets, they have to give a detailed justification for the same and also lay down how shortfalls would be compensated in ensuing quarters. Identify and explain component of internal control alluded to in above scenario.

Answer:

The above referred component of internal control is "Control activities". Control activities that may be relevant to an audit include policies and procedures that pertain to "performance reviews".

Such control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance.

The control activities pertaining to analysis of budgeted target of sales with respect to actual performance, fixing of responsibilities and taking timely corrective action falls in nature of performance reviews. Such performance reviews are part of control activities which is a component of internal control.

Test Your Understanding 5.

CA S is statutory auditor of a listed company. On reviewing internal controls of the company, he is of the view that there can be possible situations where insurance premiums for keeping insurance policies current in respect of various assets of company may have become due and payable but internal control systems established by the company may not be able to capture it. Elaborate how he should proceed to deal with the above matter.

Answer:

A deficiency in internal control exists when:

i. A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or

ii. A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

In the above situation, there is a possibility that internal control systems established by the company may not be able to capture insurance premiums which may have become due and payable. It is a significant deficiency as failure to keep insurance policies current would render assets of the company uninsured. It may lead to losses for the company in case of any eventuality.

Further, in accordance with SA 265, the significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may, therefore, exist even though the auditor has not identified misstatements during the audit.

The susceptibility to loss of an asset is a factor in determining whether a deficiency constitutes significant deficiency in internal control.

The auditor shall communicate in writing significant deficiency in internal control to those charged with governance and include in the written communication of significant deficiencies in internal control: -

a. A description of the deficiencies and an explanation of their potential effects; and

b. Sufficient information to enable those charged with governance and management to understand the context of the communication.

Illustrations from ICAI SM

Illustration 1:

Background: During the process of extracting the exception reports, the auditors noted numerous purchase entries without valid purchase orders.

Analysis: In terms of percentage, about 40% of purchases were made without valid purchase orders and also few purchase orders were validated after the actual purchase. Also, there was no reconciliation between the goods received and the goods ordered.

Assertions: Validity of purchases

Pervasive/Account Balance Level: Account Balance level Account Balance(s) affected:

(i) Purchases, (ii) Account Payable

Audit Procedures: The following procedures may address the validity of the account balance: • Make a selection of the purchases, review correspondence with the vendors, purchase requisitions (internal document) and reconciliations of their accounts.

- ✓ Review Vendor listing along with the ageing details. Follow up the material amounts paid before the normal credit period and analyse the reasons for exceptions.
- ✓ Meet with the company's purchase officer and obtain responses to our inquiries regarding the purchases made without purchase orders.
- ✓ Discuss the summary of such issues with the client.

Test Your Knowledge

Question 1 Exceptional

CA B was appointed as the auditor of ABC Limited for the financial year 2023-24. During the course of planning for the audit, CA B intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to the factors that may affect the identification of an appropriate benchmark for this purpose.

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

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

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

Answer:

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

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

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

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

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

In case ABC Limited is engaged in the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic: CA B, the auditor may consider Revenue or Gross Profit as benchmarking.

Alternatively, CA B, the auditor may consider the criteria relevant for audit of the entities doing public utility programs/ projects, Total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for that particular program/project activity. Where an entity has custody of the assets, assets may be an appropriate benchmark.

Question 2

What are the components of an internal control framework?

Answer:

There are five components of an internal control framework. They are as follows:

- ✓ Control Environment;
- ✓ Risk Assessment;
- ✓ Information & Communication;
- ✓ Monitoring;
- ✓ Control Activities.

Question 3

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

Answer:

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

i. A description of the deficiencies and an explanation of their potential effects; and

ii. Sufficient information to enable those charged with governance and management to understand the context of the communication.

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

1. The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
2. It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
3. This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
4. The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

Question 4

Explain briefly the Flow Chart technique for evaluation of the Internal Control system.

Answer:

The flow-charting technique can also be resorted to for evaluation of the internal control system. It is a graphic presentation of internal controls in the organisation and is normally drawn up to show the controls in each section or sub-section. As distinct from a narrative form, it provides the most concise and comprehensive way for reviewing the internal controls and the evaluator's findings. In a flow chart, narratives, though cannot perhaps be totally banished are reduced to the minimum and by that process, it can successfully bring the whole control structure, especially the essential parts thereof, in a condensed but wholly meaningful manner. It gives a bird's eye view of the system and is drawn up as a result of the auditor's review thereof. It should, however, not be understood that details are not reflected in a flow chart. Every detail relevant from the control point of view and the details about how an operation is performed can be included in the flow chart. Essentially a flow chart is a diagram full with lines and symbols and, if judicious use of them can be made, it is probably the most effective way of presenting the state of internal controls in the client's organisation.

So far we have seen the points of weaknesses that are evident from these flow charts. For a clearer understanding of the flow chart as a medium for evaluating internal controls, the following further points may be useful:

a. There exists proper numerical control over orders booked (except the case for the salesmen's orders).
b. There is a permanent and continuous record of the orders booked in the form of order book.
c. There is a definite basis for raising sales advices.
d. The order book record is always kept complete by entering the information about the execution of the order and this keeps the information about the pending orders ready at any moment.
e. Partly executed orders are reviewed from time to time so that as soon as goods are available, the same may be dispatched to customers.
f. The customer's purchase order and the related sales advice are matched and kept together in the customer's file.
g. The sales advices are initialed by the Dispatch Section head as token of his having satisfied himself about the correctness of the entries as regards the quantity dispatched and the date of dispatch.
h. Record of actual direct delivery is maintained through the copy of the sales advice bearing the customer's acknowledgement of his having received the goods. Similarly, the record of out station deliveries is kept in the copy of the forwarding note annexed to the sales advice copy.
i. Documents have as many copies as are necessary for ensuring proper flow and proper control. There is neither wastage through unnecessary copies nor any hold up because of inadequacy of copies.
j. There are supporting documents for raising invoices and credit notes.
k. The distribution of invoices and credit notes is such as would enable the recording of billing at the relevant centres independent of each other.
l. There is control over the number of invoices and credit notes by pre-numbering.

Question 5

As auditor of Z Ltd., you would like to limit your examination of account balance tests. What are the control objectives you would like the accounting control system to achieve to suit your purpose?

Answer:

Basic Accounting Control Objectives: The basic accounting control objectives which are sought to be achieved by any accounting control system are -

i. Whether all transactions are recorded;
ii. Whether recorded transactions are real;
iii. Whether all recorded transactions are properly valued;
iv. Whether all transactions are recorded timely;
v. Whether all transactions are properly posted;
vi. Whether all transactions are properly classified and disclosed;
vii. Whether all transactions are properly summarized

Question 6

New Life Hospital is a multi-speciality hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. According to you, which basic system of control has been violated? Also list down the other general conditions pertaining to such system which needs to be maintained and checked by the management.

Answer:

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, wherever 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.

Question 7

Compute the overall Audit Risk if looking to the nature of business there are chances that 40% bills of services provided would be defalcated, inquiring on the same matter management has assured that internal control can prevent such defalcation to 75%. At his part the Auditor assesses that the procedure he could apply in the remaining time to complete Audit gives him satisfaction level of detection of frauds & error to an extent of 60%. Analyse the Risk of Material Misstatement and find out the overall Audit Risk.

Answer:

According to SA-200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the Audit Risk is a risk that Auditor will issue an inappropriate opinion while Financial Statements are materially misstated.

Audit Risk has two components: Risk of material Misstatement and Detection Risk. The relationship can be defined as follows.

Audit Risk = Risk of Material Misstatement X Detection Risk

Risk of Material Misstatement: - Risk of Material Misstatement is anticipated risk that a material Misstatement may exist in Financial Statement before start of the Audit. It has two components Inherent risk and Control risk. The relationship can be defined as

Risk of Material Misstatement = Inherent risk X control risk

Inherent risk: It is a susceptibility of an assertion about account balance; class of transaction, disclosure towards misstatements which may be either individually or collectively with other Misstatement becomes material before considering any related internal control which is 40% in the given case.

Control risk: It is a risk that there may be chances of material Misstatement even if there is a control applied by the management and it has prevented defalcation to 75%.

Hence, control risk is 25% (100%-75%)

Risk of Material Misstatement: Inherent risk X Control risk i.e., 40% X 25 % = 10%

Chances of Material Misstatement are reduced to 10% by the internal control applied by management.

Detection risk: It is a risk that a material misstatement remained undetected even if all audit procedures applied, Detection Risk is 100-60=40%

In the given case, overall Audit Risk can be reduced up to 4% as follows:

Audit Risk: Risk of Material Misstatement X Detection Risk = 10X 40% = 4%

Question 8

ST Ltd is a growing company and currently engaged in the business of manufacturing of tiles. The company is planning to expand and diversify its operations. The management has increased the focus on the internal controls to ensure better governance. The management had a discussion with the statutory auditors to ensure the steps required to be taken so that the statutory audit is risk based and focused on areas of greatest risk to the achievement of the company's objectives. Please advise the management and the auditor on the steps that should be taken for the same.

Answer:

The auditor's objective in a risk-based audit is to obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist in the financial statements.

This involves the following three key steps:

- ✓ Assessing the risks of material misstatement in the financial statements;
- ✓ Designing and performing further audit procedures that respond to assessed risks and reduce the risks of material misstatements in the financial statements to an acceptably low level; and
- ✓ Issuing an appropriate audit report based on the audit findings.

The risk-based audit process is presented in three distinct phases:

- ✓ Risk assessment.
- ✓ Risk response; and
- ✓ Reporting.

Question 9

Y Co. Ltd. has five entertainment centers to provide recreational facilities for public especially for children and youngsters at 5 different locations in the peripheral of 200 kilometers. Collections are made in cash. Specify the adequate system towards collection of money.

Answer:

Control System over Selling and Collection of Tickets: In order to achieve proper internal control over the sale of tickets and its collection by the Y Co. Ltd., following system should be adopted -

i. Printing of tickets: Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.
ii. Ticket sales: The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.
iii. Daily cash reconciliation: Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.
iv. Daily banking: Each day's collection should be deposited in the bank on the next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.
v. Entrance ticket: Entrance tickets should be cancelled at the entrance gate when the public enters the centre.
vi. Advance booking: If advance booking of facility is made available, the system should ensure that all advance booked tickets are paid for.
vii. Discounts and free pass: The discount policy of the Y Co. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.
viii. Surprise checks: Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.

Question 10

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Explain.

Answer:

a. Communication and enforcement of integrity and ethical values: The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the product of the entity's ethical and behavioral standards, how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.
b. Commitment to competence: Competence is the knowledge and skills necessary to accomplish tasks that define the individual's job.
c. Participation by those charged with governance: An entity's control consciousness is influenced significantly by those charged with governance. The importance of the responsibilities of those charged with governance is recognised in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle blower procedures and the process for reviewing the effectiveness of the entity's internal control.

d. Management's philosophy and operating style: Management's philosophy and operating style encompass a broad range of characteristics. For example, management's attitudes and actions toward financial reporting may manifest themselves through conservative or aggressive selection from available alternative accounting principles, or conscientiousness and conservatism with which accounting estimates are developed.

e. Organisational structure: Establishing a relevant organizational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's organisational structure depends, in part, on its size and the nature of its activities.

f. Assignment of authority and responsibility: The assignment of authority and responsibility may include policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties. In addition, it may include policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable.

g. Human resource policies and practices: Human resource policies and practices often demonstrate important matters in relation to the control consciousness of an entity. For example, standards for recruiting the most qualified individuals – with emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behaviour – demonstrate an entity's commitment to competent and trustworthy people. Training policies that communicate prospective roles and responsibilities and include practices such as training schools and seminars illustrate expected levels of performance and behaviour. Promotions driven by periodic performance appraisals demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility.

Question 11

Your engagement team is seeking advice from you as engagement partner regarding steps for risk identification. Elaborate.

Answer:

- ✓ Assess the significance of the assessed risk, impact of its occurrence and also revise the materiality accordingly for the specific account balance.
- ✓ Determine the likelihood for assessed risk to occur and its impact on auditing procedures.
- ✓ Document the assertions that are affected.
- ✓ Consider the impact of the risk on each of the assertions.
- ✓ (completeness, existence, accuracy, validity, valuation and presentation) relevant to the account balance, class of transactions, or disclosure.
- ✓ Identify the degree of significant risks that would require separate attention and response by the auditor. Planned audit procedures should directly address these risks.
- ✓ Enquire and document the management's response.
- ✓ Consider the nature of the internal control system in place and its possible effectiveness in mitigating the risks involved. Ensure the controls:
    - ❖ Routine in nature (occur daily) or periodic such as monthly.
    - ❖ Designed to prevent or detect and correct errors.
    - ❖ Manual or automated.
- ✓ Consider any unique characteristics of the risk.
- ✓ Consider the existence of any particular characteristics (inherent risks) in the class of transactions,

account balance or disclosure that need to be addressed in designing further audit procedures.

✓ Examples could include high value inventory, complex contractual agreements, absence of a paper trail on certain transaction streams or a large percentage of sales coming from a single customer.

Question 12

BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2023-24. In order to review internal controls of the Sales Department of the company, you visited the Department and noticed the work division as follows: (1) An officer was handling the sales ledger and cash receipts. (2) Another official was handling dispatch of goods and issuance of Delivery challans. (3) One more officer was there to handle customer/ debtor accounts and issue of receipts.

As an internal auditor, you are required to briefly discuss the general condition pertaining to the internal check prevalent in internal control system. Do you think that there was proper division of work in BSF Limited? If not, why?

Answer: Already covered in TYK Qn

Question 13 Exceptional **(Newly Added)**

While assessing the impact of uncorrected misstatements in the audit of MINI Builders Private Limited, Mr. Gautam encountered a significant issue related to the calculation of materiality on revenue. The initial materiality calculation was based on estimated figures provided by the management. Management, to estimate full-year revenue, extrapolated the sales for 11 months to arrive at a figure for 12 months. However, given the nature of MINI Builders as a company in the construction sector, where monthly sales exhibit substantial variations, a unique challenge emerged.

The actual sales for the last month deviated significantly from the estimated sales due to an unexpected slowdown in project completions. As a result, the last month's actual sales represented only 30% of the estimated sales. Now, Mr. Gautam is confronted with a dilemma regarding the appropriate approach to evaluate uncorrected misstatements using the previously calculated materiality. Kindly Guide Mr. Gautam in the light of relevant Standards on Auditing.

Answer: Already covered in Chapter 3

Question 14 Exceptional **(Newly Added)**

Deepti & Co., Chartered Accountants, during the audit of Magma Ltd. found that certain machinery had been imported for the production of a new product. Although the auditors have applied the concept of materiality to the financial statements as a whole, they now want to re-evaluate the materiality concept for the said transaction involving foreign exchange. Give your views in this regard?

Answer:

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

The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

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

In the given case, Deepti & Co., as an auditor has applied the concept of materiality for the financial statements as a whole. But they want to re-evaluate the materiality concept on the basis of additional information of import of machinery for production of new product which draws attention to a particular aspect of the company's business.

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

Question 15 **(Newly Added)**

AMRO Ltd. is a manufacturing and trading Company of leather goods since last 10 years. You are the internal auditor of the company for the year 2023-24. In order to review internal controls of the company, you visited the departments and noticed:

1. The head of procurement, Mr. Amit, has complete control over purchasing, receiving goods, and approving payments to suppliers. His actions are not reviewed by any other person in the company.
2. The company's staff has been working in the same roles for over five years without any rotation. The finance manager, Mr. Sachin, in particular, has never had his duties rotated since joining the company.
3. The store manager, Mr. Gupta, who is responsible for maintaining the inventory, also keeps the inventory records.
    a. Briefly discuss the general conditions pertaining to the internal check system to be ensure by you as an auditor.
    b. Do you think that general conditions pertaining to the internal check system are violated in the given situation?

Answer:

a. Already covered in TYK Qn

b. Yes, in the given situation general conditions pertaining to the internal check system are violated as follows:
    i. The head of procurement, Mr. Amit, having complete control over the procurement process without oversight violates the principle that no single person should control any important aspect of the business operation.
    ii. The lack of staff rotation for over five years violates the principle that staff duties should be rotated periodically to prevent any single person from performing the same function for too long.
    iii. Allowing Mr. Gupta, the store manager, to maintain inventory records while also having custody of the inventory violates the principle that those with physical custody of assets should not have access to accounting records.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 4M)**

Deepti & Co., Chartered Accountants, during the audit of a Magma Ltd. found that certain machinery had been imported for production of new product. Although the auditors have applied the concept of materiality to the financial statements as a whole, they now want to re-evaluate the materiality concept for the said transaction involving foreign exchange. Give your views in this regard?

Answer: Already covered in TYK Qn

Question 2 **(MTP 2 Nov '24 5M)**

Suneel was appointed as the auditor of PCM Ltd. for the financial year 2022-23. During the course of planning for the audit, CA. Suneel intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to the factors that may affect the identification of an appropriate benchmark for this purpose.

What benchmark should be adopted by CA. Suneel, if PCM Ltd. is engaged in:

i. the manufacture and sale of air conditioners and is having regular profits.
ii. the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic.

Answer: Already Covered in TYK Qn

Question 3 **(MTP M25 S1 4M)**

Joy World Pvt. Ltd. operates five amusement centres that offer recreational activities for families, especially children and young adults. These centres are spread across different locations within a 250-kilometer radius. Since ticket sales and ride fees are collected primarily in cash, ensuring proper control over collections is crucial to prevent fraud, mismanagement, and revenue leakage.

To maintain transparency and accuracy in cash handling, what internal control measures should Joy World Pvt. Ltd. implement for ticket sales and collections?

Answer:

Control System over Selling and Collection of Tickets: In order to achieve proper internal control over the sale of tickets and its collection by the Joy World Pvt. Ltd., following system should be adopted -

i) Printing of tickets: Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.
ii) Ticket sales: The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.
iii) Daily cash reconciliation: Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.
iv) Daily banking: Each day's collection should be deposited in the bank on the next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.
v) Entrance ticket: Entrance tickets should be cancelled at the entrance gate when the public enters the centre.
vi) Advance booking: If advance booking of facility is made available, the system should ensure that all

advance booked tickets are paid for.

vii) Discounts and free pass: The discount policy of the Joy World Pvt. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.

viii) Surprise checks: Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.

Question 4 **(MTP M25 S2 4M)**

Ananya & Co., Chartered Accountants, during the audit of Krishna Ltd. found that certain machinery had been imported for the production of a new product. Although the auditors have applied the concept of materiality to the financial statements as a whole, they now want to re-evaluate the materiality concept for the said transaction involving foreign exchange. Give your views in this regard?

Answer:

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

The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

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

In the given case, Ananya & Co., as an auditor has applied the concept of materiality for the financial statements as a whole. But they want to re-evaluate the materiality concept on the basis of additional information of import of machinery for production of new product which draws attention to a particular aspect of the company's business.

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

Exceptional Questions

Question 1. **(PYP Jan '21)**

Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd., you observed that significant deficiency exists in the internal control system and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization.

Answer:

In the given case of ABC Ltd, Auditors, while conducting audit has come across significant deficiency existing in the internal control system and also auditors wanted to ascertain that deficiency.

As per SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management ", Indicators of significant deficiencies in internal control include, for example:

1. Evidence of ineffective aspects of the control environment, such as:
    a. Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
    b. Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
    c. Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
2. Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
3. Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
4. Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
5. Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
6. Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
7. Evidence of management's inability to oversee the preparation of the financial statements.

Question 2. Exceptional

You are engaged by M/s. Real Ltd. as an internal auditor for the financial year 2020-2021. While applying risk assessment procedures of inquiring from management and various analytical procedures, you have identified some risks which in your opinion may lead to material misstatement at the financial level and assertion level. Which factors as an auditor will you consider while exercising judgement as to whether such risks are significant risks or not?

Answer:

The internal auditor of Real Ltd. has identified some risks while he was applying risk assessment procedures and various analytical procedures.

As per SA 315, "Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and its Environment", in exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

1. Whether the risk is a risk of fraud.

2. Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment and therefore requires specific attention.
3. The complexity of transactions
4. Whether the risk involves significant transactions with related parties.
5. The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty and
6. Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Question 3. **(PYP Nov '20)**

CA. N has been appointed as an auditor of TRP Ltd. While conducting the audit he has identified some deficiencies in the Internal control. He needs to determine whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency" and has to communicate them in writing to those charged with Governance and management on a timely basis. Guide CA. N with some examples of matters to be considered while determining 'significant deficiency' in internal control with reference to relevant SA.

Answer:

As per SA 265 "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", significant deficiency in internal control means a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgement, is of sufficient importance to merit the attention of those charged with governance.

Examples of matters that CA N, auditor of TRP Ltd may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

1. The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
2. The susceptibility to loss or fraud of the related asset or liability.
3. The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
4. The financial statement amounts exposed to the deficiencies.
5. The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
6. The importance of the controls to the financial reporting process; for example:
   a. General monitoring controls (such as oversight of management).
   b. Controls over the prevention and detection of fraud.
   c. Controls over the selection and application of significant accounting policies.
   d. Controls over significant transactions with related parties.
   e. Controls over significant transactions outside the entity's normal course of business.
   f. Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).

Question 4. **(RTP May '19)**

ST Ltd is a growing company and currently engaged in the business of manufacturing of tiles. The company is planning to expand and diversify its operations. The management has increased the focus on the internal controls to ensure better governance. The management had a discussion with the statutory auditors to ensure the steps required to be taken so that the statutory audit is risk based and focused on areas of greatest risk to the achievement of the company's objectives. Please advise the management and the auditor on the steps that should be taken for the same.

Answer:

Audit should be risk-based or focused on areas of greatest risk to the achievement of the audited entity's objectives. Risk-based audit (RBA) is an approach to audit that analyzes audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas.

RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable level and the reporting to auditee of audit results. These are achieved through the following:

Step 1 - Understand auditee operations to identify and prioritize risks: Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

Step 2 - Assess auditee management strategies and controls to determine residual audit risk: Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.

Step 3 - Manage residual risk to reduce it to acceptable level: Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.

Step 4 - Inform auditee of audit results through appropriate report: The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of internal controls that affect the organization's ability to record, process, summarize and report financial data.

Question 5. **(RTP Nov '22)**

Arihant Limited was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2021-22. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to Rs.35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings.

In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement.

Answer:

As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall , based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

In accordance with SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and SA 330," The Auditor's Responses to Assessed Risks" the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level and assertion level.

The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property. However, when there is a complex revenue structure or when there is lack of controls on revenue recognition, then there is a high probability of fraud risk in revenue recognition.

Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.

In the current scenario, the company was earning revenue from multiple streams. Also, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. During the year it was identified that the management did not account for revenue from corporate hotel bookings amounting to Rs.35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

Therefore, the auditor while performing the risk assessment procedures should consider the complexity and nature of the revenue for determining the fraud risks in revenue recognition. Also, there were no adequate controls addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk. Moreover, the audit team should have recognised fraud risk by identifying the deficiencies of internal control over the revenue recognition process and should have treated the risk of improper revenue recognition as a significant risk. Also, as per Section 143(12), the auditor is required to report all the frauds identified during the course of the audit involving amounts above Rs.1 crore within the prescribed time frame to the Central Government

Question 6. **(PYP May '19)**

The volatility, unpredictability and pace of fast changes that exists in the automated environment today is far greater than in the past and consequently it throws more risk to business which requires them to have a need to continuously manage such risks. State various risks which an enterprise may have to face and manage.

Answer:

Various Risk: Businesses today operate in a dynamic environment. The volatility, unpredictability and pace of changes that exist in the business environment today is far greater than in the past. Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because of this dynamic environment the associated risks to business have also increased and companies have a need to continuously manage risks. Examples of risks include:

- ✓ Market Risks;
- ✓ Regulatory & Compliance Risks;
- ✓ Technology& Security Risks;
- ✓ Financial Reporting Risks;
- ✓ Operational Risks;
- ✓ Credit Risk;
- ✓ Business Partner Risk;
- ✓ Product or Project Risk;
- ✓ Environmental Risks.

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

The auditor of BBNS Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age to 65 years. Comment.

Answer:

Evaluating the Work of Management's Expert: As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes,

a. Evaluate the competence, capabilities and objectivity of that expert;
b. Obtain an understanding of the work of that expert; and
c. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

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

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

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

i. The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements.
ii. If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
iii. If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

In the instant case, BBNS Ltd. accepted the gratuity liability valuation based on the certificate issued by an expert i.e., a qualified actuary who is management's expert. Here the basis for computation and valuation is taken as age 65 years by the actuary, which is not correct as company is considering proposal to increase the retirement age from existing age to 65 years. Therefore, assumptions and methods used by the management's expert are not appropriate for financial reporting purposes. Hence, the auditor may qualify the report accordingly.

Test Your Understanding 2. Exceptional

CA Prabhjot has planned to observe the physical count of inventories at the plant of a company located in the remote area in the state of Uttarakhand, as part of a statutory audit exercise, few days before completion of the financial year 2023-24. He already informed his intention to management that he is planning to visit the plant site on 29th March 2024. He plans to inspect inventories, observe the counting process and perform test counts among other matters. The management has made all the necessary arrangements to facilitate the above exercise. However, an agitation in Himalayan hills started on 28th March 2024 for the announcement of a strict law regarding the conversion of agricultural land for commercial use. Many civil society groups are participating in the agitation. NH-7 leading to the plant site is blocked by protestors. The plant is not accessible through any other mode. The blockade is lifted one month after the state government announced the formation of a committee to look into protestors' demands. Does the above case highlight a situation of "impracticability of attendance" at inventory counting in terms of requirements of SA 501? How should the auditor proceed in the above situation?

Answer:

The given situation does not highlight the impracticability of attendance at inventory counting. It only shows that the auditor is unable to attend physical inventory counting due to unforeseen circumstances arising out of agitation by protestors. It has led to the inaccessibility of the plant site for a month. The blockade is lifted after a month.

SA 501 states that if the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions. Therefore, the auditor should attend the physical inventory count after the blockade is lifted and perform audit procedures on intervening transactions.

Test Your Understanding 3. Exceptional

On reviewing legal expenses account of Zed Ltd., CA. Sunitha, auditor of company, finds that legal fees amounting to Rs.10 lac was paid to B. George, a reputed lawyer, during the year 2023-24. On inquiry with management regarding the purpose of such expenditure, evasive reply was received from management stating that a lot of work is performed by the said lawyer on behalf of the company. However, no specific details were provided. She finds it proper to correspond directly with the lawyer. She obtains the address and mail id of the lawyer from his professional services bill. She shoots off an inquiry letter asking for the nature and status of litigation claims against the company on her letterhead. Is her approach proper? Irrespective of the merits of the approach followed by her, what is she trying to achieve by corresponding with the lawyer of the company?

Answer:

SA 501 states that when audit procedures performed indicate that material litigation or claims may exist, the auditor shall seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.

Therefore, her approach in communicating with an external lawyer is not correct. She needs to make management aware of her intention to communicate directly with the lawyer. The letter of inquiry has to be prepared by management and sent by her.

Her purpose in corresponding with the lawyer of the company is to identify litigation and claims involving the entity which may give rise to a risk of material misstatement. It is due to the reason that litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.

Test Your Understanding 4. Exceptional

During the audit of TS Ltd., CA Tanmaya finds that substantial inventories of the company consisting of mast lighting poles remain with "Super Industries" for certain finishing works. While planning audit procedures, he had planned about seeking confirmation from "Super Industries" regarding existence and condition of such mast lighting poles belonging to TS Ltd. lying with them as on 31st March, 2024. However, the premises of "Super Industries" were raided by DGGI officials (Director General of GST Intelligence) in connection with the busting of a fake billing scam. The proprietor of the firm was arrested in November 2023 and came out on bail in the month of March 2024. The details of the proprietor and his firm were flashed prominently in local newspapers of the city where company is located. CA. Tanmaya also belongs to the same place. Discuss how he should proceed in the above matter as auditor of TS Ltd.

Answer:

SA 501 states that when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

a. Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
b. Perform inspection or other audit procedures appropriate in the circumstances.

It further states that where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party.

Examples of other audit procedures include:

✓ Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
✓ Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
✓ Inspecting documentation regarding inventory held by third parties

In the given case, the integrity of the third party appears to be doubtful in view of DGGI raids and his possible involvement in a fake billing scam. He has already been behind bars.

Keeping in view the above, besides obtaining confirmation from such party, he may attend a third party's physical counting or ask some other auditor to attend physical counting as on reporting date, depending upon practical considerations. He can also inspect the record of goods sent and received back from such party by tracing it to challans, e-ways bills etc. and correlate the above information.

Test Your Understanding 5. Exceptional

As auditor of Groom Limited, you have sent positive confirmation requests to 30 creditors of the company in March 2024. All the creditors in the informal sector are small concerns. You selected to send positive confirmation requests to all the above parties at their business addresses stated on respective bills after discussing the matter with the CFO of the company. The CFO is cooperative and does not raise any hassles in the matter. Responses to confirmation requests are received within a week's time. Your article assistant informs you that out of 30 creditors, GST registrations of 25 creditors have been cancelled during financial year 2023-24 itself by collating information from GST portal. He further informs you that there are no fresh registrations pertaining to PANs of these parties. How would you proceed to deal with the situation as an auditor of the company?

Answer:

SA 505 states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

In the instant case, GST registrations of 25 concerns have been cancelled in the year 2023-24. It indicates that businesses on those addresses were closed. Further, there are no fresh registrations pertaining to the PANs of these parties. However, the auditor sent external confirmation requests in March 2024, which were duly responded. It raises questions on the reliability of responses received.

SA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include:

- ✓ Was received by the auditor indirectly or
- ✓ Appeared not to come from the originally intended confirming party.

Keeping in view the circumstances described in the case situation, there is a risk that the response has not come from the originally intended confirming party.

Unreliable responses may indicate a fraud risk factor that requires evaluation

Test Your Understanding 6. Exceptional

CA M. Hussain is appointed as auditor of a firm for the year 2023-24 on 31st July, 2023. The accounts of the firm were unaudited in the year 2022-23. The firm had material inventories reflected in its financial statements even as on close of 31st March, 2023. He is performing audit procedures, including attending physical inventory count as on 31st March 2024. However, there is a lingering doubt in his mind regarding opening inventories reflected in financial statements. Does there exist any responsibility on his part in such a situation?

Answer:

SA 510 states that in conducting an initial audit engagement, one of the objectives of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether opening balances contain misstatements that materially affect the current period's financial statements. The auditor has to evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances or specific audit procedures are required to be performed to obtain evidence regarding the opening balances.

In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- ✓ Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- ✓ Performing audit procedures on the valuation of the opening inventory items.
- ✓ Performing audit procedures on gross profit and cut-off.

Test Your Understanding 7. Exceptional

CA Ritesh has drawn some samples during the audit of a manufacturing company for testing controls as well as for tests of details. On the basis of the samples selected, he reaches an erroneous conclusion that access controls on applications are less effective. Further, on the basis of samples selected, he concludes erroneously that work-in progress inventories amounting to Rs.5 crore in financial statements are materially misstated. Outlining the above risk involved, discuss how it is going to affect his audit of the company.

Answer:

The described risk is sampling risk. It is a 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.

In the given case, the auditor has arrived at erroneous conclusions on the basis of the samples selected. In the case of a test of controls, he has concluded that access controls are less effective than they actually are. In the case of a test of details, he has concluded erroneously 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.

Test Your Understanding 8.

"Living Well Private Limited" is engaged in the manufacturing and export of floor coverings. Such products are labour-intensive and do not require much capital investment in machinery. The company has no plans to diversify in other product lines. Its directors are also holding significant interest in another company "My Living Private Limited" engaged in manufacturing of blankets using capital intensive machinery. During the audit of "My Living Private Limited", it was noticed that the company has sold machinery of Rs.1 crore to "Living Well Private Limited" during the year. The transaction has been done at normal market rates applicable to such used machinery. How do you view the above transaction as auditor of "My Living Private Limited"?

Answer:

In respect of significantly related party transactions outside the normal course of business of an entity, it is the responsibility of the auditor, in accordance with SA 550, to evaluate the business rationale or lack thereof of transactions that may have been entered to indulge in fraudulent financial reporting or conceal misappropriation of assets.

The auditor has to seek to understand the business rationale of such a transaction from a related party's perspective. It would help him understand the economic reality of such a transaction and why it was carried out.

In the given situation, there is no primary rationale for such a transaction. Living Well Private Limited does not manufacture blankets, and the purchase of part of old machinery pertaining to blanket manufacturing has no rationale for it primarily. A business rationale from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.

Case studies from ICAI SM

Case Study 1.

Honest Speciality Chemicals Private Limited is a company with a turnover of Rs.1,000 crore having plants in Khopoli, Mahad and Ankleshwar for manufacturing various products for fertilizer units, cosmetics and paint industry etc. The company has built up a good reputation and apart from the domestic market, it exports to the European market and the Middle East. The company is a closely held company owned by three friends and their family members. The types of materials handled and produced are hazardous. Following further latest information relating to the company is as under: -

- ✓ The company needs to import key raw materials and is exposed to high risk of price fluctuations and currency risks.
- ✓ The company carries high inventory due to the long import cycle and seasonal sales pattern.
- ✓ The working capital is almost 60% blocked in inventory and rest in receivables.
- ✓ The company has huge investments in plant and machinery financed through term loans from financial institutions.
- ✓ Since the company has large imports, it buys import licenses from the open market.
- ✓ The company has received notices from the custom department for using fake licenses for importing materials without paying duty. The company has filed an appeal against the said notice and the same is pending with the Appellate Tribunal. The amount involved is material and, along with interest and penalty, could be more than 10% of turnover.
- ✓ The company has liquid chemicals stored in huge tanks.
- ✓ The powdered form of chemicals is stored in standard-sized drums.
- ✓ Few items of stock like coal, sulphur are lying in the open area.
- ✓ The company has huge domestic sales on a consignment basis, and vast quantities of finished inventories are lying with the consignees across India.
- ✓ The company has received an order from NGT to pay a fine of INR 1.5 crores for the emission of toxic chemicals into the air and water. The company has filed an appeal against the said order.
- ✓ The type of plant is such that it has to be a continuous process, and at any time, huge quantities of materials are in process.
- ✓ Raw Materials are stored in huge tanks located 2 kilometers from the plant, and to transport the chemicals (liquid), there is a network of pipes connecting them, and at any point in time, there are huge quantities of materials lying in the pipeline.
- ✓ The company has prepared its inventory details by involving a management expert.
- ✓ During the year, the previous auditor resigned, and a new auditor got appointed.

Theoretical Questions

Based on the case study, please advise the auditor on the important aspects of carrying out the audit procedures to obtain sufficient appropriate audit evidence in respect of the following: -

Question 1:

Which audit procedures are required for verifying the existence and condition of company's inventories with specific reference to its nature of operations?

Answer:

The auditor needs to obtain sufficient appropriate audit evidence regarding existence and condition of inventory

For the above, the auditor needs to do all the following: -

a. Attendance at physical inventory counting to:

i. Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting like:
   - ✓ The existence of appropriate control activities: collection of used physical inventory count records, accounting for unused physical inventory count records, count and recount procedures.
   - ✓ The accurate identification of the stage of completion of work-in- progress, of slow moving, obsolete, or damaged items and of inventory lying in tanks, in pipes and in open areas.
   - ✓ The procedures used to estimate physical quantities, for liquid chemicals lying in process, tanks, pipelines, in open areas like coal pile, sulphur pile, etc.
   - ✓ Control over the moment of inventory between areas and the shipping and receipt of inventory before and after the cutoff date.

b. Observe the performance of Management's count procedure by observing the control over the movement of inventory before, during and after the count to determine adequacy and effectiveness of count procedure.

c. Inspect the inventory to assist in identifying obsolete, damaged or ageing of inventory.

d. Perform the test counts to obtain the sufficient appropriate audit evidence
   i. By tracing items selected from the physical inventory to management's count records,
   ii. By obtaining copies of Management's completed physical inventory count records

e. Cross matching the final inventory records with the actual inventory count results.

Question 2:

The company has prepared inventory details by involving a management's expert. Elaborating upon its rationale, discuss responsibilities of auditor in regard to information prepared by company involving such an expert.

Answer:

The company deals with speciality chemicals which are in liquid condition, powdered condition, lying in huge tanks or in plants under process, lying in pipelines or lying in open areas like coal and sulphur. The unit of measurement for each of the above categories may be different and could involve technical and mathematical principles involving technical and scientific expertise. Keeping these matters in view, inventory details have been prepared by involving management's expert.

When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, having regard to the significance of that expert's work for the auditor's purposes:

a. Evaluate the competence, capabilities and objectivity of that expert

b. Obtain an understanding of the work of that expert and

c. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Question 3:

What additional procedures does the auditor need to carry out in respect of stocks lying with consignees all over the country?

Answer:

Apart from obtaining the confirmation from the third party as to the quantities and condition of the inventory held on behalf of the entity, the auditor may perform the following other audit procedures:

- ✓ Attending, or arranging for another auditor to attend, the third party's physical counting of inventory,

- ✓ Obtaining another auditor's report or a service auditor's report on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
- ✓ Inspecting documentation regarding inventory held by third parties

Question 4:

What procedures should the auditor need to undertake for litigation matters?

Answer:

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity by:

- ✓ Inquiry of management and, where applicable, others within the entity including in-house legal counsel.
- ✓ Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel.
- ✓ Reviewing legal expense account.

The legal claims involving customs and fines of NGT are material. In such circumstances if auditor assesses risk of material misstatements regarding litigation, he can seek letter of specific inquiry from the external legal counsel including: -

- A list of litigation and claims
- Where applicable, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including cost involved and
- A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered incomplete or incorrect.
- The auditor may seek a meeting with the external legal counsel if the matter is having significant risk, it is complex or there is disagreement between management assertion and legal counsel's views.
- Obtaining written representation from the management and where appropriate those charged with governance that all the known actual or possible litigation and claims whose effects should be considered when preparing the financial statement have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

Multiple Choice Questions

1. The objectivity of the management's expert is likely to be lesser if:
   (a) The expert is competent
   (b) The expert is capable
   (c) The expert has relevant experience
   (d) The expert is employed by the entity

2. Which of the following matter is irrelevant for auditor in planning attendance at physical inventory counts?
   (a) Nature of inventory
   (b) The timing of physical inventory counting
   (c) The nature of the internal control related to inventory
   (d) Whether 100% of inventory is covered in the count

3. External confirmations for receivables are not reliable if:
   (a) The response directly received by the auditor
   (b) The confirmation has come from the address of the confirming party
   (c) The confirmation is signed by the plant manager
   (d) The confirmation is positive confirmation

4. The new auditor planned certain procedures with respect to opening balances. Which of the following procedures is not in accordance with SA 510?
   (a) Reading the most recent financial statements and audit report
   (b) Where the prior period report is modified, the impact on the current period
   (c) Correctly bringing forward of prior period closing balances
   (d) Ascertaining whether predecessor auditor had attended physical inventory count

MCQ answers

1.	(d)	2.	(d)	3.	(c)	4.	(d)

Case Study 2.

Case Study 2 "Trustworthy Real Estate Private Limited" with Mr. Bharose Lal as MD along with his wife, Maya, owned the company. The company had floated one SPV "Real Trust Developers Private Limited" in which a foreign entity became a Joint Venture partner with a 50% stake. The venture was formed with its Head Office in Mumbai to invest in SRA projects (Slum Rehabilitation Authority) and develop them into commercial units for sale. Mr. Bharose Lal was going through a rough patch in his life. He was in financial difficulty and had mounting dues and huge outstanding exposure to banks and suppliers in his companies. He approached one of his rich friends Mrs. Maya. Mrs. Maya had an expensive lifestyle and was always short of funds to maintain her lifestyle. Mr. Bharose Lal sensed a golden opportunity in the new venture because the foreign partner had no knowledge of Indian regulations and how the SRA projects worked and was solely dependent on the local partner to get all the permissions, scouting for the projects, getting consents from the slum dwellers for the project, giving contracts for the construction of projects and such matters.

M/S ABC and Company, Chartered Accountants were appointed as the auditor of the joint venture, and the engagement team was headed by CA Sceptic, who had, in his stint with the firm, was instrumental in unearthing two major frauds and had the ability to sniff out any such scenarios. Mr. Bharose Lal has a dominant personality and a powerful influence on functioning, and everybody looks to him for guidance. The governance structure was very poor in the organization, and Mr. Bharose Lal used to dictate the decisions. Even though as part of the Joint Venture, there was a detailed governance structure and policies and procedures in place for the decision-making process at the joint venture. However, the representative on the board of the Joint Venture of the foreign partner who had shifted to India to supervise the SRA project had grown friendly with Mr. Bharose Lal, and Mr. Bharose Lal had even gone out of the way to help him get good accommodation and second- hand Mercedes. Often, they both go to a club in the evening for a drink. The dealings in the SRA project are not very transparent and above board but are very opaque. Given the above situation, CA Sceptic wants to discuss with the audit team areas and situations where the risk of material misstatement is possible and there are chances of having an undisclosed related party relationship to misappropriate the funds.

Theoretical Questions

Question 1:

Please guide the engagement team on the further course of action as per SA 550.

Answer:

The engagement team shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.

- ✓ The nature and extent of the entity's relationships and transactions with related parties as identified independently by the Auditor by verification of MBP-1 data and data available on MCA website relating to directors and companies, etc.
- ✓ An emphasis on the importance of maintaining Professional Skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
- ✓ The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special purpose entities off-balance sheet transactions, or an inadequate information system).
- ✓ The records or documents that may indicate the existence of related party relationships or transactions.
- ✓ The importance of management and those charged with governance attached to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirement), and the related risk of Management override of relevant controls.
- ✓ In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:
  a. How special-purpose entities controlled by management might be used to facilitate earnings management
  b. How transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.
- ✓ An exchange of ideas among engagement team members about how and where they believe the entity's financial statements may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
- ✓ A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
- ✓ A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
- ✓ A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
- ✓ A consideration of any unusual or unexplained changes in behaviour or lifestyle of management or employees which have come to the attention of the engagement team.
- ✓ An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.

- ✓ A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- ✓ A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- ✓ A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statement to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.
- ✓ A consideration of any allegations of fraud that have come to the auditor's attention.
- ✓ A consideration of the risk of management override of controls.

Question 2:

What are fraud risk factors in given case?

Answer:

The fraud risk factors are the events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

The fraud risk factors are classified based on the three conditions that are generally present when fraud exists:

i. An incentive or pressure to commit fraud

ii. A perceived opportunity to commit fraud

iii. An ability to rationalize fraudulent actions.

In the given case scenario following fraud risk factors can be segregated in the 2 conditions of incentive or pressure to commit fraud in a perceived opportunity to commit fraud.

1. An incentive or pressure to commit fraud:
   - ✓ Financial difficulty with huge outstanding dues towards vendors and Financial Institutions.
   - ✓ Expensive lifestyle.
   - ✓ Requirement to fund Rs.5 crore as equity contribution in the SPV.
2. A perceived opportunity to commit fraud:
   - ✓ Dependency of the foreign partner and no knowledge of the foreign partner of local laws and the SRA business model in India
   - ✓ The risk is due to the way the real estate industry functions and particularly risk due to the SRA business model.
   - ✓ Dominant personality of MD, which can lead to management override of controls for undisclosed business relationships with M/s. Useless and Sons (P) Ltd.

Question 3:

Given the situation that each partner in the joint venture has to bring into the entity a contribution of 5 crores each and given the situation that Mr. Bharose Lal had appointed one agency, the name Useless & Sons Private Limited, to get consent from the slum dwellers, for which the agency was paid 20 crores as Kitty to get the job done.

CA Sceptic inclines that there is some connection between the 20 crores paid and, simultaneously, within a short span, the infusion of INR 5 crores as equity contribution by Mr. Bharose Lal.

Please guide CA Sceptic in establishing this link based on the guidance available in SA 550 and SA 240. What additional audit procedures does his team need to undertake for the conclusion?

Answer:

If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditors, the auditor shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.

In such situations, the auditor shall:

- ✓ Promptly communicate the relevant information to the other members of the engagement team in order to assist them in determining whether this information affects the results of, and conclusions drawn from risk assessment procedures already performed, including whether the risk of material misstatement needs to be reassessed.
- ✓ Where the applicable financial reporting framework establishes related party requirements:
  - i. Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and
  - ii. Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;
- ✓ Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions.
- ✓ Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclose to the auditor, and perform additional audit procedures as necessary; and
- ✓ If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit. In such cases, the requirements and guidance in SA-240 regarding the auditor's responsibilities relating to fraud in an audit of financial statements are relevant where management appears to have intentionally failed to disclose related parties or significant related party transactions to the auditor. The auditor may also consider whether it is necessary to re-evaluate the reliability of management's responses to the auditor's inquiries and management's representations to the auditor.
- ✓ The Auditor needs to carry out verification and inspection of the ownership structure and the review of the financial statements of M/s. Useless and Sons (P) Ltd through the MCA website and establish the nexus between the two.
- ✓ The Auditor needs to carry out an inspection of the data filed by Mr. Bharose Lal for his group companies to establish any past transactions/relationships between the two entities.
- ✓ - The Auditor needs to ask for all the documents for the utilization of INR 20 crore and can investigate by visiting the parties involved and asking for confirmation directly.

Question 4:

If, based on additional audit procedures undertaken by CA Sceptic, it is established that there is a likelihood of misappropriation of funds and the financial statements as a whole may be materially misstated, how CA Sceptic needs to plan the future course of action?

Answer:

The Auditor needs to reassess the reliability of evidence previously obtained as there are doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and documentation.

a. Determine the professional and legal responsibilities applicable in the circumstances, including whether there is the 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 from the

engagement is legally permitted; 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.

Multiple Choice Questions

1. Which of the following best describes the method that Mr. Bharose Lal can indulge to commit fraud?
   (a) Concealing and not disclosing facts that could affect the amounts recorded in financial statements.
   (b) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
   (c) Causing an entity to pay for goods or services not received.
   (d) Using undisclosed business partners to misappropriate funds in the garb of making a business transaction and thus siphoning off the funds.

2. In the given case scenario, the main factor giving rise to risk of material misstatement is:
   (a) The expensive lifestyle of owners.
   (b) Appointment of an auditor having experience in unearthing of frauds
   (c) The deteriorating financial condition of the owner's business.
   (d) The vulnerability and dependence of the foreign partner on the local partner.

3. In the given case scenario, which is the most important red flag for auditor:
   (a) Expensive lifestyle
   (b) Undisclosed related party relationships to siphon off the funds.
   (c) Financial crunch
   (d) The dominant influence of the owners

4. Which of the following is not a fraud risk factor?
   (a) Dominant influence of the owners
   (b) Expensive lifestyle
   (c) Fraud risk due to the nature of the industry
   (d) Floating of a new SPV itself

MCQ answers

1.	(d)	2.	(d)	3.	(b)	4.	(d)

Integrated Case Scenario from ICAI SM

Integrated Case Scenario Black & White Ltd. is into the business of manufacturing readymade garments in Amritsar. It procures all the raw material required for its production from Punjab, Himachal Pradesh & J&K. Its sales market, however, covers almost all the northern parts of the country. CA Anu is the engagement partner of Maheshwari & Co appointed as the statutory auditor of the company. She calls for a meeting of the engagement team to delegate work and responsibilities. During the audit, the engagement team comes across the following facts:-

- ✓ Woolen Private Limited is one of the vendors of the company from which the company has been purchasing wool for many years on a current account basis, but no single purchase has been made in the last nine months, and the outstanding balance stands as it is in the books of accounts. CA Anu wants to confirm the balance and requests the CFO of the company for sending a balance confirmation request to Woolen Private Ltd., to which he refuses and is not willing.
- ✓ The Fashion Jingo Ltd. is one of the customers of the company and hasn't replied to CA Anu's positive balance confirmation request sent.
- ✓ Mr. X, one of the fashion designers, had sold his designs to the company but owing to a dispute, the contract got cancelled, and now both the parties are under litigation in the local court of law. The engagement team is guided as to the procedures to be designed and performed to identify this matter.
- ✓ CA Anu simultaneously seeks direct communication with the company's external legal counsel sensing the risk of material misstatement. However, it ends up in vain as the external legal counsel, Mr. Chadha, refuses to comment. She is unable to obtain sufficient appropriate audit evidence in this regard through alternative audit procedures either. The team documents all the relevant information w.r.t. the above facts, and CA Anu issues the audit report accordingly.

Multiple Choice Questions

1. Fashion Jingo Ltd. has not responded to CA Anu's request. What would be proper course of action for her in such a situation?
   (a) Perform alternative audit procedures
   (b) Consider it as a negative confirmation
   (c) Give a Qualified opinion
   (d) Should visit the customer company premises herself and confirm the balance on the spot.

2. With respect to Advocate Chadha's cold shoulder to CA Anu's request, what she should do?
   (a) Modify her audit opinion
   (b) Give an unqualified opinion
   (c) Give a disclaimer of opinion
   (d) Withdraw from this engagement

3. What should be CA Anu's first and foremost response in the case of request made relating to balance confirmation from Woolen Pvt. Ltd.?
   (a) Perform alternate audit procedures.
   (b) Withdraw from the engagement.
   (c) Communicate with Those charged with Governance telling the effects on his audit opinion.
   (d) Inquire as to the reasons behind the management's response and seek audit evidence as to its validity and reasonableness.

4. Which of the following procedures will not be performed by the engagement team as audit procedures while dealing with the case of Mr. X?
   (a) Inquiry of Management.
   (b) Inquiry of Mr. X
   (c) Reviewing Minutes of Meetings
   (d) Reviewing Legal expenses account

Answer to MCQs of Integrated Case Scenario

1.	(a)	2.	(a)	3.	(d)	4.	(b)

Test Your Knowledge

Question 1: Exceptional

Coccyx Ltd. supplies navy uniforms across the country. The company has 3 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. Coccyx Ltd. appointed M/s OPAQE & Co. to conduct its audit for the financial year 2023-24. Mr. P, partner of M/s OPAQE & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s OPAQE & Co.,

I. How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

II. How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?

Answer:

I. Special Consideration with Regard to Inventory: As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

1. Attendance at physical inventory counting, unless impracticable, to:
   i. Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
   ii. Observe the performance of management's count procedures;
   iii. Inspect the inventory; and
   iv. Perform test counts; and
2. Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

II. Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

Question 2:

GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31-03-2024 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates 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.

Answer:

The auditors, GHK Associates 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.

Question 3: Exceptional

Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2023-24. Chintan & Mani seem to have different opinions on the Audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population.

Chintan is concerned that whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.

Answer:

As per SA 530, "Audit Sampling", the auditor shall evaluate:

a. The results of the sample; and
b. Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

i. Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
ii. Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

Question 4: Exceptional

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

Answer:

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

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

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

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

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

Question 5: Exceptional **Newly Added**

Mr. Atharv, while conducting the audit of Black Mountain Mining Ltd., which is involved in phosphate mining, decided to engage an auditor's expert to assess environmental liabilities and site clean-up costs. Black Mountain Mining Ltd. re-appointed Mr. Aman as an independent expert for this task. For the past five years, the management has consistently re-appointed Mr. Aman. He calculated the environmental liabilities for both completed mining sites and sites scheduled for closure in the near future, including provisions for clean-up costs. Management accepted his assessment.

Mr. Atharv, after performing the inquiries with management, was of the opinion that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. Hence, there is no need to raise a question on the objectivity of Mr. Aman or on his work performed for the company. However, the audit partner was of the opinion that the audit team needs to evaluate the objectivity of an expert engaged by the entity, irrespective of the fact that he was appointed as an independent expert.

Guide the audit partner and Mr. Atharv with respect to requirements pertaining to evaluating the objectivity of the management expert.

Answer: Already covered in MRP Qns in chapter 3

Question 6: Exceptional **Newly Added**

While conducting the statutory audit of Tasty Foods Limited, CA. Careful has planned attendance at physical inventory count of the company from 29th March to 31st March 2024. The company is engaged in the business of extracting rice from paddy grains and caters to domestic as well as international market particularly in Gulf region. It has its plant spread in an area of about 20 acres located in National Capital Region (NCR). Paddies contained in jute bags of nearly standard sizes is purchased from dealers/agents. It is stored in heaps on pallets (kind of wooden structures) in an open area covered by protective sheets and in steel silos (silos are huge steel containers with measuring strain gauges) in company's premises.

The company mainly produces three rice brands viz. "Raja" and "Shehzada" (both for the domestic market) and "Badshah" (for the international market). The process of obtaining rice from paddy consists of various steps like cleaning of paddy, removing outer husk layer from paddy grains to obtain brown rice, whitening, polishing, grading and sorting, packaging which is accomplished by means of various types of machineries installed in plant.

The company's management has prepared a set of instructions and procedures to be followed for recording and controlling results of company's physical inventory counting which are listed as under: -

- ✓ The physical inventory count process is to be supervised by a responsible officer of company responsible for storage functions.
- ✓ There should be no disturbance to the routine process of receiving goods and despatch during the counting time period.
- ✓ Counting process is to be undertaken by constituting different teams of 3 members each for counting/verifying raw material, work in progress and finished goods.
- ✓ Paddy in steel silos is to be estimated using their capacity.
- ✓ Quantity of work in progress is to be estimated considering plant capacity as whole.
- ✓ The responsible officer should ensure that stocks have been counted/verified in all areas.

Before proceeding to attend physical inventory count process of company, evaluate management's instructions and procedures sent to CA Careful as stated above. You may suggest modification, addition or removal of such instructions to ensure effective count process.

Answer:

The set of instructions and procedures given in the case scenario are incomplete and not properly followed, which are discussed as under:

- ✓ The physical inventory count process should be supervised by a responsible officer of the company, preferably from finance department. The supervision of the count process should not be done by person responsible for storage function. However, storage in-charge of each area should be present during inventory count process for co-ordination and facilitation.
- ✓ During inventory count process, inward and outward movement of goods should not be allowed as allowing such movement may distort the results or make it difficult to arrive at proper results.
- ✓ The instruction relating to the constitution of teams for counting process does not specify that counting shall be undertaken by members drawn from departments not connected with storage function. For example, these members may be from the finance department. Further, within each team, duties should be fixed separately for counting and recording on serially numbered count sheets. It is nowhere stated that once counting in an area is complete, certain distinctive marks or tags are required to be put.
- ✓ Count sheets should contain description of products in accordance with inventory records of company.

- ✓ The management's instructions are silent about how team members would proceed with their work. Team members should be provided with lay out plans for different sections/ storage areas so that all areas are covered.
- ✓ The management's instructions are silent on how paddy lying in open is to be counted and verified. Paddy in jute bags lying in open in heaps should be verified by counting number of bags in one heap. As each bag is of nearly standard size, the quantity of paddy can be determined by counting number of bags in a heap and correlating it with the weight of standard bag.
- ✓ Paddy in steel silos should be determined using measuring strain gauges on silos. Determining quantity in silos based on silo capacity may lead to wrong results as paddy may have been used from such silos.
- ✓ Quantities of work in progress should be estimated at each stage of production and not for the plant as a whole. Estimating WIP inventories for plant as a whole would give inaccurate picture of work in progress inventories.
- ✓ Finished goods inventories need to be counted category wise. Rice bags should be verified by checking the name of brand.
- ✓ There is no instruction regarding damaged or obsolete stock items particularly in the case of finished goods i.e. rice. Damaged/obsolete inventories should be counted and shifted to a separate area for assessment of their condition and to prevent mix-up with other standard inventories.
- ✓ Count sheets need to be signed by each team member.

The responsible officer should ensure that stocks have been counted/verified in all areas and distinctive marks are put to confirm completion of counting.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

As auditor of Growth Limited, you have sent positive confirmation requests to 45 creditors of the company in March 2024. All of the creditors in the informal sector are small concerns. You choose to send positive confirmation requests to all the above parties at their business addresses stated on respective bills after discussing the matter with the CFO of the company. The CFO is cooperative and does not raise any hassles in the matter.

Responses to confirmation requests are received within a week's time. Your articled clerk informs you that out of above 45 creditors, GST registrations of 38 concerns have been cancelled during financial year 2023-24 itself by collating information from GST portal. He further informs you that there are no fresh registrations pertaining to PANs of these parties.

How would you proceed to deal with the situation as auditor of the company?

Answer: Similar to TYU Qn 5

Question 2 **(MTP 1 May '24 5M)**

While conducting the statutory audit of Tasty Foods Limited, CA. Careful has planned attendance at physical inventory count of the company from 29th March to 31st March 2024. The company is engaged in business of extracting rice from paddy grains and caters to domestic as well as international market particularly in Gulf region. It has its plant spread in area of about 20 acres located in National Capital Region (NCR). Paddy contained in jute bags of nearly standard sizes is purchased from dealers/agents. It is stored in heaps on pallets (kind of wooden structures) in open area covered by protective sheets and in steel silos (silos are huge steel containers with measuring strain gauges) in company's premises.

The company mainly produces three rice brands viz. "Raja" and "Shehzada" (both for the domestic market) and "Badshah" (for the international market). The process of obtaining rice from paddy consists of various steps like cleaning of paddy, removing outer husk layer from paddy grains to obtain brown rice, whitening, polishing, grading and sorting, packaging which is accomplished by means of various types of machineries installed in plant.

The company's management has prepared a set of instructions and procedures to be followed for recording and controlling results of company's physical inventory counting which are listed as under: -

- ✓ The physical inventory count process is to be supervised by a responsible officer of company responsible for storage functions.
- ✓ There should be no disturbance to the routine process of receiving goods and despatch during the counting time period.
- ✓ Counting process is to be undertaken by constituting different teams of 3 members each for counting/verifying raw material, work in progress and finished goods.
- ✓ Paddy in steel silos is to be estimated using their capacity.
- ✓ Quantity of work in progress is to be estimated considering plant capacity as whole.
- ✓ The responsible officer should ensure that stocks have been counted/verified in all areas.

Before proceeding to attend physical inventory count process of company, evaluate management's instructions and procedures sent to CA. Careful as stated above. You may suggest modification, addition or removal of such instructions to ensure effective count process.

Answer: Already covered in TYK Qn

Question 3 **(PYP Nov '24 5M)**

PQR Ltd. is engaged in the business of construction and real estate having various projects across the states. M/s ST & Co., Chartered Accountants have been appointed as statutory auditors. CA T, an engagement partner, who leads engagement team, during preliminary verification, identified a few agreements entered by PQR Ltd. for the provision of services to some parties under terms and conditions that are outside PQR Ltd.'s normal course of business, suggestive of the indications about existence of related party transactions that management has not previously disclosed to the auditor. Highlight the aspects that M/s ST & Co., shall consider on identification of previously undisclosed related party transactions with reference to the relevant standard on auditing.

Answer:

As per SA 550, "Related Parties," M/s ST & Co. should take the following steps upon identifying previously undisclosed related party transactions:

- ✓ Verify whether the circumstances substantiate the existence of such transactions.
- ✓ Ensure timely communication of the relevant information to all members of the engagement team.
- ✓ Confirm that appropriate substantive audit procedures have been conducted.
- ✓ Inquire why the entity's controls failed to identify or disclose the related party relationships or transactions.
- ✓ Carry out substantive audit procedures specifically for these newly identified related parties or significant related party transactions.
- ✓ Reassess risks associated with other related parties.
- ✓ Request management to identify all transactions involving the newly identified related parties.
- ✓ If it appears that management intentionally did not disclose such transactions, evaluate the implications for the audit.

Question 4 **(Model TP 5M)**

Whilst the Audit team has identified few matters, they need your advice to conclude on the same. Engagement Partner have asked them to review the Board minutes and other secretarial/ regulatory records based on which the following additional matters were brought to the attention of the Partner:

(i) An amount of ₹4.75 Lakhs per month is paid to M/s. MNJ Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by Rs. 0.18 Lakh per month. Whilst the transaction was accounted in the financial statements based on the amounts' paid, no separate disclosure of this related party transaction has been made in the notes to accounts forming part of the financial statements highlighting the same as a 'related party' transaction.

(ii) The long-term borrowings from the parent company has no written terms and neither the interest nor the principal has been repaid so far.

(iii) Certain computers were received from the parent company free of cost, the value of which is Rs. 0.75 lakh and no accounting or disclosure of the same has been made in the notes to accounts.

Audit Manager has reported that she had asked certain information relating to another 'related party' transaction (amounting to approx. Rs. 35 lakh) but the CFO refused to provide the same since the same is perceived to be confidential and cannot be shared with the auditors.

You are required to advise about items to be reported to those charged with governance, where applicable, based on your audit findings in the given situation.

Answer:

As per SA 550, "Related Parties", communicating significant matters arising during the audit in connection with the entity's related parties helps the auditor to establish a common understanding with those charged with governance of the nature and resolution of these matters. Examples of significant related party matters include, non-disclosure (whether intentional or not) by management to the auditor of related parties or significant related party transactions, which may alert transactions of which they may not have been previously aware; The identification of significant those charged with governance to significant related party relationships and related party transactions that have not been appropriately authorised and approved, which may give rise to suspected fraud; etc.

It may be noted that unless all of those charged with governance are involved in managing the entity, the auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties.

The auditor is also required to ensure the compliance of Ind AS 24 Related Party Disclosures.

In view of above in the given scenario, the auditor is required to prepare a summary of following items to be reported to those charged with governance in accordance with SA 260 Communication with Those Charged with Governance:

(i) A related party transaction with M/s. MNJ Associates involving ₹4.75 lakh per month for marketing services was identified, where ₹0.18 lakh per month exceeds the arm's length price. This transaction has not been disclosed as a related party transaction in accordance with Ind AS 24 Related Party Disclosures.

(ii) The refusal by the CFO of the company to provide details of a related party transaction amounting to ₹ 35 lakh on the grounds of confidentiality, is not in order, as denying for the related party details of ₹ 35 lakh is imposing limitation of scope of auditor in view of SA 705.

(iii) The receipt of free-of-cost computers and long-term borrowings (without agreed terms for repayment of interest and principal) from the parent company needs to be separately disclosed in the financial statements as per Ind AS 24 Related Party Disclosures.

Further, in all the above cases, the auditor would also need to assess his reporting requirements under the clause (xiii) of Paragraph 3 of CARO 2020 with respect to related party transactions that whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the financial statements etc., as required by the applicable Accounting Standards.

Question 5 **(Model TP 4M)**

Kavyanjali Limited appoints Ridhi & Sidhi as statutory auditors for the financial year 2023-24. Ridhi & Sidhi seems to have different opinions on audit approach to be adopted for audit of Kavyanjali Limited. Sidhi is of the opinion that 100% checking is not required and they can rely on audit sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population.

Ridhi is concerned whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

You are required to guide Ridhi about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.

Answer:

As per SA 530, "Audit Sampling", the auditor shall evaluate:

(a) The results of the sample; and

(b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

In the given case, Ridhi concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, Ridhi may:

i) request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or

ii) tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

Question 6 **(MTP M25 S1 5M)**

CA. Jin, a recently qualified practicing Chartered Accountant, got his first audit assignment of Ordinary (P) Ltd. for the financial year 2023-24. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA. Jin left failed to obtain sufficient audit evidence, such as confirmations, for the outstanding Accounts Receivable amounting to Rs. 250 lakhs, continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year.

Relying merely on the management's affirmation that there were no receipts or further credits during the year, CA Jin excluded the audit of accounts receivable from his audit program, assuming that the amount pertained to the prior year, which had already been audited by the predecessor auditor. Comment on the appropriateness of CA Jin's approach. (5 Marks)

Answer:

Verification of Accounts Receivable: As per SA 510, "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-

(i) Opening balances contain misstatements that materially affect the current period's financial statements; and

(ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

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

In addition, according to SA 580, "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient

appropriate audit evidence on their own for that assertion.
In the given case, the management of Ordinary (P) Ltd. has restrained CA. Jin, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Jin, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.
Thus, CA. Jin should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme. Consequently, CA. Jin shall also be held guilty for professional misconduct for not exercising due diligence, or grossly negligence in the conduct of his professional duties as per the Code of Ethics.

Question 7 **(MTP M25 S2 5M)**

During the audit of Goldy Ltd., a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of Rs. 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation.
Answer: Already covered in TYK Qn

Question 8 **(MTP M25 S2 5M)**

The Engagement Partner of the audit team of High Inventory Limited assessed that the inventory is material with respect to the audit of the financial statement for the current period. Upon inquiring with the management, the Engagement Partner identified that the management will be performing an annual physical inventory count at all the warehouses where the entity stores and maintains its inventory. Moreover, management confirmed in its written representation that they will be performing a 100% physical count of inventory for the current period.
As a result, the Engagement Partner decided not to perform any physical count of inventory as it will be a duplication of the work. Moreover, he decided that the written representation from management stating "the inventory exists and is in appropriate physical condition" will be sufficient and appropriate with respect to audit evidence to conclude that the inventory balance in the financial statement is free from any material misstatement.
In the light of SA 501, evaluate whether the decision taken by the Engagement Partner is appropriate or not.
Answer: Already covered in TYK Qn 1
Hence in the given case, the approach of Engagement Partner is not appropriate as when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. This should be done by performing various audit procedures which also includes attending physical count, observing the count, inspecting the inventory and reperforming physical counts.

Exceptional Questions

SA 505

Question 1. Exceptional

Write about factors that assist in determining external confirmation procedures as substantive audit procedures?

Answer:

Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

a. The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.

b. The ability or willingness of the intended confirming party to respond – For example, the confirming party:
   1) May not accept responsibility for responding to a confirmation request.
   2) May consider responding too costly or time consuming.
   3) May have concerns about the potential legal liability resulting from responding.
   4) May account for transactions in different currencies or
   5) May operate in an environment were responding to confirmation requests is not a significant aspect of day-to-day operations.

   In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

c. The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

Question 2. (PYP Nov '22, RTP May '18)

During the course of audit of Moon Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one old outstanding of Rs.25 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.

Answer: Already covered in TYK Qn

ANALYSIS AND CONCLUSION:

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of Rs.25 lacs has not sent the confirmation on the credit balance.

But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

Question 3. [QP May 2018]

Neverpermit Limited refuses to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that at least outstanding above a threshold limit needs to be confirmed and reconciliation is to be carried out before finalising the audit. If the Company does not relent, how will you respond? [SA 505]

Answer:

SA 505 "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. If management refuses to allow the auditor to send a confirmation request, the auditor shall:

1. Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness.
2. Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures and
3. Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.
4. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.
5. The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.

A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation.

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

SA 510

Question 4. **(PYP Nov '19)**

Mr. X has been appointed as an auditor of M/s ABC Ltd., Mr. X wants to be satisfied about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements. Lay down the audit procedure, Mr. X should follow, in the initial audit engagement of M/s ABC Ltd. Also suggest the approach to be followed regarding mention in the audit report if Mr. X is not satisfied about the correctness of 'Opening Balances'?

Answer:

AUDIT PROCEDURE FOR OPENING BALANCES:

As per SA 510, the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

1. Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss.
2. Determining whether the opening balances reflect the application of appropriate accounting policies and
3. Performing one or more of the following:
   a. Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements.
   b. Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances or
   c. Performing specific audit procedures to obtain evidence regarding the opening balances.

AUDIT REPORTING RELATED TO OPENING BALANCES:

1. UNABLE TO OBTAIN EVIDENCE: If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate.
2. MMS IN OPENING BALANCES: If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

Question 5. Exceptional **(RTP May '21)**

I. In an initial audit engagement, the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow in cases:
   a. When the financial statements are audited for the preceding period by another auditor and
   b. When financial statements are audited for the first time.

II. If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances', what approach you will adopt in drafting your audit report in two situations mentioned in (I) above?

Answer:

I. AUDIT PROCEDURE:

a. Financial Statements Audited by another Auditor – Audit Procedure:
   1. If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements.
   2. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

b. Audit of Financial Statements for the First Time – Audit Procedure:

   When the audit of financial statements is being conducted for the first time, the auditor has to perform auditing procedures to obtain sufficient appropriate audit evidence.

   Since opening balances represent effect of transaction and events of the preceding period and accounting policies applied in the preceding period, the auditor needs to obtain evidence having regard to nature of opening balances, materiality of the opening balances and accounting policies.

   Since it will not be possible for auditor to perform certain procedures, e.g., observing physical verification of inventories, etc. the auditor may obtain confirmation, etc. and perform suitable procedures in respect of fixed assets, investments, etc. The auditor can also obtain management representation with regards to the opening balances.

II. DRAFTING AUDIT REPORT:

1. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate.

2. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

SA 530

Question 6.

CA B is appointed as an auditor of M/s. Divine pharmacy, a wholesale medicine supplier. While auditing for the financial year 2020-21, CA B wants to use test checking technique. Advise CA B, what kind of precautions should be taken by him in this regard.

Answer:

Precautions to be taken while applying test check techniques are:

1. Thorough study of accounting system should be done before adopting sampling
2. Proper study of internal control systems.
3. Areas which are not suitable for sampling should be carefully considered. Eg: compliance with statutory provisions, transactions of unusual nature etc.
4. Proper planning for Sampling methods to be used and explaining the staff,
5. Transactions and balances have to be properly classified (stratified)
6. Sample size should be appropriately determined.
7. Sample should be chosen in unbiased way,
8. Errors located in the sample should be analysed properly.

SA 550

Question 7. Exceptional **(PYP Nov '20)**

Mr. X, while conducting audit of PQR Ltd, comes across certain transactions which according to him are significant transactions with related parties and identified to be outside the entity's normal course of business. Guide Mr. X with examples of such transactions and to understand the nature of significant transactions outside the entity's normal course of business.

Answer:

In the given case of PQR Ltd, Mr. X, while conducting audit has come across certain significant related party transaction which are identified to be outside the entity's normal course of business. Mr. X wants guidance through examples of such significant transactions which are given in SA 550

As per SA 550 "Related Parties", examples of transactions outside the entity's normal course of business may include:

1. Complex equity transactions, such as corporate restructurings or acquisitions.
2. Transactions with offshore entities in jurisdictions with weak corporate laws.
3. The leasing of premises or the rendering of management services by the entity to another party if NO consideration is exchanged.
4. Sales transactions with unusually large discounts or returns.
5. Transactions with circular arrangements, for example, sales with a commitment to repurchase.
6. Transactions under contracts whose terms are changed before expiry.

Question 8.

How can an auditor verify the existence of related party relationships and transactions?

Answer:

During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Records of the entity's investments and those of its pension plans.
5. Contracts and agreements with key management or those charged with
6. governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Life insurance policies acquired by the entity.
9. Significant contracts re-negotiated by the entity during the period.
10. Internal auditors' reports.
11. Documents associated with the entity's filings with a securities regulator e.g., prospectuses.

Question 9. **(RTP Nov '21)**

While formulating the audit plan and responding to the risks of material misstatement identified and assessed in related party transaction and relationships, Ms. K the engagement manager of the audit team of ABC Limited, placed for identification and disclosure of related party relationships and transactions in accordance with the applicable financial reporting framework.

You are requested to guide Ms. K regarding the necessity to test the controls to obtain sufficient and appropriate audit evidence. Also guide, whether Ms. K can use the audit evidence obtained, regarding operative effectiveness of control on identification and disclosure of related party relationships and transactions, in the interim period.

Answer:

As per SA 550, "Related Parties", according to para on "Responses to the risks of material misstatement associated with related party relationships and transactions", the auditor should design and performs further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.

Further, as per SA 330, "The Auditor's Responses to Assessed Risks", the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

(a) the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures); or

(b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. Moreover, the auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to when the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, and the timing of test of controls over significant risks, in order to provide an appropriate basis for the auditor's intended reliance.

When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:

(a) Obtain audit evidence about significant changes to those controls subsequent to the interim period; and

(b) Determine the additional audit evidence to be obtained for the remaining period.

In the current case, Ms. K shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls as she intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures.

Further, she is also required to obtain the audit evidence about significant changes to those controls subsequent to the interim period along with the additional audit evidence to be obtained for the remaining period in accordance with the requirements of Standards on Auditing as discussed above.

Question 10. Exceptional **(QP Nov '18)**

You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was Rs.12,000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for Rs.850 crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with Ind AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises. Analyse this issue in finalizing the Audit Report.

Answer:

Related Party Disclosures: As per Ind AS 24, "Related Party Disclosures", a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with:

1. a government that has control or joint control of, or significant influence over, the reporting entity and
2. another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:

1. the name of the government and the nature of its relationship with the reporting entity (i.e., control, joint control or significant influence);
2. the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
    a. the nature and amount of each individually significant transaction; and
    b. for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

SA 550 – AUDITORS RESPONSBILITY:

Further, as per SA 550 Related Parties, in forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In the instant case, Power Supply Corporation Limited, a Government Company has procured spares for transmitters for rupees 850 crore from abroad through a corporation namely Procurement and Supply India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Power Supply Corporation Limited has to disclose the matters specified above (i.e.name of Government, natures of its relationship with reporting entity, the nature and amount of transaction etc.).

Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise in not tenable.

Question 11. (PYP May '22)

JKL Limited is engaged in the business of Construction and real estate having various projects across states. M/s YT & Co, Chartered Accountants have been appointed as Statutory Auditors. Audit Team from M/s YT & Co for audit of JKL Limited comprises of CA Z-Engagement Partner, CA Q, a paid assistant and 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is a managing partner. The engagement team discussed that SA 315 and SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the JKL Limited's related party relationships and transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant Standard on Auditing. [SA 550]

Answer:

As per SA 550 "Related Parties", the engagement team discussion that SA 315 and SA 240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions. Accordingly matters that are to be addressed in the discussion by CA Z among the engagement team include:

1. The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).
2. An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
3. The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special - purpose entities for off-balance sheet transactions, or an inadequate information system).
4. The records or documents that may indicate the existence of related party relationships or transactions.
5. The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the

applicable financial reporting framework establishes related party requirements), and the related risk of management override of relevant controls.

6. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:
   a. how special-purpose entities controlled by management might be used to facilitate earnings management.
   b. how transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

Test Your Understanding from ICAI SM

Test Your Understanding 1.

"Move Fast Limited" is engaged in the manufacturing of shoes and slippers located in Bahadurgarh in Haryana. Due to unprecedented rains in the area in the month of September 2023, many areas of the town got inundated due to the choking of sewer systems. As a result of the above, the company's premises located in town were also affected, resulting in damage of stocks. The company has lodged a claim with the insurance company for Rs.1 crore, and the same is shown as a claim receivable as of 31st March 2024, as the claim was not settled at year end. The insurance surveyor appointed in the case submitted a report to the insurance company recommending a claim of Rs.45 lacs in the month of April 2024. The company has also given its consent for the same, and the settled amount of Rs.45 lacs was transferred to the bank account of the company on 15th May 2024. You have just finished performing substantive procedures of the company by the end of May 2024. Is there any responsibility cast upon you as auditor of the company in the above situation?

Answer:

The given situation provides evidence of conditions that existed at the date of Financial Statements. Initially, the company had lodged claim of Rs.1 crore and the same is reflected as claim receivable in financial statements as on 31st March, 2024.

However, subsequent events occurring have provided evidence that claim was settled for Rs. 45 lacs only. Such a settled amount has already been accepted by the company by providing its consent. Therefore, such events have provided fresh information about items included in financial statements.

Further, the performance of substantive procedures has been finished implying that the audit report is not yet issued.

Therefore, financial statements as on 31st March, 2024 should be adjusted to reflect fresh information emanating from described events and management should be asked to take appropriate action in this regard so that adjustment pertaining to above is properly reflected in financial statements in accordance with applicable financial reporting framework.

Test Your Understanding 2.

CA Anuj is the auditor of a listed company, and he is in the midst of conducting an audit of the said company for the financial year ending 31st March 2024. At a meeting of the Board of Directors held on 17th April 2024, a dividend of Rs.1 crore is proposed to equity shareholders @ Rs.10/- per share, and such a proposal has a good chance of being approved in the AGM of the company to be held after few months. His audit procedures are near completion. He is contemplating finalizing the audit report by 31st July 2024. Is there any responsibility thrust upon him as an auditor of the company?

Answer:

In the given situation, dividend has been proposed by Board of Directors on 17th April, 2024. It is an example of conditions that arose after the reporting period. No liability exists for the company on the reporting date because there is no obligation to pay at the reporting date in accordance with Ind AS 1. Therefore, the above situation does not require recognition of the above proposed dividend in financial statements. It is an example of events which do not require adjustments. However, it should be disclosed in financial statements in notes to accounts. Therefore, it should be ensured that it is disclosed in notes to accounts in financial statements. He should verify in accordance with SA 560 that it is disclosed in notes to accounts.

Test Your Understanding 3.

CA Somya is auditor of a company engaged in rearing of poultry birds and obtaining eggs therefrom. The company has performed very well since its incorporation in 2013. Its sales had also grown and the company had expanded its market from the native northern state of promoters to far-flung areas in eastern parts of country.

However, since last two years, company's fortunes have nosedived. First, due to the effects of the pandemic and then due to recurrent outbreaks of bird flu thrice in a span of two years. The company's sales have dipped from around Rs.50 crores to Rs.10 crores. Further, a major part of its livestock was also wiped off during bird flu. She is not optimistic about the going concern assumption followed by management.

The management now wants to start with new batches of birds. The earlier working capital facilities of the company granted by bank have also been restructured to support the business. She was informed that the repayments of restructured working capital term loans are to begin from ensuing year. No fresh credit facilities have been granted by the bank. The company also plans longer credits from animal feed suppliers. The company plans to take additional measures to prevent the safety of live stocks, including aggressive vaccination, preventive health check-ups, and more frequent visits of veterinary staff.

The villagers in surrounding areas have accused the company of spreading air pollution.

The management has prepared a cash flow forecast for her examination. Discuss the approach to be adopted by her in examining the "going concern" assumption keeping in view above with specific reference to cash flow forecast.

Answer:

In accordance with SA 570,"Going Concern", if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern by performing additional audit procedures, including consideration of mitigating factors.

Where the entity has prepared a cash flow forecast, and analysis of forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions, it includes

i. Evaluating the reliability of the underlying data generated to prepare the forecast and
ii. Determining whether there is adequate support for the assumptions underlying the forecast.

In the above situation, cash flow forecast has been prepared by management. Therefore, she should carefully evaluate assumptions underlying forecast and also reliability of data to prepare the forecast. For example: -

- ✓ She should verify assumption regarding fresh batch of livestock. The bankers have not provided fresh credit facilities. How funds from the same would be arranged? The reasonability of assumption in cash flow forecast needs to be looked into.
- ✓ She needs to check loan sanction letters/agreement to verify when repayments are beginning to see their accuracy in cash flow forecasts.
- ✓ The company plans to avail longer credits from animal feed suppliers. In the downturn situation of the company, how would suppliers extend longer credits? This is going to have effect on the cash flow forecast.

- ✓ Whether company has accounted for increased expenditure on preventive health check-up, vaccination and more frequent visits of veterinary staff in cash flow forecast.
- ✓ Since villagers have accused the company of spreading air pollution, how does the company plan to

deal with the same? Whether any proposed expenditure in this regard is accounted for in the cash flow statement. She may also consider other implications of this issue and possible effect on cash flows.

Test Your Understanding 4.

CA Sooraj finds that key financial ratios of a company, like current ratio, debt-service coverage ratio, inventory turnover ratio, and trade receivables turnover ratio, are in red and have deteriorated considerably as compared to last year. The company is also not able to pay to its creditors on time. The company is requesting time and again to its bankers to grant additional credit facilities, but bankers are not listening. There have been significant losses to the company due to the lack of response of the company's products in the market. As a result of it, many products are sold at below cost price. There have been situations where the company is not able to pay the salaries of staff on time. All these negative findings have led him to conclude that the use of going concern as the basis of accounting is not appropriate. He brings this matter to the knowledge of CFO of the company. What is reporting duty cast upon him in such a scenario? The CFO informs him that the management, in turn, is ready to include in the disclosures the inappropriateness of its use of going concern assumption of accounting. How should it impact the auditor's opinion in case management itself discloses the inappropriateness of its use of going concern assumption of accounting now?

Answer:

If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the financial statements is inappropriate, the auditor shall express adverse opinion.

The requirement for an auditor to express an adverse opinion applies regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern basis of accounting.

Therefore, even if management discloses that its use of going concern assumption of accounting is inappropriate, it would have no impact on auditor's opinion. He would need to express adverse opinion.

Test Your Understanding 5.

Following is a written representation given by RES Limited to its statutory auditors i.e. M/s CTK & Associates for audit of financial year 2023-24. The audit was completed and report dated 31-07-2024 was issued.

Point out, if there is any, anomaly in written representation reproduced below:

15th April, 2024

To

CTK & Associates

Chartered Accountants

Dear Sir,

This representation letter is provided in connection with your audit of the financial statements of RES Limited for the year ended March 31, 2024 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the applicable accounting standards in India.

We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

Financial Statements

- ✓ We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated 17th August 2023 for the preparation of the financial statements in accordance with financial reporting

Standards, in particular, the financial statements give a true and fair view in accordance with the applicable accounting standards in India.

- ✓ Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- ✓ Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of applicable accounting standards in India. (SA 550)
- ✓ All events subsequent to the date of the financial statements and for which applicable accounting standards in India require adjustment or disclosure have been adjusted or disclosed. (SA 560)
- ✓ The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (SA 450)

Information provided

- ✓ We have provided you with: -
  - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- ✓ All transactions have been recorded in the accounting records and are reflected in the financial statements.
- ✓ We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- ✓ We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves: -
  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the financial statements.
- ✓ We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.
- ✓ We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.
- ✓ We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (SA 550)

Chief Financial Officer

Answer:

The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. As the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In the given situation, written representation is dated 15th April 2024. The audit report is dated 31st July 2024. There is a considerable lag between date of written representations and date of audit report.

It could signify that all subsequent events after date of financial statements requiring adjustments or disclosure may not have been adjusted or disclosed in the financial statements by management.

As audit report is dated 31St July, 2024, it reflects that auditor has considered subsequent events occurring between date of financial statements and date of auditor's report. However, written representations pertain to 15th April 2024.

Case Studies from ICAI SM

Case Study 1.

Infinity Hospitality Private Limited was established in 1996 and was in the business of running hotels in tourist destinations in state of Kerala. It took leased properties on long-term leases ranging from 10 to 12 years, most with a lock-in of a whole term. The terms did not cover the force majeure clause. The company was family-owned business and had created a good reputation as value for a money-budget hotel. Most of the time, hotels clocked 60 to 75% occupancy rate, and during the festive season/ vacations, hotel business clocked 100% Occupancy.

The capital structure of the company was debt oriented and over-leveraged.

Primary working capital was blocked in maintaining and upkeeping the leased properties, running the restaurant, leases, food and beverages, salary, Director's remuneration etc.

The owners looked at the business as a cash cow and did not plough back the funds to expand the business but were content with the decent profits the hotels were generating.

As the properties were leased and not owned, most of the cash flow generated from operations was used in servicing the property and huge loans from financial institutions. What was left was withdrawn as Directors' remuneration and dividend.

Everything was going on smoothly. However, there were flash floods in Kerala due to unprecedented rains. There were landslides and roads were blocked. The entire tourist season was washed away due to infrastructural challenges. Accessibility to resorts and hotels was badly hindered. Logistics support took time to reach in far flung areas. Visit to the "The God's own country" was last on the mind of tourists. The company was hardly trying to get back to some semblance of normalcy when pandemic struck. It was double whammy for the company.

The impact on travel, tourism and hospitality business was very severe. The management of Infinity Hospitality Private Limited believed that bad days would end soon and the business would be back to normal. They also were optimistic about the government coming up with support for the industry and were hopeful of negotiating with lessors and Financial Institutions for relief. They decided on humanitarian grounds not to terminate the employees and continued paying them a regular salary, maybe deferring 25% to be paid after one year. The immediate fallout was on the top line as suddenly, the business stopped.

The auditors, M/s XYZ and Associates, were conducting the audit of the company and were grappling with the situation and are seeking your guidance for the course of action they need to follow.

Theoretical Questions

Based on the case scenario, you are required to provide your answers to the following:-

Question 1:

What additional audit procedures must the auditor undertake as per requirements of SA 570 based on the facts given in the case?

Answer:

In the given case scenario the events and conditions have been identified which cast significant doubt on the entity's ability to continue as a Going Concern, the auditor needs to obtain sufficient appropriate audit evidence to determine whether or not material uncertainty and gather evidence including of mitigating factors. It can be done by performing following additional procedures: -

- ✓ Analysing and discussing cash flow, profit and other relevant forecast with management.
- ✓ Analysing and discussing the entity's latest available interim financial statement.

- ✓ Reading the terms of loan agreements and determining whether any have been breached.
- ✓ Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- ✓ Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their out come and the estimate of their financial implications.
- ✓ Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third party and assessing the financial ability of such parties to provide additional funds.
- ✓ Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.
- ✓ Confirming the existence, terms and adequacy of borrowing facilities.
- ✓ Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
- ✓ Evaluating management's plans for further actions in relation to its going concern assessment, whether the outcome of these plan is likely to improve the situation and whether the management's plans are feasible in the circumstances.
- ✓ Evaluating management's plans for future actions may include inquiries of management as to its plan for future action, including, for example, its plan to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital.
- ✓ Considering whether any additional facts or information have become available since the date on which management made it assessment.
- ✓ Requesting written representation from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

Question 2:

According to your judgment, what risk assessment procedures should the auditor consider for arriving at a conclusion based on the management assertion of the entity being Going Concern?

Answer:

When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue the going concern. In so doing, the auditor shall consider whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern.

- ✓ The auditor shall discuss the assessment with management and determine whether management has identified events and conditions that, individually or collectively, cast significant doubt on the entity's ability to continue as a going concern and if so, management's plan to address them.
- ✓ The auditor shall specifically draw attention of Management on following events or condition and get the response on how they plan to address them:

The company is debt heavy and over leveraged. The leased properties are having considerable lock-in period with absence of force majeure clause. There are no contingency reserves available with company. All these factors shall be taken into account while performing risk assessment procedures.

Question 3:

What should be approach of the auditor if the management agrees that the material uncertainly exists, but the entity is a Going Concern? Also discuss reporting requirements.

Answer:

If the auditor concludes that the management's use of going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditors shall determine whether the financial statements:

a. Adequately disclose the principal events or conditions that make a significant doubt on the entity's ability to continue as a going concern and management's plan to deal with these events or conditions, and
b. Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on entity's ability to continue as a going concern and therefore, that it may be unable to realize its assets, and discharge its liabilities in the normal course of business.
c. The disclosures may include:
   i. Management's evaluation of the significance of the events or conditions relating to the entity's ability to meet its obligations; or
   ii. Significant judgements made by management as a part of its assessment of the entity's ability to continue as a going concern
   iii. Disclosures about the magnitude of the potential impact of the principal events or conditions, and the likelihood and timing of the occurrence.
   iv. The auditor shall express and unmodified opinion and the auditor's reports shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
      - ✓ Draw attention to the note in the financial statement that discloses the events or conditions and
      - ✓ State that these events are conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and the auditor's opinion is not modified in respect of the matter and how the matter was addressed in the audit.

Question 4:

What if the auditor believes, on the basis of his additional audit procedures conducted to conclude that the entity is not a Going Concern, but the management is not accepting the same? What course of action the auditor needs to undertake?

Answer:

If management has prepared financial statements using the Going Concern assertion to which auditor differs as according to his judgement, the Going Concern assertion by the management is not appropriate, then the auditor is required to express an adverse opinion.

Question 5:

What kind of written representation does the auditor need to obtain in case of the scenario covered in Q3 above?

Answer:

The auditor needs to obtain written representation from management and where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.

Multiple Choice Questions

1. Which of the following is not a financial event/ condition that may cast significant doubt on companies ability to continue as a going concern as per SA 570?
   (a) Change from credit to cash on delivery model with suppliers

(b) Arrears or discontinuance of dividend
(c) Opening of a new chain of hotels by renowned competitor near the entity's area
(d) Adverse key financial ratios

2. Please choose the mitigating measure as the management is unable to pay lease rentals.
(a) Cancel the lease
(b) Restructure the lease agreement and negotiate for deferment and relief
(c) Terminate the employees and pay the lessor
(d) All the above

3. Which one of the following is not a responsibility of the auditor relating to communicating events or conditions identified that may cast significant doubt on the entity's Going Concern assertion?
(a) Perform additional audit procedures to identify events/ conditions beyond 12 months from the date of financial statements
(b) Whether the events constitute a material uncertainty
(c) The adequacy of related discloses in the financial statements
(d) The implications for the auditor's report

4. Written Representation need to be mandatorily obtained from:
(a) Audit Committee
(b) Client relationship Managers
(c) Company Secretary
(d) CFO

5. Which of the following is not main pillar of written representations?
(a) The management responsibility for preparation of financial statement
(b) Assertion related to completeness
(c) Assertion related to access to data and information
(d) Written representation provides sufficient appropriate audit evidence

Answers to Multiple Choice Questions

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

Case Scenario's from ICAI SM

Case Scenario 1

CA Sneha, a partner in M/s J & Associates, is carrying out a statutory audit of M/s ABC Stores Ltd. for the Financial Year 2023-24, and she is ready to sign her audit report on 01.07.2024. There are some written representations which are pending with the management of the company pertaining to such an audit, and she sent Deepak (her articled trainee), who is also a member of the engagement team, to the company's office for collection of the same.

On returning back, Deepak tells CA Sneha that major stocks of the company got destroyed because of a fire in their plant on 27.06.2024, and it has affected the company's operations badly. However, the business operations are likely to be resumed by management at an alternate place.

CA Sneha postponed the issuance of the audit report to consider the impact of such an event on the financial state of affairs of the company. She wants the management to disclose the impact of this unfortunate event in financial statements for the year 2023-24, to which management is disinclined. After the management's refusal, she issued her audit report on 15.07.2024.

The management of the company seeks an appointment from CA Sneha to discuss an important matter on 20.07.2024. They informed her that the company had lost a lawsuit filed against it by one of the creditors on 18.07.2024 in a fast-track court, and now the company has to pay the plaintiff a huge amount of Rs.2 crores. The events causing this lawsuit arose after 31.03.2024.

CA Sneha is a bit perplexed, and her first question to the people from management visiting her office was whether audited financial statements have been made available to any third parties or filed with the regulator. The management responded negatively.

Now, CA Sneha wants them to amend the financial statements to include the impact of this lawsuit on the financial affairs of the company. This time, they agreed and amended the financial statements accordingly to cover the impact of both the events – that of the fire in the plant and losing the lawsuit, but they requested CA Sneha to issue a new audit report against the earlier one dated 15.7.2024.

The management amends the financial statements, which are finally approved on 25.7.2024. CA Sneha issues a new audit report.

Considering the above situation, answer the following questions: -

1. What would be the appropriate date of signing of the new audit report?
   (a) 20.07.2024
   (b) Anytime between 15.07.2024 & 18.07.2024
   (c) On or after 25.07.2024
   (d) Anytime between 15.07.2024 & 25.07.2024

2. CA Sneha would have taken into account a lot of procedures to get knowledge of the events occurring after the balance sheet date up to the date of the audit report relating to the company. Which of the following does not fall under such audit procedures as per SA 560?
   (a) Obtaining an understanding of the management's procedures set up to identify subsequent events.
   (b) Inquiring of the management w.r.t the occurrence of any such subsequent events.
   (c) Reading the minutes of the meetings of the board held after the balance sheet date during this period.
   (d) Getting the Interim financial statements prepared till the date of the audit report mandatorily as a condition to issue the audit report

3. W.r.t the first audit report dated 15.07.2024, which type of opinion was most likely provided by her?
   (a) Modified opinion
   (b) Unqualified opinion
   (c) Disclaimer of opinion
   (d) Including a statement in Emphasis of Matter/Other matters para

4. W.r.t the new audit report issued, which type of opinion is most appropriate?
   (a) Disclaimer of opinion
   (b) Unqualified opinion
   (c) Adverse opinion
   (d) Unqualified opinion and a statement in Emphasis of Matter/Other matters para.

5. The fire event occurring on 27.6.2024 in the company's plant requires the following action on part of management: -
   (a) Disclosure in notes to accounts
   (b) Adjustment in financial statements
   (c) Waiting for the insurance company to settle the claim
   (d) Preparing financial statements afresh

Answers to Integrated Case Scenario 1

1.	(c)	2.	(d)	3.	(a)	4.	(d)	5.	(a)

Case Scenario 2

CA Namit, a partner in M/s J & Associates, is carrying out a statutory audit of M/s XYZ Gears Ltd. for the Financial Year 2023-24 and is in the process of issuing an audit report. His articled trainee, Manpreet, is very curious about knowing the various facts relating to the consideration of Standards on Auditing while carrying out an audit and issuing the audit report.

She asks CA Namit about the relevance of the Going concern assumption in their audit and further reporting to which CA Namit explains to her that both parties have got their own responsibilities w.r.t this accounting assumption. The management of the company has its own set of responsibilities while reporting upon the same is a very strict and sensitive matter for the auditor as per the requirement of the relevant standard on auditing.

He tells Manpreet to prepare a list of procedures as she thinks that an auditor should carry out when he identifies that the company is facing a downfall in business never seen before due to newer technology in the market and other competitors having sprung up swiftly adopting new technology.

He finds that this condition may cast significant doubt on the company's ability to continue as a going concern.

Manpreet thinks and researches and hands over a list of audit procedures to CA Namit for a final discussion. CA Namit clarifies accordingly. CA Namit concludes that the use of a going concern basis of accounting is appropriate in this company's case, but a material uncertainty exists as to the future prospects of the current business. However, the management has made an appropriate disclosure w.r.t such material uncertainty in the financial statements.

Manpreet's list of audit procedures includes: -

I. Requesting management to make its assessment relating to the company's ability to continue as a going concern.

II. Evaluating management's plan of future actions.
III. Make a specific assessment of the company's ability to continue as a going concern.
IV. Analysing the cashflow forecast of the company.
V. Considering the additional facts or information available from the date of management's assessment.
VI. Make appropriate disclosures in the financial statements in connection with going concerns.
VII. Requesting Written Representation from management regarding the plans for future actions and the feasibility of these plans.
VIII. Writing a para addressed to the stakeholders in the audit report citing the results of procedures adhered to relating to the going concern assumption.

Keeping in view above, answer the following questions: -

1. CA Namit tells Manpreet about the auditor's responsibilities in the above case on the matter under discussion. Which of the following doesn't fall under the auditor's responsibilities?
   (a) Obtaining sufficient and appropriate audit evidence on the matter under discussion.
   (b) Conclude on the appropriateness of the management's use of going concern.
   (c) Assessing whether a material uncertainty exists about the company's ability to continue as a going concern.
   (d) Guarantee the company's ability to continue as a going concern based upon his audit procedures.

2. Identify which set of audit procedures are relevant in the above case scenario as per the list prepared by Manpreet.
   (a) (I), (II), (IV), (V) & (VII)
   (b) (I), (III) & (V)
   (c) (II), (IV), (VI), (VII) & (VIII).
   (d) (I), (II), (III), (IV) & (V).

3. CA Namit's conclusion in the above case will lead him to give which type of audit opinion from the following?
   (I) Modified opinion
   (II) Unmodified opinion.
   (III) A separate section "Material uncertainty w.r.t Going concern" in his audit report.
   (a) (I) only
   (b) (II) only
   (c) (I) & (III)
   (d) (II) & (III)

4. Consider the following statements: -
   Statement I: - The Management is under a responsibility to make specific assessment of the company's ability to continue as a going concern.
   Statement II:-. The Management is under a responsibility to make appropriate disclosures in connection with going concern in the financial statements.
   (a) Statement I is correct only.
   (b) Statement II is correct only as Statement I falls under the auditor's responsibilities.
   (c) Both statements are correct.
   (d) Both statements are incorrect.

5. Which of the following is most appropriate regarding "going concern" assumption?

(a) It signifies that company is reflecting net losses in its financial statements.

(b) It signifies that company is not modernising its plant and machinery.

(c) It signifies that company has no intention of curtailing materially the scale of its operations in foreseeable future.

(d) It signifies that assets are likely to be recorded at the prices they would fetch.

Answers to Integrated Case Scenario 2

1.	(d)	2.	(a)	3.	(d)	4.	(c)	5.	(c)

Test Your Knowledge

Question 1 Exceptional

Ramadhan & Co. are the auditors of XYZ Company Ltd. for the year ended on 31/03/2024. The Audit Report for that year was signed by Ramadhan & Co. on 04/05/2024. The Annual General Meeting was decided to be held during the month of August 2024. On 06/05/2024, the Company had received a communication from the Central Government that an amount of Rs.5800 crore kept pending on account of incentives pertaining to Financial Year 2023-24 had been approved and the amount would be paid to the Company before the end of May 2024. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2024. On 08/05/2024, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh audit report on the Financial Statements for the year ended on 31/03/2024. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

Answer:

Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

i. Discuss the matter with management and, where appropriate, those charged with governance.
ii. Determine whether the financial statements need amendment and, if so,
iii. Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, XYZ Company Ltd. received an amount of ` 5800 crore on account of incentives pertaining to the year 2023-24 in the month of May 2024 i.e. after finalisation of financial statements and signing of audit report. The Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested Ramadhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31-03-2024.

After applying the conditions given in SA 560, Ramadhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

Question 2

M/s Airlift Ltd., carrying on the business of passenger transportation by air, is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2024 are to be now finalized. The

Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the issue involves uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the "Going Concern" would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter.

Answer:

Reporting requirements in case of Uncertainty clamping on the Going Concern: As per SA 570 "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements : (i)adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and (ii) disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

i. Draw attention to the note in the financial statements that discloses the matters set out above; and
ii. State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

In the instant case, M/s Aircraft Ltd. is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of its ability to continue in near future. Therefore, a committee has been constituted to study this aspect and till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts. Therefore, the auditor should disclose about the material uncertainty and express an unmodified opinion and in his audit report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to draw attention to the note in the financial statements that discloses the matters set out above; and state that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Question 3

PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. The annual turnover of the company is Rs.2000 crores and profits are Rs.190 crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of, and period covered by written representation in view of SA 580.

Answer:

As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated WR.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

Question 4 **Newly Added**

CA Shobit is conducting an audit of XYZ Ltd. for the year 2023-24. The company is engaged in the export of handicraft items in Europe. The audit is nearing completion in the month of July 2024. However, it becomes known to CA Shobit that one of overseas buyers has made a legal claim against the company on 1st June 2024 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August 2023. The management of the company has decided to agree to an out of court settlement of Rs.4 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, CA Shobit should proceed to deal with above issue.

Answer:

In the given case, the auditor has come to know the legal claim against the company before the issuance of the audit report. It has also come to his knowledge that the management of the company has agreed to an out of court settlement of ₹ 4 crore.

This is an example of a subsequent event between the date of the financial statements and the date of the auditor's report. It provides evidence of conditions that existed at the date of the financial statements and requires adjustment in financial statements.

Further as per SA 560, "Subsequent Events", the auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, "Written Representations" that all the 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.
CA Shobit should ensure that appropriate adjustments and disclosures are made by the management. In the absence of the same, he should consider the impact of the said event and report accordingly.

Question 5 Exceptional **Newly Added**

CA N is carrying out an audit of restated financial statements of BQR Limited for past 3 financial years i.e. 2023-24, 2022-23 and 2021-22 for onward submission to SEBI pursuant to their upcoming IPO (Initial Public Offer). CA N is planning to issue an Audit Report on 5th August, 2024 covering these restated financial statements. Before issuing the audit report, CA N requested Management Representation Letter from the management of the Company for this assignment. The Management of the Company provided Management Representation Letter dated 1st April, 2024 covering the period of financial year 2023-24 only as they were not in position to provide for the financial year 2022-23 and 2021-22 because they were not in place during that period.
How would CA N deal with the above situation as per relevant Standard on Auditing?

Answer:
In the given situation, CA N is carrying out an audit of restated financial statements of BQR Limited for past 3 financial years i.e., 2023-24, 2022-23 and 2021-22 so he requested Management Representation Letter from the management of the Company for this assignment before issuance of the report. The management of the Company provided the Management Representation Letter only for the financial year 2023-24 as they were not in place during that period.
As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated before the date of the written representations.
As per SA 560, "Subsequent Events", the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.
In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.
The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.
Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole.
Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies. Therefore, as per the above requirement of SA 580 CA N should take written representation letter from management of BQR Limited for the financial year 2022-23 and 2021-22 also.

Question 6 **Newly Added**

Mudit & Associates is appointed as Statutory Auditors of GRF Private Limited for the financial year 2023-24. The company is into the business of Health Club, Fitness Centre and gym costumes. CA M is the Engagement Partner for the audit assignment. CA M observed the following points while auditing:

i. Customer's base is reducing continuously due to tough competition and discount war existing in the market.
ii. Payments of creditors are delayed and made with overdue interest.
iii. Company has not been able to pay the salaries of staff and trainers on time.
iv. Key financial ratios of the company, like current ratio, debt-service coverage ratio, are in the red and have deteriorated considerably as compared to last year.
v. The company has requested its bankers to provide it with additional working capital credit facilities of Rs.1.5 Crores, but bankers are not considering the company's proposal favorably.

What audit procedures should be followed by CA M considering the above circumstances as per SA 570 - "Going Concern"? How auditor should deal if the use of going concern basis of accounting is appropriate, but a material uncertainty exists, and adequate disclosure of material uncertainty is made in the financial statements?

Answer:

As per SA 570, "Going Concern", if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

a. Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
b. Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
c. Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
   i. Evaluating the reliability of the underlying data generated to prepare the forecast; and
   ii. Determining whether there is adequate support for the assumptions underlying the forecast.
d. Considering whether any additional facts or information have become available since the date on which management made its assessment.
e. Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

In the given case, CA M has observed such points that may cast significant doubt on the entity's ability to continue as a going concern. Therefore, CA M should follow audit procedures such as:

✓ Review of management's assessment of the company's ability to continue as a going concern.
✓ Examine and challenge the reasonableness of the company's cash flow forecasts and key assumptions.
✓ Review events after the reporting period that might affect the going concern assumption, such as further financial deterioration or inability to secure financing.

- ✓ Analysis of the company's key financial ratios and compliance with loan agreements to assess liquidity and solvency.
- ✓ Review of the company's challenges and efforts to secure additional financing and the reasons for the bank's reluctance to provide further credit.
- ✓ Assess the impact of declining customer base, delayed payments, and other operational challenges on the company's ability to continue as a going concern.

Further, as per SA 570 if adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

a. Draw attention to the note in the financial statements that discloses the matters set out in paragraph 19; and
b. State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Question 7 Exceptional **Newly Added**

The audit report of Rare (P) Ltd for F.Y. 2023-24 was issued by SRM & Co. on 23rd July, 2024. However, a case was filed against Rare (P) Ltd on 9th August, 2024, with the Civil Court, with respect to an incident caused in its factory on 24th January, 2024, the future outcome of which may result into paying kolsi by Rare (P) Ltd, which was informed to Mr. Rishabh Pandey, the partner of SRM & Co.

Mr. Rishabh discussed the said matter with the management, and it was determined to amend the financial statements for F.Y. 2023-24. Further, Mr. Rishabh inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.

The management told Mr. Rishabh that such disclosure was enough as he would be further going to provide description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.

In the context of aforesaid case-scenario, please answer to the following questions: -

i. Whether Mr. Rishabh on behalf of SRM & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Rare (P) Ltd?
ii. Whether the contention of management of Rare (P) Ltd is valid with respect to the disclosure of court case in the financial statements?

Answer:

i. As per SA 560, 'Subsequent Events', the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
   1. Discuss the matter with management and, where appropriate, those charge
   2. Determine whether the financial statements need amendment and, if so,
   3. Inquire how management intends to address the matter in the financial statements.

   In the given case, on becoming aware of the court case filed against Rare (P) Ltd., Mr. Rishabh discussed the said matter with the management, and was determined to amend the financial statements. Also, he inquired how the management intended to address the said matter in the financial statements.

Thus, it can be said that Mr. Rishabh has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Rare (P) Ltd.

ii. As per SA 706, 'Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report', an Emphasis of Matter paragraph is not a substitute for:

  a. A modified opinion in accordance with SA 705 (Revised) when required by the circumstances of a specific audit engagement;
  b. Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or
  c. Reporting in accordance with SA 570 (Revised) 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.

  In the given case, the management of Rare (P) Ltd. has presumed that as the auditor was going to provide a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report, there was no further need for it to provide additional disclosures about the court case in the financial statements.

  The said contention of management of Rare (P) Ltd. is not valid as 'Emphasis of Matter' paragraph cannot be used as a substitute for disclosures required to be made in the financial statements as per the applicable financial reporting framework or that is otherwise necessary to achieve fair presentation, which is the responsibility of the management.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 4M)**

CA Shobit is conducting an audit of XYZ Ltd. for the year 2023-24. The company is engaged in the export of handicraft items in Europe. The audit is nearing completion in the month of July 2024. However, it becomes known to CA Shobit that one of overseas buyers has made a legal claim against the company on 1st June 2024 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August 2023. The management of the company has decided to agree to an out of court settlement of ` 4 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, CA Shobit should proceed to deal with above issue.

Answer: Already covered in TYK Qn.

Question 2 **(MTP 1 May '24 5M)**

The audit report of Rare (P) Ltd for F.Y. 2022-23 was issued by SRM & Co. on 23rd July, 2023. However, a case was filed against Rare (P) Ltd on 9th August, 2023, with the Civil Court, with respect to an incident caused in its factory on 24th January, 2023, the future outcome of which may result into paying heavy penalty by Rare (P) Ltd, which was informed to Mr. Rishabh Pandey, the partner of SRM & Co.

Mr. Rishabh discussed the said matter with the management, and it was determined to amend the financial statements for F.Y. 2022-23. Further, Mr. Rishabh inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.

The management told Mr. Rishabh that such disclosure was enough as he would be further going to provide description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.

In the context of aforesaid case-scenario, please answer to the following questions: -

(i) Whether Mr. Rishabh on behalf of SRM & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Rare (P) Ltd?

(ii) Whether the contention of management of Rare (P) Ltd is valid with respect to the disclosure of court case in the financial statements?

Answer: Already covered in TYK Qn

Question 3 **(PYP May '24 5M)**

CA N is carrying out an audit of restated financial statements of BQR Limited for past 3 financial years i.e. 2023-24, 2022-23 and 2021-22 for onward submission to SEBI pursuant to their upcoming IPO (Initial Public Offer). CA N is planning to issue an Audit Report on 5th August, 2024 covering these restated financial statements. Before issuing the audit report, CA N requested Management Representation Letter from the management of the Company for this assignment. The Management of the Company provided Management Representation Letter dated 1st April, 2024 covering the period of financial year 2023-24 only as they were not in position to provide for the financial year 2022-23 and 2021-22 because they were not in place during that period.

How would CA N deal with the above situation as per relevant Standard on Auditing?

Answer: Already covered in TYK Qn

Question 4 **(MTP M25 S2 5M)**

CA Ashish is carrying out an audit of restated financial statements of Krop Limited for past 3 financial years i.e. 2023-24, 2022-23 and 2021-22 for onward submission to SEBI pursuant to their upcoming IPO (Initial Public Offer). CA Ashish is planning to issue an Audit Report on 2nd August, 2024 covering these restated financial statements. Before issuing the audit report, CA Ashish requested a Management Representation Letter from the management of the company for this assignment. The management of the company provided Management Representation Letter dated 1st April, 2024 covering the period of financial year 2023-24 only as they were not in position to provide for the financial year 2022-23 and 2021-22 because they were not in place during that period. How would CA Ashish deal with the above situation as per relevant Standard on Auditing?

Answer: Already covered in TYK Qn 5

In the given situation, CA Ashish is carrying out an audit of restated financial statements of Krop Limited for the past 3 financial years i.e., 2023-24, 2022-23 and 2021-22 so he requested a Management Representation Letter from the management of the Company for this assignment before issuance of the report. The management of the Company provided the Management Representation Letter only for the financial year 2023-24 as they were not in place during that period.

Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies. Therefore, as per the above requirement of SA 580, CA Ashish should take written representation letter from management of Krop Limited for the financial year 2022-23 and 2021-22 also.

In case the management of Krop Limited does not provide written representation as requested, the auditor shall discuss with the management, re-evaluate the integrity of management, and take appropriate actions including the impact on the audit report as per SA 705.

Exceptional Questions

SA 560

Question 1. **(RTP Nov '21)**

The audit report of Kolsi (P) Ltd. for F.Y. 2020-21 was issued by Bishnoi & Co. on 25th July 2021. However, a case was filed against Kolsi (P) Ltd. on 4th August 2021, with the Civil Court, with respect to an incident caused in its factory on 17th January 2021, the outcome of which may result in paying heavy penalty by Kolsi (P) Ltd.

Mr. Raj Bishnoi, the partner of Bishnoi & Co., discussed the said matter with the management and it was determined to amend the financial statements for F.Y. 2020-21. Further, Mr. Raj inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.

The management told Mr. Raj that such disclosure was enough as he would further going a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.

In the context of aforesaid case scenario, please answer the following questions:

(a) Whether Mr. Raj on behalf of Bishnoi & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Kolsi (P) Ltd.?

(b) Whether the contention of management of Kolsi (P) Ltd. is valid with respect to the disclosure of the court case in the financial statements?

Answer: Already covered in TYK Qn

Question 2. **(PYP Nov '20)**

You are the auditor of PQR Ltd. which is in the business of supplying food products to various airline companies operating aircrafts in domestic circle only. As per terms of agreement with airlines, the company needs to stock various non- perishable food items for coming one month (average holding of inventory to the tune of INR 75 Crores). Also the payment terms have been settled and the company receives payment in 45 days after the supply of goods. Everything was going-on well till the end of March 2020 when pandemic Covid hit the world and everything came to a standstill. Aviation sector was hit hard and there were No flights from April 2020 onwards. Consequently, the business of PQR Ltd. also got severely affected and the scheduled supplies of goods to airlines also were not made. Also, the liquidity position of airline companies got hit and the scheduled payments were also not received on due dates. As the auditor of PQR Ltd. what audit procedures would you perform to ensure that all subsequent events are considered, so that financial statements for the year ended 31.03.2020 represent true and fair view?

Answer:

As per SA 560 "Subsequent Events", the auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

Being the auditor of PQR Ltd, to ensure that all subsequent events are considered so that financial statements for the year ending 31.03.2020 represent true and fair view, the auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

1. Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
2. Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
3. Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
4. Reading the entity's latest subsequent interim financial statements, if any.

Based on the above audit procedures, if the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

Question 3. **(PYP Nov '18)**

Amudhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2018. The Audit Report for that year was signed by the Auditors on 04/05/2018. The Annual General Meeting was decided to be held during the month of August 2018. On 06/05/2018, the Company had received a communication from the Central Government that an amount of Rs.5800 crore kept pending on account of incentives pertaining to Financial Year 2017-18 had been approved and the amount would be paid to the Company before the end of May 2018. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2018. On 08/05/2018, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2018. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

Answer: Already covered in TYK Qn

Question 4. **(MTP 1 Nov 24 4M)**

CA Shobit is conducting an audit of XYZ Ltd. for the year 2023-24. The company is engaged in the export of handicraft items in Europe. The audit is nearing completion in the month of July 2024. However, it becomes known to CA Shobit that one of overseas buyers has made a legal claim against the company on 1st June 2024 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August 2023. The management of the company has decided to agree to an out of court settlement of ` 4 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, CA Shobit should proceed to deal with above issue.

Answer: Already covered in TYK Qn

SA 580

Question 5. Exceptional

What are the circumstances where the auditor would ask the management to re confirm its acknowledgement and understanding of those responsibilities in written representations?

Answer:

1. Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities.
2. The terms of the audit engagement were prepared in a previous year.
3. There is any indication that management misunderstands those responsibilities or
4. Changes in circumstances make it appropriate to do so.

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

The auditors of a listed company have affirmed in their audit report communication of significant audit findings including significant deficiencies in internal control of the company identified to those charged with governance. Where are such matters included in the audit report of a listed company? Also dwell upon the importance of such communication.

Answer:

Such matters are in nature of auditor's responsibilities and are stated in "The Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report in accordance with SA 700. Communication of significant audit findings and deficiencies identified in internal control to those charged with governance is one of important responsibilities of auditor.

Such communication assists those charged with governance in fulfilling their responsibility to oversee the financial reporting process and in fulfilling their oversight responsibilities.

Test Your Understanding 2.

Below is draft extract of audit report of a listed company. Para (A) below reflects certain matters stated in audit report communicated with CFO of company and Para (B) is in nature of auditor's response to said matter. (A) The Company recognizes revenues when the control of goods is transferred to the customer at the net consideration which the Company expects to receive for those goods from customers in accordance with contracts terms and conditions. The terms of sales arrangements based on the terms and conditions of relevant contracts and nature of discount and rebates create complexities that require judgment in determining revenues. (B) We read the Company's revenue recognition policy and assessed its compliance in terms of Ind AS 115 "Revenue from contracts with customers". We assessed design and tested the operating effectiveness of internal controls related to sales and rebates/discounts. We tested on a sample basis that revenue has been recognized in the proper period with reference to the supporting documents including confirmations from customers. From the description given above, identify what auditors are trying to report and under what heading such matter should be reflected in audit report of the company?

Answer:

The above matter is in nature of Key audit matter and should be stated under heading "Key audit matters" in audit report. Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

SA 701 states that the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, significant auditor judgments relating to areas in the financial statements that involved significant management judgment including accounting estimates that have been identified as having high estimation uncertainty be taken into account.

The above described matter relates to revenue recognition and creation of complexities requiring judgment in revenues. Further, the description also describes how the matter was addressed by auditors by performing various audit procedures in accordance with SA 701.

Test Your Understanding 3. Exceptional

PTD Limited is engaged in the business of executing construction contracts for its clients. There are non-current receivables outstanding in the financial statements of the company as on 31st March, 2024 for Rs.500 crore. Such amounts represent caused by claims raised by the company on its clients relating to cost overruns necessitated due to delays clients, change in work specifications and related matters. Besides negotiations, the company has also gone for arbitration in some of the said cases. The management of the company has considered the above amounts to be fully recoverable as stated in notes to accounts.

CA Piyush, auditor of the company, has relied only upon management representation in this regard. Besides, he has decided to include the said matter in "Emphasis of Matter" Paragraph in audit report. How do you view decision to include above matter in "Emphasis of Matter" Paragraph by auditor of the company?

Answer:

In accordance with SA 706, Emphasis of Matter Paragraph is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

As per SA 706, the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to: -

a. A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements or
b. As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Further, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor would not be required to modify the opinion in accordance with SA 705 as a result of the matter.

In the given situation, auditor has relied upon management representation letter only. He has not performed any other audit procedures like verifying contracts with customers, status of arbitration proceedings etc. Since management representations by themselves do not constitute sufficient appropriate evidence, performing necessary audit procedures may lead auditor to conclude that modification in opinion is necessary. In such circumstances, matter cannot be included in Emphasis of matter Paragraph.

Therefore, auditor should form his opinion by performing necessary audit procedures and obtaining sufficient appropriate evidence. It is only when he concludes that modification of opinion is not required as a result of said matter in terms of SA 705, the said matter may be included in Emphasis of Matter paragraph.

Illustrations from ICAI SM

Illustration 1:

CA Sameer is the statutory auditor of Tram Fram Ltd. for the FY 2023-24. While concluding the audit CA Sameer decided to issue an unmodified opinion, though he also concluded that a material uncertainty exists with respect to the company's ability to continue as a going concern on account of a pending litigation related to labour laws. He is of the view that the company has made appropriate disclosures with respect to such pending litigation in the notes to accounts annexed to the financial statements of Tram Fram Ltd. for the FY 2023-24. Explain how CA Sameer will deal with the above situation in his auditor's report (draft the relevant portion of the auditor's report).

Answer:

Material Uncertainty Related to Going Concern

We draw attention to Note 10 in the financial statements, which indicates that the outcome of a litigation on account of labour laws is pending in case of the company during the year 31 March, 2024. As stated in Note 11, this event or condition, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Illustration 2:

The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

Key Audit Matters

[Except for the matter described in the Basis for Qualified (Adverse) Opinion section or Material Uncertainty Related to Going Concern section,] We have determined that there are no [other] key audit matters to communicate in our report.]

Illustration 3:

XYZ Ltd. is a company engaged in the manufacture of cranes. CA Sudhir is the statutory auditor of the company for the FY 2023-24. The company has taken long-term funding for fixed capital requirements and short-term funding for its working capital requirements. During the course of audit, CA Sudhir found that the company's financing arrangements are about to expire, and the company is unable to re-negotiate or obtain the replacement financing. As such the company may be unable to realize its assets and discharge its liabilities in the normal course of business. Notes to accounts annexed to the financial statements discuss the magnitude of financing arrangements, the expiration and the total financing arrangements; however, the financial statements do not include discussion on the impact or the availability of refinancing. Thus, the financial statements (and notes thereto) do not fully disclose this fact. What kind of opinion should CA Sudhir issue in case of XYZ Ltd.?

Answer:

In the present case, XYZ Ltd. is unable to re- negotiate or obtain the replacement financing for its long term and short-term funding requirements. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore, XYZ Ltd. may be unable to realize its assets and discharge its liabilities in the normal course of business. Further, the financial statements of XYZ Ltd. do not disclose this fact adequately.

Thus, the financial statements of XYZ Ltd. are materially misstated due to the inadequate disclosure of the material uncertainty. CA Sudhir will express a qualified opinion as the effects on the financial statements of this inadequate disclosure are material but not pervasive to the financial statements.

The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion section of our report, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of XYZ Ltd. as at March 31, 2024, and profit/loss, for the year ended on that date.

Basis for Qualified Opinion

As discussed in Note 6, the Company's financing arrangements are about to expire, and the Company has been unable to conclude renegotiations or obtain replacement financing. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this matter.

Illustration 4:

ABC Ltd. is a company engaged in the manufacture of iron and steel bars. PP & Associates are the statutory auditors of ABC Ltd. for FY 2023-24. During the course of audit, CA Prakash, the engagement partner, found that the Company's financing arrangements have expired, and the amount outstanding was payable on March 31, 2024. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. What opinion should CA Prakash express in the case of ABC Ltd.?

Answer:

In the present case based on the audit evidence obtained, CA Prakash has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and the entity is considering bankruptcy. The financial statements of ABC Ltd. omit the required disclosures relating to the material uncertainty.

In such circumstances, CA Prakash should express an adverse opinion because the effects on the financial statements of such omission are material and pervasive.

The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of the entity as at March 31, 2024, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

The financing arrangements of ABC Ltd. have expired, and the amount outstanding was payable on March 31, 2024. The entity has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this fact.

Illustration 5:

MNO Ltd. is a power generating company having its plants in the northeastern states of the country. For the FY 2023-24, M/s PRT & Associates are the statutory auditors of the company. During the audit, the audit team was unable to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment (in XYZ Ltd.) that represents over 90% of the entity's net assets. What kind of opinion should the statutory auditor's issue in such case?

Answer:

M/s PRT & Associates are unable to obtain sufficient appropriate audit evidence about the financial information of a joint venture investment that represents over 90% of the entity's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are both material and pervasive to the consolidated financial statements.

Therefore, the statutory auditor should issue a disclaimer of opinion.

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of MNO Ltd. 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

The Group's investment in its joint venture XYZ Company is carried at Rs.95 crores on the Group's consolidated balance sheet, which represents over 90% of the Group's net assets as at March 31, 2024. We were not allowed access to the management and the auditors of XYZ Company, including XYZ Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, (and the elements making up the consolidated statement of changes in equity) and the consolidated cash flow statement.

Illustration 6:

CA Yash is the statutory auditor of Laksmi Vardhan Limited for the FY 2023-24. In respect of loans and advances of Rs.55,00,000/- given to Sarvagya Private Limited, the Company has not furnished any agreement to CA Yash and in absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms. What kind of opinion should CA Yash give in such situation?

Answer:

In the present case, with respect to loans and advances of Rs.55,00,000/- given to Sarvagya Private Limited, the Company has not furnished any agreement to CA Yash. In absence of such agreement, CA Yash is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidences is the loan agreement. Therefore, the absence of such a document in the present case, tantamount to a material misstatement in the financial statements of the company. However, the inability of CA Yash to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion.

Thus, in the present case, CA Yash should give a qualified opinion

The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Laksmi Vardhan Limited give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2024 and profit/ loss for the year ended on that date.

Basis for Qualified Opinion

The Company is unable to furnish the loan agreement with respect to loans and advances of Rs.55,00,000/- given to Sarvagya Private Limited. Consequently, in the absence of such an agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.

Illustration 7:

In the financial year 2023-24, MSD Ltd. faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. These circumstances indicate material uncertainty about the company's ability to continue as going concern. Due to such an event, it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. The financial statement and notes to the financial statements of the company do not disclose this fact. What kind of opinion should the statutory auditor of MSD Ltd. issue in such circumstances?

Answer:

In the present case, there exists a material uncertainty that casts a significant doubt on the company's ability to continue as going concern and the same is not disclosed in the financial statements of MSD Ltd.

As such, the financial statements of MSD Ltd. for the FY 2023-24 are materially misstated, and the effect of the misstatement is so material and pervasive on the financial statements that giving only a qualified opinion will be insufficient and therefore the statutory auditor of MSD Ltd. should issue an adverse opinion. The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of MSD Ltd. as on March 31, 2024, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

MSD Ltd. has faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. Due to such an event, it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statement and notes to the financial statements of the company do not disclose this fact.

Illustration 8:

CA Abhimanyu is the statutory auditor of PQR Ltd. for the FY 2023-24. During the course of audit CA Abhimanyu noticed the following:

1. With respect to the debtors amounting to Rs.150 crores, no balance confirmation was received by the audit team. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of Rs.25 crores. during the year under audit. The Company has stated that the provision is based on receivables which are older than 36 months, which according to the audit team is inadequate and as such the audit team is unable to ascertain the carrying value of trade receivables.
2. Further, in respect of Inventories (which constitutes 40% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. The audit team was unable to undertake the physical inventory count as such the value of inventory could not be verified. Under the above circumstances what kind of opinion should CA Abhimanyu give?

Answer:

In the present case, CA Abhimanyu is unable to obtain sufficient and appropriate audit evidence with respect to the following:

1. The balance confirmation with respect to debtors amounting to Rs.150 crores is not available. Further there has been default in payment by the debtors and the provision so made is not adequate. The audit team is also unable ascertain the carrying value of trade receivables.
2. With respect to 40% of the company's inventory, neither the physical verification has been done by the management nor are adequate inventory records maintained. The audit team is also unable to undertake the physical inventory count as such the value of inventory could not be verified.

In the above two circumstances the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Thus, CA Abhimanyu should give a Disclaimer of Opinion.

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of PQR Ltd. 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 are unable to obtain balance confirmation with respect to the debtors amounting to Rs.150 crores. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of Rs.25 crores during the year under audit which is inadequate in the circumstances of the company. The carrying value of trade receivables could not be ascertained.

Further, in respect of Inventories (which constitutes 40% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. We were unable to undertake the physical inventory count and as such the value of inventory could not be verified.

Illustration 9:

In respect of the audit of BDS Ltd., the statutory auditor of the company noticed some matters. The statutory auditor wants to draw the user's attention towards such matters, though his opinion is not modified in respect of such matters. Draft the relevant paragraphs of the audit report for the following matters:

i. The company has a plan to resume its construction activities with respect to one of its thermal power project, The activity of such power plant was suspended in the FY 2021-22. The thermal power project comprises of the plant and equipment amounting to Rs.5.95 crore and capital work in progress of Rs.147.50 crore.

ii. The financial statements of 5 branches are included in the Standalone Financial Statements of BDS Ltd. whose financial statements reflect total assets of Rs.90 crores as at 31.03.2024 and total revenue from operations of Rs.40 crores for the year ended on that date. The financial statements of these branches have been audited by the branch auditors.

Answer:

Emphasis of Matter

We draw attention to the following note of the standalone financial statements:

Note 27 regarding the plans of the Company to resume construction/developmental activities of a thermal power project. The carrying amounts related to the project as at 31st March, 2024 comprise of plant and equipment of Rs.5.95 crore and capital work in progress of Rs.147.50 crore.

Our opinion is not modified in respect of this matter.

Other Matter

We did not audit the financial statements of 5 branches included in the Standalone Financial Statements of the company whose financial statements reflect total assets of Rs.90 crores as at 31.03.2024 and total revenue from operations of Rs.40 crores for the year ended on that date. The financial statements of these branches have been audited by the branch auditors whose reports have been furnished to us, and our opinion in so far as it relates to the amounts and disclosures included in respect of these branches, is based solely on the report of the branch auditors.

Our opinion is not modified in respect of this matter.

Test Your Knowledge

Question 1

Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here.

Question 2

Write a short note on Emphasis of matter paragraph in Audit Reports.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here.

Question 3

Write a short note on Certificate for Special Purpose vs. Audit Report.

Answer:

Certificate for Special Purpose vs. Audit Report:

A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. The term 'certificate' is, therefore, used where the auditor verifies the accuracy of facts. An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain figures and is in a position to vouch safe their accuracy as per his examination of documents and books of account.

A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill. The 'report' involves expression of opinion which may differ from one professional to another. There is no question of exactitude in case of a report since the information contained therein is based on estimates and involves judgement element.

Question 4

Compare and explain the following:

(i) Reporting to Shareholders vs. Reporting to those Charged with Governance

(ii) Audit Qualification vs. Emphasis of Matter.

Answer:

i) Reporting to Shareholders vs. Reporting to those Charged with Governance:

REPORT Reporting to Shareholders	Reporting to those Charged with Governance
✓ Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.	✓ Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.
✓ Statutory Audit Report is on true and fair view and as per prescribed Format.	✓ It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
✓ Statutory Audit Reports are in public	✓ Reporting to those Charged with

domain.	Governance is an internal document i.e., private report.

ii) Audit Qualification vs. Emphasis of Matter:

REPORT	
Audit Qualification	Emphasis of Matter
✓ Standard on Auditing 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with the provisions relating to Audit Qualification.	✓ Standard on Auditing 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with the provisions relating to Emphasis of Matter.
✓ Audit Qualifications are modifications to the opinion of the Auditors opinion where the auditor concludes that there is a material misstatement in the financial statement due to which the modification to the opinion of the auditor is necessary.	✓ Emphasis of Matter is a paragraph which is included in auditor's report to draw users' attention to important matter(s) which are already disclosed in Financial Statements and are fundamental to users' for understanding of Financial Statements. ✓ The Emphasis of matter pre-supposes that there is Sufficient Appropriate audit evidence, and the matter has been correctly disclosed.
✓ Audit Qualifications are given when auditor has concluded that the financial statements are materially misstated or do not confirm to the financial reporting framework. Depending upon the nature of material misstatement being pervasive or otherwise the appropriate type of modified opinion is issued.	✓ Emphasis of Matter is a paragraph which is issued when the auditor feels that it is necessary to invite attention to a particular mater which has been appropriately disclosed in the financial statements which in the opinion of the auditor is necessary for better understanding of the financial statement.

Question 5

"When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." As an expert you are required to brief the special considerations required for expressing:

(a) Qualified Opinion;

(b) Adverse Opinion and

(c) Disclaimer of Opinion.

Answer:

(a) Qualified Opinion;

(a) When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section: (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or

(b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework]. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) …" for the modified opinion.

(b) Adverse Opinion and

When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

a. When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

b. When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

(c) Disclaimer of Opinion.

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

a. State that the auditor does not express an opinion on the accompanying financial statements;

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

c. Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Question 6

ADKS & Co. LLP are the newly appointed statutory auditors of PKK Ltd. During the course of audit, the statutory auditors have come across certain significant observations which they believe could lead to material misstatement of financial statements. Management has a different view and does not concur with the view of the statutory auditors. Considering this the statutory auditors are determining as to how to address these observations in terms of their reporting requirement. Please advise.

Answer:

As per SA 705 (Revised), if the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in his report.

The auditor in such a case needs to determine the modification as follows:

(i) Qualified Opinion: The auditor shall express a qualified opinion when:

(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(ii) Adverse Opinion: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements

(iii) Disclaimer of Opinion: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements

If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

Question 7

KPI Ltd. is a joint venture of KPI Inc., a company based in US, and OPQ Ltd., a company based in Japan (hereinafter referred to as 'JV partners'). KPI Ltd. was registered in India and is operating as a marketing support company for KPI Inc. All the costs of KPI Ltd. are incurred in India and entire revenue of KPI Inc. is generated in USD. The entire funding requirements of KPI Ltd. are taken care of by the JV partners. Since KPI Ltd. is based in India, hence it is also required to get its financial statements audited.

The company appointed new auditors for the audit of the financial statements for the year ended 31 March 2024 after doing all appointment formalities wherein auditors are required to ensure compliance with Standards on Auditing and Internal Standards on Auditing.

As an expert you are required to advise the auditor about the requirements regarding the auditor's report for audits conducted in accordance with both Standards on Auditing issued by ICAI and International Standards on Auditing.

Answer:

An auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

a. There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:
   i. to form a different opinion, or
   ii. not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; and
b. The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall

thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

Question 8

TUV Ltd. is a company engaged in the business of manufacturing spare parts. Saroj & Associates are the statutory auditors of the company for the FY 2023-24. During the audit, CA Saroj noticed that the company had a major customer, namely, Korean Mart from South Korea. Owing to an outbreak of war and subsequent destruction leading to government ban on import and export in South Korea, the demand from Korean Mart for the products of TUV Ltd. ended for an unforeseeable time period. When discussed with the management, CA Saroj was told that the company is in the process of identifying new customers for their products. CA Saroj understands that though the use of going concern assumption is appropriate, but a material uncertainty exists with respect to the identification of new customers. This fact is duly reflected in the financial statements of TUV Ltd. for FY 2023-24. How should CA Saroj deal with this matter in the auditor's report for the FY 2023-24?

Answer:

As per SA 570, "Going Concern", loss of a major market or a key customer is one of the operating indicators that may cast significant doubt on the company's ability to continue as a going concern.

In the present case, TUV Ltd. has a key customer in South Korea from which the demand for its products has ended on account of outbreak of war, subsequent destruction and government ban on import and export in South Korea. Further, the company has not yet identified new customers and is in the process of doing the same. As such, the identification of new customers is a material uncertainty that cast a significant doubt on the company's ability to continue as a going concern.

However, this matter is duly disclosed by the management of TUV Ltd. in the financial statements for the year ended 31-03-2024.

As such, considering that the going concern assumption is appropriate but a material uncertainty exists with respect to identification of new customer, CA Saroj should:

1. Express an unmodified opinion and
2. Include in his audit report, a separate sectsion under the heading "Material Uncertainty Related to Going Concern" to:
   (i) Draw attention to the note in the financial statements that discloses the matters and
   (ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Thus, CA Saroj should deal with this matter in his auditor's report in the above mentioned manner.

Question 9

Sun Moon Ltd. is a power generating company which uses coal as raw material for its power generating plant. The company has been allotted coal blocks in the state of Jharkhand and Odisha. During the FY 2023-24, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Sun Moon Ltd. This happened in the month of December 2023 and as such entire power generation process of Sun Moon Ltd, came to a halt in that month. As a result of such ban, and the resultant stoppage of the production process, many key managerial personnel of the company left the company. There were delays in the payment of wages and salaries and the banks from whom the company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of the company.

Further, when discussed with the management, the statutory auditor understood that the company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected in the financial statements of Sun Moon Ltd. What course of action should the statutory auditor of the company consider in such situation?

Answer:

SA 570 - "Going Concern" deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

When the use of Going Concern Basis of Accounting Is Inappropriate i.e. if the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

Also, when adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements the auditor shall:

i. Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and
ii. In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

In the present case, the following circumstances indicate the inability of Sun Moon Ltd. to continue as a going concern:

- ✓ Ban on the allotment of coal blocks
- ✓ Halt in power generation
- ✓ Key Managerial Personnel leaving the company.
- ✓ Banks decided not to extend further finance and not to fund the working capital requirements of the company.
- ✓ Non availability of sound action plan to mitigate such circumstances.

Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the company. Further, such circumstances are not reflected in the financial statements of the company. As such, the statutory auditor of Sun Moon Ltd. should:

1. Express an adverse opinion in accordance with SA 705 (Revised) and
2. (2). In the Basis of Opinion paragraph of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

The auditor is also required to report as per clause (xix) of CARO 2020 that on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date.

Question 10

CA Omkar is the statutory auditor of Sabhyata Ltd. for the FY 2023-24. The company is engaged in the business of manufacture of floor tiles. During the audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Discuss as to how CA Omkar should deal with the situation in the auditor's report.

Answer:

SA 705 (Revised) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

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

a. The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
b. The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

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

In the present case, during the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Therefore, CA Omkar should modify his report in accordance with SA 705- "Modifications to The Opinion In The Independent Auditor's Report".

CA Omkar should issue either a qualified opinion or an adverse opinion depending upon the circumstances of the case:

i. CA Omkar shall express a qualified opinion when, having obtained sufficient appropriate audit evidence, he concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements
ii. CA Omkar shall express an adverse opinion, when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

    Thus, since CA Omkar has obtained audit evidence which is inconsistent with the affirmations made in the financial statement, CA Omkar should modify his opinion as per the circumstances of the case.

Question 11 **Newly Added**

Neptune Ltd. is a company that holds significant investments in a portfolio of equity securities. Due to a decline in market value, the company's investments have suffered a notable diminution in value. For the financial year ended 31st March 2023, the audit report of Neptune Ltd. included a qualification regarding the non-provision of ₹ 70 lakh for the diminution in the value of these investments. As the auditor for the financial year 2023-24, how would you report in the following situations:

i. If the company does not make a provision for the diminution in the value of investments in the year 2023-24?
ii. If the company makes an adequate provision for the diminution in the year 2023-24?

Answer:

As per SA 710, "Comparative Information – Corresponding Figures and Comparative Financial Statements", 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 Neptune Ltd. does not make a provision for a diminution in the value of investment to the extent of Rs. 70 lakh, the auditor will have to modify his report for both the 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.

Question 12 **Newly Added**

During the course of audit of PEC Limited, CA Guru has reason to believe that a fraud involving ₹ 75 lakhs has been committed in the company by its employees. Is CA Guru under statutory obligation to report the above matter to Central government by filing prescribed form on MCA Portal? How should he proceed to report above said matter?

Answer:

As per section 143(12) of the Companies Act, 2013 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of Rs. 1 crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as prescribed.

In the given case, CA Guru has reason to believe that a fraud involving Rs. 75 lakhs has been committed in the company by its employees. Therefore, he is under no statutory obligation to report this matter to Central Government by filing prescribed Form (ADT-4) on MCA portal.

In case of a fraud involving lesser than the specified amount [i.e. less than Rs. 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed. Besides, auditor has obligation to report matters pertaining to fraud under clause (xi) of paragraph 3 of CARO, 2020.

Question 13 Exceptional **Newly Added**

Discuss the reporting responsibilities of statutory auditor in the following situations for year 2023-24 under CARO, 2020:

i. In the financial year 2023-2024, Candy Ltd. decided to upgrade its registered office, located at a prime spot in Bangalore. As a part of this upgrade, the company sought to acquire an adjacent plot of land owned by Mr. Sidhant, who is also a director of Candy Ltd. Initially hesitant to sell, Mr. Sidhant was persuaded to transfer his property to the company in exchange for a larger plot owned by Candy Ltd. This plot, located on a nearby street, is double the size of Mr. Sidhant's land.
Satisfied with the exchange, Mr. Sidhant agreed to transfer the property, and the exchange was formalised in a deed executed by the company's authorised representatives and Mr. Sidhant. The registration of the properties was completed by December 31, 2023.

ii. On 15th May, 2023, a TDS survey was carried out in premises of SSO Industries Limited in accordance with the provisions of the Income Tax Act, 1961.The survey team pointed out certain lapses regarding non-deduction of tax at source and subsequently Deputy Commissioner of Income Tax (TDS) raised a demand of ₹ 25 lacs on the company treating it as "assessee in default". The company has not deposited demand raised and filed appeal against impugned order on 01st March, 2024 under e-appeals scheme with JCIT (Appeals).

Answer:

i. The auditor is required to report the transaction as per Clause (xv) of Paragraph 3 of the CARO, 2020 which states that whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of the Companies Act have been complied with.
Further, as per Clause (xiii) of Paragraph 3 of the CARO, 2020, auditor should report whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards.
In the given situation, Candy Ltd. has entered into non-cash transactions with one of the directors, Mr. Sidhant during the year, by transferring the property (by Mr. Sidhant) in favour of the Company in a deed of exchange of a site owned by the company.
Thus, the auditor is required to report the same as per Clause (xv) and Clause (xiii) of Paragraph 3 of the CARO, 2020.

ii. As per clause (vii) (b) of Paragraph 3 of CARO,2020, the auditor is required to report where statutory dues have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.
In the given situation, the survey team pointed out certain lapses regarding non-deduction of TDS and demand raised by DCIT(TDS). TDS dues are in the nature of statutory dues and the company has filed appeal against order of DCIT (TDS) raising a demand of ₹ 25 lacs with JCIT (Appeals). Therefore, these are in the nature of disputed statutory dues. Thus, it should be reported in accordance with Clause (vii) (b) of Paragraph 3 of CARO, 2020.

Question 14 Exceptional **Newly Added**

Fancy Limited is a foreign company providing software support services having its Branch Office at Delhi. During the year 2023-24, Fancy Limited incorporated a subsidiary Nancy Private Limited in Gurgaon. For furtherance of objectives, Fancy Limited entered into a Business Transfer Agreement dated 5th October 2023 with Nancy Private Limited for transfer of all assets and liabilities along with the business of Delhi Branch to Nancy Private Limited on a going concern basis effective from 01st April, 2023. Further necessary approval from regulatory authorities is also received on 20th December, 2023 for such transfer. Fancy Limited promised that it shall provide continuing financial and operational support to Delhi Branch and further confirmed that any losses incurred post the date of transfer shall be borne by Fancy Limited.

During the year 2023-24, Delhi Branch of Fancy Limited have prepared its financial statements on the basis that the Branch Office does not continue to be a going concern and all its assets are carried in the books of accounts at the values likely to be recovered at the time of closure of operations, to the extent ascertainable at the time of preparation of the financial statements. Delhi Branch has incorporated above matter in detailed form in Note XX to the financial statements.

You are the statutory auditor of Delhi Branch of Fancy Limited for the financial year 2023-24. According to you, Delhi Branch has correctly disclosed about the matter in Note XX to the Financial Statements regarding management's intention to close the operations of the branch office. Further you have obtained sufficient appropriate audit evidence concerning audit and on the verge of finalization of audit report.

Draft a suitable opinion paragraph and basis thereof in the given case along with disclosure of Note XX with suitable place in audit report in terms of relevant auditing standard.

Answer:

Drafting of Opinion Paragraph and basis thereof along with disclosure of Note XX:

INDEPENDENT AUDITOR'S REPORT

To the Members of Delhi Branch Office of Fancy Limited

Report on the Audit of the Standalone Financial Statements

Opinion

We have audited the standalone financial statements of Delhi Branch Office of Fancy Limited ("the Company"), which comprise the balance sheet as at March 31, 2024, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, give a true and fair view, in conformity with the accounting principles generally accepted in India, of the state of affairs of the Delhi Branch Office of the Company as at March 31, 2024 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the ICAI's Code of Ethics and the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note XX regarding Delhi Branch Office management's intention to close the operations of the Branch Office subject to regulatory approvals. Accordingly, the financial statements have been prepared on the basis that the Delhi Branch Office does not continue to be a going concern and provisions have been made in the books of account for the losses arising or likely to arise on account of closure of operations including the losses on the realizability of current assets.

Our opinion is not modified in respect of this matter.

Question 15 **Newly Added**

You are appointed as a Statutory Auditor of SDA Limited for the year 2023-24 in the place of CA T. During the audit you found an order dated 01.05.2023 under section 148 of the Income-tax Act, 1961 wherein tax of ₹ 50 lakhs were demanded owing to undisclosed cash sales of ₹ 150 lakhs for the financial year 2020-21 which was accepted by the company and the applicable tax was paid by the Company during the year 2023-24. The company has not recorded such undisclosed income in their books of account during the year 2023-24. On further inquiring the matter with CA T, you came to know that CA T resigned due to non-recording of such transaction by the company. Is there any reporting responsibility cast on you regarding the above matters under CARO, 2020 for the year 2023-24?

Answer:

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

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

In the given situation, during audit an order dated 01.05.2023 under section 148 of the Income-tax Act, 1961 was noticed wherein tax of Rs. 50 lakh were demanded owing to undisclosed cash sales of 150 lakh for the financial year 2020-21 which was accepted by the company and the applicable tax was paid by the company during the year 2023-24. The company has not recorded such undisclosed income in their books of account during the year 2023-24. The auditor would be required to report as per Clause (viii) of Paragraph 3 of CARO, 2020.

Further CA T, the auditor of SDA Limited resigned due to non-recording of such undisclosed income in their books of account. The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020.

Hence, the auditor would be required to report as per Clause (viii) and Clause (xviii) of Paragraph 3 of CARO 2020 for the year 2023-24.

Question 16 Exceptional **Newly Added**

While conducting audit of CGX Limited, a listed company, for year 2023-24, CA Srishti notices that company has extinguished following material liabilities unilaterally without entering into settlement with creditors and reported these amounts as gains under "Other income". The details in this respect are as under: -

S. No.	Particulars	Amount involved
(i)	Liabilities for purchases of raw material were written back on account of poor quality of raw material and difference in rates	Rs.3.50 crores
(ii)	Liabilities for capital goods were written back on account of defects in machinery supplied by creditors	Rs.2.00 crores

The management is of the opinion that these dues are no longer payable. Therefore, retaining these liabilities on financial statements would lead to overstatement of liabilities. Extinguishment of liabilities was made by company in accordance with normal trade practices and outstandings were written back after stopping dealing with such creditors. She wanted to send external confirmation requests to such creditors. However, management informed her that sending such requests may be used by creditors as proof of existence of liability.

She is contemplating inclusion of above matters under "Key audit matters" in audit report. Analyse the situation threadbare.

Answer:

A liability is a present obligation of the entity to transfer an economic resource as a result of past events. Instead of fulfilling an obligation to transfer an economic resource to the party that has a right to receive that resource, entities sometimes decide to, for example: -

(a) settle the obligation by negotiating a release from the obligation;

(b) transfer the obligation to a third party; or

(c) replace that obligation to transfer an economic resource with another obligation by entering into a new transaction.

In the above situations, an entity has the obligation to transfer an economic resource until it has settled, transferred or replaced that obligation.

In the given situation, the company has written back liabilities due to creditors unilaterally. The company has not settled the obligation by negotiating a release from the obligation from respective creditors. Such an accounting treatment by management is questionable and against the conceptual framework for financial reporting under Ind AS.

CA Srishti wanted to send external confirmations in accordance with SA 505, "External Confirmations" but management informed her that sending such requests may be used by creditors as proof of existence of liability. In fact, she should display professional skepticism and be alert to the possibility of misstatements in financial statements, if restrained by management from obtaining external confirmations. The reasons advanced by management do not appear to be valid and reasonable. In accordance with SA 505, she should reassess risks and perform alternative audit procedures to mitigate such risks. Besides, she should consider implications of same for her audit opinion.

Further, SA 705, "Modifications to the Opinion in the Independent Auditor's Report" requires that the auditor shall modify the opinion in the auditor's report when: -

a. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

SA 705 also states that misstatements in financial statements arise when selected accounting policies are not in accordance with an applicable financial reporting framework. It also states that examples of an inability to obtain sufficient appropriate audit evidence arise from a limitation on the scope of audit imposed by management when management prevents the auditor from requesting external confirmation of specific account balances. Therefore, she needs to issue a modified opinion.

Keeping in view above, her contemplation of including above matters under "Key audit matters" is not proper and is not in accordance with SA 701," Communicating Key Audit Matters in the Independent Auditor's Report". It states that the auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with SA 705 as a result of the matter. Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705.

Question 17 **Newly Added**

Naresh & Co., Chartered Accountants, have been appointed Statutory Auditors of Suchi Ltd. for the F.Y. 2023-24. The audit team has completed the audit and is in the process of preparing audit report. The management of the company has also prepared draft annual report.

The audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating a downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. The Audit Manager discussed this issue with a partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management. Do you think that the partner is correct in his approach on this issue?

Discuss the Auditor's duties with regard to reporting with reference to the relevant Standards on Auditing.

Answer:

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists:

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be included in the other information.

The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor's duties with regard to reporting in the given case are given hereunder:

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", if the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

i. Agrees to make the correction, the auditor shall determine that the correction has been made; or
ii. Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

Question 18 Exceptional **Newly Added**

Nandini Ltd., a chemical manufacturing company, having its factory located at Kanawali Village, for the year 2023-24 appointed Vasu & Co. as their statutory auditors. During the audit, Vasu & Co. identified that Nandini Ltd. received a show cause notice from the National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Nandini Ltd. was dumping toxic solid waste, without treating it, on the nearby grounds, and because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation carried out by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 and a lot of damage has been done to the environment by Nandini Ltd. A show cause notice was already issued to Nandini Ltd. by the National Green Tribunal for levying the penalty of an amount of Rs.700 crore. The unaudited profit for the financial year 2022-23 of Nandini Ltd. was Rs.49 crore and the unaudited turnover was Rs.120 crore. Upon inquiry it was identified that Nandini Ltd. has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

"The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws and the company's legal department has assessed and found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices."

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter.

Answer:

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor is required to obtain an understanding and need to evaluate the impact of other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:

a. Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
b. Inspecting correspondence, if any, with the relevant licensing or regulatory authorities

As per section 143(3)(j) read with Rule 11(a), the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

As per SA 570, "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

i. Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
ii. Disclose clearly that there is material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall (a) Express a Qualified opinion or Adverse opinion, as appropriate, in accordance with SA 705; and (b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

In the current scenario, Nandini Ltd. has received a show cause notice from the National Green Tribunal of an amount which is more than the net profit and the turnover of the company for the year. In the event of an unfavourable order for Nandini Ltd., there will be an impact on Nandini Ltd.'s ability to continue as a going concern.

As a result, appropriate disclosure should be provided by management for such events, which cast significant doubt on the entity's ability to continue as a going concern. As no appropriate disclosure has been provided by Nandini Ltd. for such show cause notice, Vasu & Co. should report this matter in their audit report under "Going Concern Para" as per SA 570 and under clause (j) of section 143(3) of the Companies Act, 2013. Also, the auditor is required to issue an Adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

Question 19 **Newly Added**

BPMR and Associates, a renowned audit firm in the field of CA practice for the past three decades, was appointed to conduct the statutory audit of Rexlon Ltd., an unlisted company engaged in the business of paper manufacturing. The firm decided to commence the audit for the recently concluded financial year. After making significant progress in the audit, the auditors made the following observations:

Observation 1: The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2: Due to the flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material.

You are required to advise whether BPMR and Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported?

Answer:

Observation 1 - The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material. As per SA 706, "Emphasis of Matter Paragraph & Other Matter Paragraph in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to matter appropriately disclosed in the financials, that in the auditor's judgement is of such importance that it is fundamental to users' understanding of the financials. Hence, in this case, the auditor shall report about the consequences of the flood which affected the company's warehouse under Emphasis of Matter Paragraph.

Observation 2 - Due to flood, few records maintained by the Company with respect to a particular transaction were destroyed and no duplicate records were maintained by the Company. However, those details were not pervasive, but material. As per SA 705, "Modifications to the Opinion in the Independent Auditor's Report", where the auditor is unable to obtain sufficient and appropriate audit evidence and where such matter is material but not pervasive, the auditor shall issue a Qualified opinion. Thus, in the given situation, on account of flood few records pertaining to particular transactions were completely destroyed and in the absence of duplicate records, the auditor was unable to obtain sufficient and appropriate audit evidence and those details were material but not pervasive. Therefore, in accordance with SA 705, the auditor is required to issue Qualified opinion.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

Spice Ltd., FMCG company, having its tea gardens in northeastern states of the country is exclusively dealing in blending, processing, packing and selling of various brands of tea. During the year under audit, the company entered into joint venture for purchasing Tea Gardens in South Africa and Vietnam. M/s Dharam & Associates are the statutory auditors of the company for the financial year 2023-24. During the audit, the audit team was unable to obtain sufficient appropriate evidence about a single element of the consolidated financial statements being Joint venture investment in Croptop Ltd. representing over 89% of the group's net assets having both material and pervasive possible effect to the consolidated financial statements. The group's investment in Croptop Ltd. is carried at Rs.120 crore in the group's consolidated balance sheet.

Draft the opinion paragraph and basis of opinion paragraph to be included in the Independent Auditor's report.

Answer: Already covered in above Illustration Questions

Question 2 **(MTP 1 Nov '24 5M)**

Discuss the reporting responsibilities of statutory auditor in the following situations for year 2023-24 under CARO, 2020:

(i) In the financial year 2023-2024, Candy Ltd. decided to upgrade its registered office, located at a prime spot in Bangalore. As a part of this upgrade, the company sought to acquire an adjacent plot of land owned by Mr. Sidhant, who is also a director of Candy Ltd. Initially hesitant to sell, Mr. Sidhant was persuaded to transfer his property to the company in exchange for a larger plot owned by Candy Ltd. This plot, located on a nearby street, is double the size of Mr. Sidhant's land.
Satisfied with the exchange, Mr. Sidhant agreed to transfer the property, and the exchange was formalised in a deed executed by the company's authorised representatives and Mr. Sidhant. The registration of the properties was completed by December 31, 2023.

(ii) On 15th May, 2023, a TDS survey was carried out in premises of SSO Industries Limited in accordance with the provisions of the Income Tax Act, 1961.The survey team pointed out certain lapses regarding non-deduction of tax at source and subsequently Deputy Commissioner of Income Tax (TDS) raised a demand of Rs.25 lacs on the company treating it as "assessee in default". The company has not deposited demand raised and filed appeal against impugned order on 1st March, 2024 under e-appeals scheme with JCIT (Appeals).

Answer: Already covered in TYK Qn

Question 3 **(MTP 2 Nov '24 5M)**

Neptune Ltd. is a company that holds significant investments in a portfolio of equity securities. Due to a decline in market values, the company's investments have suffered a notable diminution in value. For the financial year ended 31st March 2023, the audit report of Neptune Ltd. included a qualification regarding the non-provision of ₹ 70 lakh for the diminution in the value of these investments. As the auditor for the financial year 2023-24, how would you report in the following situations:

(i) If the company does not make a provision for the diminution in the value of investments in the year 2023-24?

(ii) If the company makes an adequate provision for the diminution in the year 2023-24?

Answer: Already covered in TYK Qn

Question 4 **(MTP 2 Nov '24 5M)**

Pratibha Ltd. is a company engaged in the manufacturing of iron doors. JLN & Associates are the statutory auditors of Pratibha Ltd. for the Financial Year 2023-24. During the course of audit, CA Shiv, the engagement partner, found that the Company's financing arrangements have expired, and the amount outstanding was payable on March 31, 2024. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. What opinion should CA Shiv express in case of Pratibha Ltd.?

Answer: Already covered in above Illustration Questions

Question 5 **(MTP 2 Nov '24 4M)**

During the course of audit of PEC Limited, CA Guru has reason to believe that a fraud involving Rs.75 lakhs has been committed in the company by its employees. Is CA Guru under statutory obligation to report the above matter to Central government by filing prescribed form on MCA Portal? How should he proceed to report above said matter?

Answer: Already covered in TYK Qn

Question 6 **(MTP 2 Nov '24 5M)**

Mr. Arjun was appointed as the engagement partner for conducting the audit of Kurukshetra Tech Ltd. for financial year 2023-24, on behalf of NEMI & Associates. Mr. Krishna was appointed as the engagement quality control reviewer (EQCR) by the firm for the said audit.

During financial year 2023-24, Kurukshetra Tech Ltd. implemented an ERP system in phases, leading to the automation of certain business processes. This implementation had a substantial impact on the auditor's overall audit strategy. Mr. Arjun discussed the implementation of such a system with Mr. Krishna and also told him that such matter may be a key audit matter to be reported in the audit report. Mr. Krishna considered the significance of said matter, however, he was of the opinion that ERP implementation did not appear to link with the matters disclosed in the financial statements and so there was no need to disclose such matter as a key audit matter.

Whether the contention of Mr. Krishna is appropriate with respect to the matters to be communicated as a key audit matter?

Answer:

As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report', the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

(i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.

(ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.

(iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the aforesaid matters considered were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

These aforesaid considerations focus on the nature of matters communicated with those charged with governance. Such matters are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.

The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit.

In addition to matters that relate to the specific required considerations, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

In the given case, there was implementation of ERP system in the company due to which some of its business processes got automated and which had a significant effect on the auditor's overall audit strategy during the period.

As per Mr. Arjun, Engagement Partner, above mentioned matter can be considered as a key audit matter and should be reported in the audit report since it requires significant attention that had affected his overall audit strategy. Mr. Krishna, EQCR, considered the significance of said matter, however, he was of the opinion that ERP implementation did not appear to link with the matters disclosed in the financial statements, therefore, no need to disclose such matter as a key audit matter.

In view of the above, the contention of Mr. Krishna is not appropriate as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter, if it requires significant attention.

Question 7 **(MTP 1 May '24 5M)**

While conducting audit of CGX Limited, a listed company, for year 2022-23, CA. Srishti notices that company has extinguished following material liabilities unilaterally without entering into settlement with creditors and reported these amounts as gains under "Other income". The details in this respect are as under: -

S. No.	Particulars	Amount involved
(i)	Liabilities for purchases of raw material were written back on account of poor quality of raw material and difference in rates	Rs.3.50 crores
(ii)	Liabilities for capital goods were written back on account of defects in machinery supplied by creditors	Rs.2.00 crores

The management is of the opinion that these dues are no longer payable. Therefore, retaining these liabilities on financial statements would lead to overstatement of liabilities. Extinguishment of liabilities was made by company in accordance with normal trade practices and outstandings were written back after stopping dealing with such creditors. She wanted to send external confirmation requests to such creditors. However, management informed her that sending such requests may be used by creditors as proof of existence of liability.

She is contemplating inclusion of above matters under "Key audit matters" in audit report. Analyse the situation threadbare.

Answer: Already covered in TYK Qn

Question 8 **(MTP 1 May '24 5M)**

CA. Navya is the statutory auditor of Lakshay Ltd. for the Financial year 2022-23. In respect of loans and advances of ₹ 75 Lakh given to Hariharan Pvt. Ltd., the Company has not furnished any agreement to CA. Navya and in the absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms.

Justify the type of opinion which CA. Navya should give in such a situation. Also, Draft an appropriate Opinion paragraph and Basis of opinion paragraph.

Answer: Already covered in TYK Qn

Question 9 **(MTP 1 May '24 5M)**

Naresh & Co., Chartered Accountants, have been appointed Statutory Auditors of Suchi Ltd. for the F.Y. 2022-23. The audit team has completed the audit and is in the process of preparing audit report Management of the company has also prepared draft annual report.

The audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating a downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. The Audit Manager discussed this issue with a partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Do you think that the partner is correct in his approach on this issue?

Discuss with reference to relevant Standard on Auditing the Auditor's duties with regard to reporting.

Answer: Already covered in TYK Qn

Question 10 **(MTP 2 May '24 4M)**

BPMR and Associates, a renowned audit firm in the field of CA practice for the past three decades, was appointed to conduct the statutory audit of Rexlon Ltd., an unlisted company engaged in the business of paper manufacturing. The firm decided to commence the audit for the recently concluded financial year. After making significant progress in the audit, the auditors made the following observations:

Observation 1: The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2: Due to the flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material.

You are required to advise whether BPMR and Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported?

Answer: Already covered in TYK Qn

Question 11 **(MTP 2 May '24 5M)**

Jinchandra & Co., Chartered Accountants, has been appointed statutory auditor of Gurudeva Ltd. for the F.Y. 2022-23. The audit team has completed the audit and is in the process of preparing the audit report. Management of the company has also prepared draft annual report.

The audit in-charge was going through the draft annual report and observed that the company has included an item in its annual report indicating a downward trend in market prices of key commodities/raw material as compared to the previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. The Audit Manager discussed this issue with a partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management. Do you think that the partner is correct in his approach on this issue? Discuss with reference to the relevant Standard on Auditing the Auditor's duties with regard to reporting.

Answer: Already covered in TYK Qn

Question 12 **(PYP May '24 5M)**

Fancy Limited is a foreign company providing software support services having its Branch Office at Delhi. During the year 2023-24, Fancy Limited incorporated a subsidiary Nancy Private Limited in Gurgaon. For furtherance of objectives, Fancy Limited entered into a Business Transfer Agreement dated 5thOctober 2023 with Nancy Private Limited for transfer of all assets and liabilities along with the business of Delhi Branch to Nancy Private Limited on a going concern basis effective from 01st April, 2023. Further necessary approval from regulatory authorities is also received on 20th December, 2023 for such transfer. Fancy Limited promised that it shall provide continuing financial and operational support to Delhi Branch and further confirmed that any losses incurred post the date of transfer shall be borne by Fancy Limited.

During the year 2023-24, Delhi Branch of Fancy Limited have prepared its financial statements on the basis that the Branch Office does not continue to be a going concern and all its assets are carried in the books of accounts at the values likely to be recovered at the time of closure of operations, to the extent ascertainable at the time of preparation of the financial statements. Delhi Branch has incorporated above matter in detailed form in Note XX to the financial statements.

You are the statutory auditor of Delhi Branch of Fancy Limited for the financial year 2023-24. According to you, Delhi Branch has correctly disclosed about the matter in Note XX to the Financial Statements regarding management's intention to close the operations of the branch office. Further you have obtained sufficient appropriate audit evidence concerning audit and on the verge of finalization of audit report.

Draft a suitable opinion paragraph and basis thereof in the given case along with disclosure of Note XX with suitable place in audit report in terms of relevant auditing standard.

Answer: Already covered in TYK Qn

Question 13 **(PYP May '24 5M)**

You are appointed as a Statutory Auditor of SDA Limited for the year 2023-24 in the place of CA T. During audit you found an order dated 01.05.2023 under section 148 of the Income-tax Act, 1961 wherein tax of Rs.50 lakhs were demanded owing to undisclosed cash sales of ₹ 150 lakhs for the financial year 2020-21 which was accepted by the company and the applicable tax was paid by the Company during the year 2023-24. The company has not recorded such undisclosed income in their books of account during the year 2023-24. On further inquiring the matter with CA T, you came to know that CA T resigned due to non-recording of such transaction by the company. Is there any reporting responsibility casted on you regarding the above matters under CARO, 2020 for the year 2023-24?

Answer: Already covered in TYK Qn

Question 14 Exceptional **(PYP Nov '24 5M)**

TEA Ltd., a public company is exclusively dealing in blending, processing, packing and selling of various brands of Tea. During the year 2023-24, it had availed credit facilities from Kuber Bank Ltd. The bank had sanctioned a working capital cash credit facility on 21st April, 2023, for a limit of Rs.4.50 crore and Letter of Credit facility for a limit of Rs.2.50 crores aggregating to Rs. 7 crore on the basis of the hypothecation of stocks and book debts of the company against which utilisation of the limits by TEA Ltd. during the year in the case of cash credit facility was Rs.3.90 crore and of Letter of credit was Rs.1.05 crore aggregating to Rs.4.95 crore. During the year under review, the company had faced sluggish market conditions for its various brands of teas due to its inability to cater to the requirements of its customers' expectations. It faced severe cash crunch and found it difficult to manage working capital stress. In order that the bank does not reduce its drawing power of working capital limit, the management decided to peg up the values of the stock statements it submitted to bank by a hike of 15% during the quarters ended June 2023, September 2023 and December 2023. When an engagement partner leading the audit team happened to review the stock statements submitted to the bank, it was noticed that the stock figures declared were not in agreement with book figures and had been hiked as above. The matter was taken up with CFO of the company who contended that auditors need not examine and compare the quarterly statements with the books of accounts as the utilisation of working capital limits is less than the specified sanctioned limit as on 31st March 2024 and hence this case is beyond the scope of reporting under CARO, 2020. Is the contention of CFO correct? Analyse the issue and discuss the reporting responsibilities of the auditor.

Answer:

Reporting Responsibility of the auditor as per para 3(ii)(b) of CARO, 2020: As per para 3(ii) (b) of CARO, 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

The above clause requires the auditor to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of Rs.5 crores in aggregate. Tea Ltd. has been sanctioned a working capital cash credit facilities for a limit of Rs.4.50 crore and for Letter of Credit facility for a limit of Rs.2.50 crores aggregating working capital facilities/limit of Rs.7 crores which is apparently in excess of Rs.5 crores. based on the security of current assets i.e. Hypothecation of stocks and book debts of the company.

In addition, the auditor is required to ensure that whether the quarterly returns filed by the Tea Ltd. company with Kuber Bank Ltd. are in agreement with the book of accounts of the company.

In the instant situation, management of Tea Ltd. submitted its Stock Statement by a hike of 15% during the quarter ended June 2023, September 2023 and December 2023, to peg up the values of the stock due to fear of reduction in the drawing power of working capital limit. The auditor noticed that the stock figures declared by Tea Ltd. were not in agreement with the book figures and had been hiked as above.

Thus, the contention of CFO is not correct regarding applicability of CARO, 2020 as the working capital is more than specified sanctioned limit as on 31st March, 2024. Hence the auditor is required to report the same in accordance with Clause (ii) (b) of Paragraph 3 of CARO, 2020.

Question 15 Exceptional **(PYP Nov '24 5M)**

M/s JPP & Associates have been appointed as auditors of ABC Ltd., an ISO certified listed Indian multinational Jewellery Company having headquarters at Mumbai for F.Y. 2024-25. The company has more than 100 showrooms in India and 60 showrooms across the globe. During the course of audit, from the matters communicated with those charged with governance the auditors determined certain matters as most significant in the audit of the financial statements of the current period which are related to the company's offence of money laundering against which Enforcement Directorate has enforced the stringent provisions of the Prevention of Money Laundering Act (PMLA). Public disclosure of this specific matter by the auditor is not precluded by authorities under PMLA since the same may not prejudice investigation which has already been officially completed and settled on 30th September 2024. What would be the considerations of M/s JPP & Associates in determining the matter requiring significant attention in performing the audit? State the introductory language that JPP & Associates would use while communicating such matter in their audit report as per relevant Standard on Auditing.

Answer:

Communicating Key Audit Matters in the Independent Auditor's Report: As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, M/s JPP & Associates shall take into account the following:

(i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315

(ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.

(iii) The effect on the audit of significant events or transactions that occurred during the period.

In view of the above, the matter related to the company's offence of money laundering against which Enforcement Directorate has enforced the stringent provisions of the Prevention of Money Laundering Act (PMLA) is a key audit matter, and the same shall be communicated in the auditor's report KAM.

The introductory language that M/s JPP & Associates would use while communicating matters in this section of the auditor's report shall state that:

(i) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and.

(ii) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

Question 16 **(Model TP 5M)**

It was observed from the modified audit report of the financial statements of Param Limited for the year ended 31st March 2024 that depreciation of ₹ 3.75 crore for the year 2023-24 had been charged off to the Statement of Profit and Loss instead of including it in "carrying value of asset under construction". State in relation to the audit for the year ended 31st March 2024, whether such modification in the previous year's audit report would have any audit implication for the current year and if yes, how would you deal with it in your audit report?

Answer: Already covered in TYK Qn

In the instant case, if Param Limited does not correct the treatment of depreciation extent of ₹ 3.75 crore for previous year, the auditor will have to modify his report for both current and previous year's figures as mentioned above. If, however, the figures and provisions are corrected, the auditor need not refer to the earlier year's modification.

Question 17 **(Model TP 5M)**

Mr. Ashish was appointed as the engagement partner on behalf of Legacy & Co., a Chartered Accountant Firm, to conduct statutory audit assignment of Capital Limited, unlisted public company.

Mr. Sodi, one of the senior engagement team members, was given the responsibility to audit the matters as per the requirements of CARO, 2020 and in that connection, he made the following observations, that may be relevant for reporting as per the said order:-

Sr.No.	Observations
(i)	One of the Plant and Equipment taken on a lease ('right of use' asset) by Capital Limited was revalued based on the valuation by a registered valuer and the net carrying value of Plant and Equipment in aggregate was changed from Rs. 3 crore to Rs. 3.35 crore.
(ii)	During the year under consideration, the cash credit limit of Rs. 5.10 crore was sanctioned to Capital Limited by BDD Bank based on the security of current assets which was reduced to Rs. 4.75 crore after 6 months. In this connection, quarterly returns have been filed by the company with the BDD bank which are in agreement with Books of Accounts.

You are required to examine the contention of Mr. Sodi regarding reporting of the above observations in accordance with CARO 2020.

Answer:

(i) Matters to be reported by Mr. Sodi as per CARO, 2020 are as follows:-

According to Clause (i) (d) of Para 3 of CARO 2020, the auditor is required 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 the change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant And Equipment or intangible assets;

In the given situation, Capital Limited has revalued one of the Plant and Equipment taken on a lease ('right of use' asset) based on the valuation by a registered valuer. The amount of change in the value of such Plant and Equipment is ₹ 35 lakh. As the net carrying value of Plant and Equipment in aggregate was changed from ₹ 3 crore to ₹ 3.35 crore i.e. change was 10% or more.

Thus, the auditor is required to report the amount of change of ₹ 35 lakh in accordance with Clause (i) (d) of Para 3 of CARO 2020.

(ii) As per Clause (ii) (b) of Para 3 of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

In the instant case, Capital Limited has been sanctioned a cash credit limit of ₹ 5.10 crore by BDD Bank during the year under consideration, which is exceeding the prescribed limit of ₹ 5 crore based on the security of current assets. Further, quarterly returns have also been filed by the company with the BDD bank in this connection which is in agreement with Books of Accounts.

In view of the above, the auditor is required to report the same in accordance with Clause (ii) (b) of Para 3 of CARO 2020.

Question 18 **(Model TP 5M)**

CA. Suchi is the statutory auditor of RJ Limited for the financial year 2023-24. The company is engaged in the production of electronic products. During the audit, CA. Suchi obtained certain audit evidence of incorrect disclosure of related party transactions and structured finance deals which was not considered with the affirmation leading to misstatement in the financial statements.

Discuss how CA. Suchi should deal with the situation in the auditor's report and the different options which can be considered?

Answer:

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

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

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

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

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

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

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

Question 19 **(MTP M25 S1 5M)**

Fun Fiesta Ltd., an entertainment company that operates a traveling circus, has been facing a significant decline in popularity over the past few years, with attendance reportedly dropping by as much as 75% in the current financial year. The circus has also been continuously targeted by animal rights activists for its use of animals like elephants in performances. The CEO observed that audiences were shifting to other entertainment options, making the business model unsustainable due to the high costs of moving the show from city to city.

As a result, several key managerial personnel resigned, there were delays in the payment of wages and salaries, and the bank from which the company had obtained funds decided not to extend further financing or fund additional working capital requirements.

During discussions with management, the statutory auditor understood that Fun Fiesta Ltd. had no action plan to address these financial difficulties, making the use of the going concern assumption inappropriate. However, these critical circumstances were not disclosed in the company's financial statements.

What course of action should the statutory auditor take in the auditor's report in such situation? Discuss with reference to the applicable Standards on Auditing.

Answer: Already covered in TYK Qns

In the present case, the following circumstances indicate the inability of Fun Fiesta Ltd. to continue as a going concern:

- Losing popularity over the past few years.
- Animal Rights activists continuously targeting the circus.
- Audience abandoning the circus due to their expanding entertainment options.
- High Cost of moving the show from city to city making the business model untenable.
- Key Managerial Personnel leaving the Company.
- Banks decided not to extend further finance and not to fund the working capital requirements of the Company.
- Non availability of sound action plan to mitigate such circumstances.

Question 20 **(MTP M25 S1 5M)**

Kailash & Co., Chartered Accountants, has been appointed as statutory auditor of Diksha Ltd. for the F.Y. 2023-24. The audit team has completed the audit and is in the process of preparing the audit report. The management of the company has also prepared a draft annual report.

The audit in-charge was going through the draft annual report and observed that the company has included an item in its annual report indicating a downward trend in market prices of key commodities/raw material as compared to the previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. The Audit Manager discussed this issue with a partner of the firm who replied that auditors are not covered with such disclosures made by the management in their annual report, it being the responsibility of the management.

Is the partner's approach appropriate in this situation? Analyse the issue with reference to the relevant Standard on Auditing and the auditor's duties with regard to reporting.

Answer: Already covered in TYK Qn

Question 21 **(MTP M25 S1 5M)**

Groof Limited is engaged in the business of executing construction contracts for its clients. As on 31st March, 2024, the company's financial statements reflect non-current receivables outstanding amount of Rs. 500 crore. Such amounts arise from claims raised by the company on its clients due to cost overruns caused by project delays, change in work specifications and related matters. Besides negotiations, the company has also gone for arbitration in some of the said cases. The management has stated in the notes to account that these amounts are fully recoverable.

CA Arohan, auditor of the company, has relied only upon management representation in this regard. Additionally, he has decided to include this matter in "Emphasis of Matter Paragraph" in audit report.

Evaluate the appropriateness of the auditor's decision to include this matter in "Emphasis of Matter Paragraph"?

Answer: Already covered in TYU Qn

Therefore, CA Arohan should form his opinion by performing necessary audit procedures and obtaining sufficient appropriate evidence. It is only when he concludes that modification of opinion is not required as a result of said matter in terms of SA 705, the said matter may be included in Emphasis of Matter paragraph.

Question 22 **(MTP M25 S2 5M)**

CA Ram is the Statutory Auditor of RJ Ltd. for the financial year 2023-24. The company is engaged in the production of electronic products. During the audit, CA Ram obtained certain audit evidence of incorrect disclosure of related party transactions and structured finance deals which was not considered with the affirmation leading to misstatement in the financial statements. Discuss how CA Ram should deal with the situation in the auditor's report and the different options which can be considered?

Answer: Already covered in MRP Qns

Question 23 **(MTP M25 S2 4M)**

Act Pharma Limited is engaged in manufacturing of active pharmaceutical ingredients. Due to change in laws and regulations, every company engaged in manufacturing in active pharmaceutical ingredients would now require production capacity license which will restrict the production of companies. Management of the company assessed the impact of the change in law over the financial position of company and appropriately disclosed the same in the financial statement.

Audit Team of the company evaluated management's disclosure and found it appropriate and sufficient. However, considering the said matter as most important and fundamental to users understanding regarding financial statement the audit team decided to disclose the same in Other Matter Paragraph.

You as an Engagement Partner are required to guide the Audit Team with respect to reporting of the said matter in Audit Report.

Answer:

As per SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

i) The auditor would not be required to modify the opinion in accordance with SA 705 as a result of the matter; and
ii) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

In the instant case, since Act Pharma Limited is engaged in manufacturing of active pharmaceutical ingredients, would now require production capacity license which will restrict the production of companies, due to change in laws and regulations. Management of the Act Pharma Limited assessed the impact of the change in law over the financial position of company and appropriately disclosed the same in the financial statements.

Audit team of the Act Pharma Limited evaluated management's disclosure and found it appropriate and sufficient. However, considering the said matter as most important and fundamental to users understanding regarding financial statements the audit team decided to disclose the same.

The said matter is already disclosed and presented appropriately in financial statements and is of such importance that is fundamental to the users understanding of the financial statements and hence, it required to be disclosed under Emphasis of Matter paragraph.

Therefore, decision of audit team to disclose the same in Other Matter Paragraph is not in order, it should be disclosed in Emphasis of Matter Paragraph.

Question 24 **(PYP May 25 5M)**

PQR Motors Ltd., a listed entity engaged in the manufacture, and sale of automobiles and related parts has prepared its annual financial statements for the financial year 2024-25. The company's management is also responsible for preparing other information, which includes:

1. Annual Report:
   - A Director's Report and Management Discussion & Analysis (MD&A) prepared by the management.
   - A Corporate Social Responsibility (CSR) report highlighting the company's initiatives and outcomes.
2. Chairman's Message:
   - A message from the chairman discussing the company's financial performance and strategic outlook.
3. Future Projections:
   - Forward-looking statements in the annual report about anticipated growth in revenue and expansion plans.

     The Statutory auditors, M/s ST & Co., Chartered Accountants, have completed its audit of the financial statements and prepared the auditor's report. During the course of the audit, the following circumstances arise:
   - The Director's Report and MD&A are finalized and provided to the auditor before the date of the auditor's report.
   - The Chairman's Message and Future Projections are not finalized but are expected to be included in the annual report, which will be released after the auditor's report is issued.

Issues Identified:

(1) In the MD&A, M/s ST & Co., noted a misstatement regarding the company's claim of achieving a 20% reduction in production costs. Audit evidence suggests the reduction was only 10%.

(2) The Chairman's Message, which is yet to be reviewed, contains optimistic revenue projections that appear inconsistent with the historical growth trend.

Answer the following with reference to the relevant Standard on Auditing:

(i) What should M/s ST & Co., include in the "Other Information" section of the auditor's report for PQR Motors Ltd.?

(ii) If management does not correct the identified misstatement in the MD&A, even after the same was brought to their attention, what should M/s ST & Co. report under the "Other Information" section?

Answer:

(i) As per SA 720 (Revised), "The Auditor's Responsibilities Relating to Other Information", the auditor is required to report on "Other Information" in the auditor's report for listed entities. "Other Information" refers to financial and non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

In the "Other Information" section of the auditor's report, the following should be included:

- ✓ A statement that management is responsible for the other information included in the annual report.
- ✓ Identification of other information obtained:
  - The Director's Report and MD&A have been obtained prior to the date of the auditor's report.

- Mention of other information expected to be obtained later (e.g., Chairman's Message and Future Projections)

✓ A statement that the auditor's opinion does not cover the other information, and the auditor does not express any form of assurance conclusion on it.

✓ A description of the auditor's responsibilities relating to reading, considering, and reporting on the other information as per SA 720.

✓ A statement on the results of the auditor's review of the other information:

- If no misstatement is identified, a statement to that effect.
- If a material misstatement is identified, a description of the uncorrected misstatement (as applicable)

(ii) As per SA 720 (Revised), if the auditor identifies a material misstatement in the other information and management refuses to correct it, M/s ST & Co. shall report the uncorrected misstatement in the "Other Information" section as:

✓ We have identified a material misstatement in the MD&A regarding the company's claim of a 20% reduction in production costs. However, based on our audit evidence, the reduction was only 10%.

Question 25 **(PYP May 25 5M)**

Brown Enterprises Limited, an unlisted public company, has granted loans to two of its subsidiaries, stood as a guarantor for loans taken by a Limited Liability Partnership (LLP), and made investments in a start-up company during the financial year 2024-25. The company's financial statements disclose the following:

1. Loans Provided:

✓ Rs. 10 crore to Subsidiary A, with Rs. 6 crore outstanding as of March 31, 2025.

✓ Rs. 5 crore to Subsidiary B, fully repaid during the year.

✓ Rs. 3 crore loan to a UR & Co. a partnership firm with Rs. 1.5 crore overdue for 120 days. UR & Co. is not a related party.

2. Guarantees:

✓ Guarantee provided to Milestone LLP for Rs. 7 crore loan availed from a bank, outstanding in full as of March 31, 2025.

3. Investments:

✓ Rs. 4 crore equity investment in KD start-up.

Additional information:

✓ For the overdue loan, Brown Enterprises Ltd. has initiated legal proceedings for recovery but no settlement has been achieved.

✓ All loans and guarantees have been documented with terms and conditions.

✓ One loan, Rs.2 crore to Subsidiary A, was renewed upon maturity without repayment, adjusting the overdue balance.

Based on the above facts you are required to:

(i) Analyse the reporting requirements under CARO, 2020, for Brown Enterprises Ltd.

(ii) The management of Brown Enterprises Limited contended that reporting requirements under CARO, 2020, of overdue in respect of UR & Co., and Subsidiary A, are not applicable. Comment.

Answer:

(i) Reporting Requirements Under Clause (iii) of Para 3 of CARO 2020

- ✓ Loans and Advances provided:
  - Report the aggregate amount of loans provided during the year to subsidiaries (Rs. 15 crore) and other parties (Rs. 3 crore).
  - Disclose the outstanding balance as of March 31, 2025:
    - ➢ Subsidiary A: Rs. 6 crores.
    - ➢ Subsidiary B: Nil (fully repaid).
    - ➢ UR & Co., Partnership firm: Rs. 1.5 crore overdue for 120 days.
- ✓ Guarantees and Security Offered:
  - o Disclose the guarantee of Rs. 7 crore provided to Milestone LLP and confirm whether it was prejudicial to the company's interest.
- ✓ Investments Made:
  - Report the Rs. 4 crore equity investment and ensure compliance with terms and disclosure requirements.
- ✓ Overdue Loan:
  - In the case of UR & Co., disclose the overdue amount of Rs. 1.5 crore for more than 90 days and assess the company's recovery actions. Mention if legal proceedings are progressing adequately.
- ✓ Loan Renewal:
  - Report the renewal of the Rs. 2 crore loan to Subsidiary A as a fresh loan granted to settle existing dues.
  - Include this amount and its proportion in the total loans granted during the year.

In view of above it can be concluded that the contention of management of Brown Enterprises Limited is not correct as the auditor is required to report the overdue loan amount in respect of UR & Co. and Subsidiary A under Clause (iii) of Paragraph 3 of CARO 2020.

Alternative Answer:

(i) Clause (iii) of Para 3 of CARO, 2020, requires the auditor to report whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so-

(a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-

A. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;

B. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;

(b) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;

(c) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(d) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

(f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;

In the given situation, the auditor of Brown Enterprises Limited, an unlisted public company, is required to report under Clause (iii) of Paragraph 3 of CARO 2020:

- ✓ aggregate amount of loans provided to subsidiaries [i.e., Rs. 10 crore to Subsidiary A & Rs. 5 crore to Subsidiary B] and Rs. 6 crore for the loan outstanding from subsidiary A at the balance sheet date.
- ✓ the loans provided to Partnership firm UR & Co. of Rs. 3 crore and Guarantee provided to Milestone LLP of Rs. 7 crore.
- ✓ an amount of Rs. 1.5 crore in respect of the loan given to the partnership firm UR & Co., as the amount has been overdue for 120 days i.e., more than 90 days] and reports that Brown Enterprises Ltd. has taken reasonable steps initiated legal proceedings for the recovery, but no settlement has been achieved.
- ✓ loan of Rs. 2 crore to Subsidiary A, was renewed upon maturity without repayment, adjusting the overdue balance.

(ii) In view of above it can be concluded that the contention of management of Brown Enterprises Limited is not correct as the auditor is required to report the overdue loan amount in respect of UR & Co. and Subsidiary A under Clause (iii) of Paragraph 3 of CARO 2020.

Exceptional Questions

SA 701

Question 1 Exceptional **(RTP May '22)**

What is the auditor's responsibility to report a key audit matter for which there are no relevant disclosures in the financial statements?

Answer:

When communicating key audit matters, the fact that there are no disclosures in the financial statements related to a matter determined to be a key audit matter does not relieve the auditor from the requirement to communicate it.

An auditor may determine a key audit matter related to the audit for which relevant disclosure requirements do not exist in the applicable financial reporting framework. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular, if such a change had a significant effect on the auditor's overall audit strategy or related to significant risk (e.g., changes to a system affecting revenue recognition

Also, if an auditor determines that it is necessary to include information about the entity in order to effectively describe a key audit matter that has not been disclosed by management and management does not agree to disclose that information, the auditor should reconsider the adequacy of the disclosures in accordance with applicable financial reporting framework.

SA 570

Question 2 Exceptional **(PYP May '18]**

Toddle Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31st March, 2017. The Financial Statements for the year ended 31/03/2017 had been prepared on the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above. [SA 701 AND SA 570]

Answer:

SA 570 PROVISION:

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

WHEN MATERIAL UNCERTAINTY EXIST: The auditor shall determine whether the financial statements:

a. Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions and
b. Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business. [ILFS Audit report 2017 – 2018]

WHEN MATERIAL UNCERTAINTY DO NOT EXIST: If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

SA 701 PROVISION:

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

Analysis and conclusion:

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

Thus, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern is a key audit matter.

Therefore, the auditor is required to Communicate the Key Audit Matters in accordance with SA 570 in above stated manner. Simple reference as to a possible cessation of business and making of adjustments, if any, be made at the time of cessation only by the auditor in his report is not sufficient.

SA 710

Question 3 **(RTP Nov '18)**

Write a short note on Auditor's responsibilities regarding comparatives.

Answer:

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

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

(i) The comparative information agrees with the amounts and other disclosures presented in the prior period; and

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

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

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

Question 4 **(MTP 2 Nov '24 5M)**

Neptune Ltd. is a company that holds significant investments in a portfolio of equity securities. Due to a decline in market values, the company's investments have suffered a notable diminution in value. For the financial year ended 31st March 2023, the audit report of Neptune Ltd. included a qualification regarding the non-provision of ₹ 70 lakh for the diminution in the value of these investments. As the auditor for the financial year 2023-24, how would you report in the following situations:

(i) If the company does not make a provision for the diminution in the value of investments in the year 2023-24?

(ii) If the company makes an adequate provision for the diminution in the year 2023-24?

Answer: Already covered in TYK Qn

Test Your Understanding from ICAI SM

Test Your Understanding 1.

CA Lalita is auditor of a company. She is also offered professional work of audit of financial statements prepared specifically for meeting requirements of a loan agreement for the same period.

She chooses to accept work and has made up her mind to disclose this fact in "Emphasis of Matter Paragraph" in audit report to be issued by her for this specific engagement. Is her approach proper?

Answer:

In the given situation, the approach of CA Lalita is proper. There is no bar upon accepting such an engagement even though she is the auditor of the company. Besides, she has intended to disclose this fact in "Emphasis of Matter Paragraph" of the audit report to be issued by her for such specific engagement.

Test Your Understanding 2.

CA Lakshmi has prepared a draft audit report for financial statements of X Ltd. prepared in accordance with financial reporting provisions of a contract with Y Ltd. She has drafted an unmodified opinion to be given in audit report. Besides, she has also drawn attention in draft audit report to Note "A "to the financial statements which describes the basis of accounting (under the heading "Basis of accounting"). How she should ensure that report would not be misused? Draft a suitable para to be included in the report for this purpose.

Answer:

She may consider it appropriate to indicate that the auditor's report is intended solely for specific users. Depending on the law or regulation applicable, this may be achieved by restricting the distribution or use of the auditor's report. In these circumstances, the paragraph alerting the readers may be expanded to include these other matters and the heading modified accordingly. The draft para should read as under: -

Basis of Accounting and Restriction on Distribution and Use

Without modifying our opinion, we draw attention to Note A to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the company to comply with the financial reporting provisions of the contract referred to above.

As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for X Ltd. and Y Ltd. and should not be distributed to or used by parties other than X Ltd. and Y Ltd.

Test Your Understanding 3.

CA M. Surya is auditor for financial statements of an entity prepared in accordance with financial reporting provisions of a contract. He is also offered an audit of trade receivables appearing in above financial statements. Can he accept such an engagement? Discuss brief outline of his audit approach in such a situation.

Answer:

The single financial statement or the specific element, account or item of a financial statement may be prepared in accordance with a general or special purpose framework. If prepared in accordance with a special purpose framework, SA 800 also applies to the audit.

In the given case, financial statements of the entity are prepared in accordance with financial reporting provisions of a contract. It is a special purpose framework. The auditor of financial statements prepared in accordance with the special purpose framework is also offered to audit trade receivables appearing in the above financial statements, which relate to the audit of the elements of financial statements prepared in accordance with the special purpose framework. Hence, his audit approach should include considering requirements of both SA 800 and SA 805.

Test Your Understanding 4.

CA G is offered appointment for audit of trade payables of financial statements of a company. However, financial statements prepared under Companies Act, 2013 are audited by CA Jignesh. Discuss why it would be practically difficult for CA G to perform such an audit.

Answer:

Compliance with the requirements of SAs relevant to the audit of a single financial statement or of a specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete set of financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, including its internal control, as an auditor who also audits the entity's complete set of financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records.

In the case of an audit of a specific element of a financial statement, certain SAs require audit work that may be disproportionate to the element being audited. If the auditor concludes that an audit of a single financial statement or of a specific element of a financial statement in accordance with SAs may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable.

Test Your Understanding 5.

CA Madhur is auditor of a company and has issued audit report dated 15th June of a particular year. The audit report on summary financial statements derived from such audited financial statements is dated 15th July of that particular year. Discuss whether there exists any additional reporting responsibility for auditor in such a situation in respect of audit report on summary financial statements.

Answer:

The audit report on summary financial statements derived from audited financial statements is dated 15th July of that particular year. However, the audit report on audited financial statements is dated 15th June of that year.

In the above situation, the auditor's report on summary financial statements should state that the summary financial statements and the audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements.

Test Your Understanding 6.

Consider that the audit report on financial statements issued by CA Madhur for above said company contains qualified opinion. Can he issue an unmodified opinion on summary financial statements derived from audited financial statements? Discuss.

Answer:

If the auditor is satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, he can issue an unmodified opinion.

However, when auditor's report on audited financial statements contains a qualified opinion, the auditor's report on the summary financial statements shall, also contain following:

a. State that the auditor's report on the audited financial statements contains a qualified opinion
b. Describe:
    i. The basis for the qualified opinion on the audited financial statements, and that qualified opinion in the auditor's report on the audited financial statements; and
    ii. The effect thereof on the summary financial statements, if any.

Hence, above points should be included by CA Madhur.

Test Your Knowledge

INTEGRATED CASE SCENARIO from ICAI SM

Question 1

Given below is an extract of abridged financial statements of schemes of "Smart Investment Mutual Fund". The abridged financial statements have been derived from audited financial statements of the schemes of "Smart Investment Mutual Fund" as at 31St March 20XX and for year ended 31st March,20XX.

Abridged Balance sheet as at 31st March 20XX (in Rs. Lacs)

Liabilities	Smart investment equity and debt fund	Smart investment equity savings fund
Unit Capital	20000.00	15000.00
Reserve and Surplus	160000.00	80000.00
Other current liabilities & provisions	100.00	100.00
Total	180100.00	95100.00
Assets		
Investments	170000.00	90000.00
Deposits	100.00	100.00
Other Current assets	10000.00	5000.00
Total	180100.00	95100.00

Abridged revenue account for year ended 31st March 20XX (In Rs. Lacs)

Income	Smart investment equity and debt fund	Smart investment equity savings fund
Income	34000.00	1000.00
Expenses and losses	3400.00	1500.00
Net realized gains	30600.00	(500.00)
Add: Change in unrealized appreciation in value of investments	2000.00	700.00
Net Surplus	32600.00	200.00
Dividend appropriation	3000.00	50.00
Retained Surplus	29600.00	150.00

The abridged financial statements of the Schemes of the Fund have been prepared by Board of Trustees of Fund pursuant to SEBI regulations and in accordance with format prescribed by SEBI. Previous year figures have been ignored for purpose of case.

Unmodified opinion has been expressed by auditor in audited financial statements of the schemes of "Smart Investment Mutual Fund" as at 31St March 20XX and for year ended 31st March, 20XX.

Keeping in view above, answer the following questions: -

1. Given the above extract of abridged financial statements and description, which of the following statements is most appropriate?
   (a) The auditor may presume that criteria applied by the Board of Trustees in the preparation of the abridged financial statements are acceptable.
   (b) The auditor cannot presume that criteria applied by the Board of Trustees in preparation of abridged financial statements are acceptable.
   (c) The abridged financial statements have been prepared by the Board of Trustees. The auditor cannot ordinarily accept criteria applied by them for the preparation of

such abridged financial statements before detailed evaluation.

(d) The auditor is duty bound to accept the criteria applied by the Board of Trustees in the preparation of abridged financial statements.

2. Which of the following statements in reference to abridged financial statements is not in accordance with the requirements of SA 810?

   (a) The notes to accounts should specifically disclose that these abridged financial statements have been derived from audited financial statements.

   (b) The Board of Trustees has disclosed that audited financial statements are available on the website of the company.

   (c) It should be stated in the auditor's report that abridged financial statements have been compared with the related information in the audited financial statements to determine whether the abridged financial statements agree with or can be recalculated from the related information in the audited financial statements.

   (d) It should be stated in auditor's report that reading the abridged financial statements is not a substitute for reading the audited financial statements of the Schemes of the Fund.

3. Which of the following paras is most appropriate to be included under heading "Auditor's responsibility" in the auditor's report?

   (a) Our responsibility is to express an opinion on the Abridged financial statements based on our procedures, which were conducted in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India.

   (b) Our responsibility is to express an opinion on the Abridged financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

   (c) Our responsibility is to express an opinion on the Abridged financial statements based on our procedures, which were conducted in accordance with Standards on Auditing adapted in circumstances including (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

   (d) Our responsibility is to express an opinion on the Abridged financial statements based on our procedures, which were conducted in accordance with SEBI regulations and Standards on Auditing adapted in circumstances including (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

4. Which of the following paras is most appropriate to be included under heading "Opinion" in auditor's report?

   (a) In our opinion, the abridged financial statements, derived from the audited financial statements of the Schemes of the Fund as at March 31, 20XX and for the year ended March 31, 20XX are a fair summary of those financial statements, and are in accordance with the accounting policies and standards specified in SEBI regulations and generally accepted accounting principles in India to the extent applicable.

   (b) In our opinion, the abridged financial statements, as at March 31, 20XX and for the year ended March 31, 20XX are a fair summary of those financial statements.

   (c) In our opinion, the abridged financial statements, derived from the audited financial statements of the Schemes of the Fund as at March 31, 20XX and for the year ended March 31, 20XX are consistent with audited financial statements and are in accordance with the accounting policies and standards specified in SEBI regulations and generally accepted accounting principles in India to the extent applicable.

(d) In our opinion, the abridged financial statements, derived from the audited financial statements of the Schemes of the Fund as at March 31, 20XX and for the year ended March 31, 20XX are consistent with audited financial statements.

5. Which of the following is usually not an element of audit report on abridged financial statements in accordance with SA 810?

(a) Emphasis of Matter paragraph.

(b) Other Matter paragraph.

(c) Management's responsibility for abridged financial statements.

(d) Key Audit Matters.

Answers to Case Scenario

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

Test Your Knowledge

Question 1

CA P is auditor of a company responsible for auditing the complete set of financial statements. He intends to express adverse opinion on complete set of financial statements considering conclusions drawn by him during course of audit. He is also auditing trade receivables of company for the same period in a separate engagement. Can he express an unmodified opinion in respect of trade receivables? If so, discuss those circumstances.

Answer: Refer to Goat Notes

Question 2

SA 800 deals with special considerations applicable in respect of audit of financial statements prepared in accordance with special purpose framework. Explain, by giving examples, the meaning of special purpose framework.

Answer: Refer to Goat Notes

Question 3

CA Y is auditor of a company. He has expressed adverse opinion on audited financial statements. What additional points he has to keep in mind while expressing opinion on summary financial statements derived from such audited financial statements?

Answer: Refer to Goat Notes

Question 4

CA Y is the auditor of Stekk Ltd., a company that recently faced material misstatements in its financial records, leading to an adverse opinion on the audited financial statements for the financial year 2023-24. Now, the management of the company has prepared summary financial statements derived from the audited financial statements and requested CA Y to express his opinion on these summaries. What additional points should CA Y consider when expressing an opinion on these summary financial statements?

Answer: Refer to Goat Notes

Question 5

Mr. BK has been engaged by XYZ Ltd. to report on summary financial statements derived from the financial statements audited by him in accordance with SAs. Mr. BK wants to determine whether the applied criteria are acceptable before accepting such assignment. Guide him the factors affecting auditor's determination of the acceptability of applied criteria as per relevant Standard on Auditing.

Answer:

In the given situation, Mr. BK has been engaged by XYZ Ltd. to report on summary financial statements derived from the financial statements audited by him in accordance with SAs. Mr. BK wants to determine whether the applied criteria are acceptable before accepting such assignment.

As per SA 810, "Engagements to Report on Summary Financial Statements", before accepting an engagement to report on summary of financial statements, the auditor shall determine whether applied criteria are acceptable. 'Applied criteria' refers to the criteria applied by management in the preparation of the summary financial statements.

Factors affecting the auditor's determination of the acceptability of the applied criteria are:

✓ The nature of the entity;

- ✓ The purpose of the summary financial statements;
- ✓ The information needs of the intended users of the summary financial statements; and
- ✓ Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

Question 6

When auditor's report on the audited financial statements contains a qualified opinion, but the auditor is satisfied that the summary financial statements are a fair summary of the audited financial statements, in accordance with the applied criteria, which other matters shall the auditor's report on the summary financial statements contain in addition to elements of auditor's report described in SA 810?

If summary financial statements are not a fair summary of the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, what are implications for auditor's opinion on summary financial statements?

Answer: Refer to Goat Notes

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 4M)**

CA Y is the auditor of Stekk Ltd., a company that recently faced material misstatements in its financial records, leading to an adverse opinion on the audited financial statements for the financial year 2023-24. Now, the management of the company has prepared summary financial statements derived from the audited financial statements and requested CA Y to express his opinion on these summaries. What additional points should CA Y consider when expressing an opinion on these summary financial statements?

Answer:

As per SA 810, "Engagements to Report on Summary Financial Statements", when the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor's report on the summary financial statements shall, additionally:

(a) State that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion;

(b) Describe the basis for that adverse opinion or disclaimer of opinion; and

(c) State that, as a result of the adverse opinion or disclaimer of opinion, it is inappropriate to express an opinion on the summary financial statements.

Question 2 **(MTP 1 May '24 4M)**

When auditor's report on the audited financial statements contains a qualified opinion, but the auditor is satisfied that the summary financial statements are a fair summary of the audited financial statements, in accordance with the applied criteria, which other matters shall the auditor's report on the summary financial statements contain in addition to elements of auditor's report described in SA 810?

If summary financial statements are not a fair summary of the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, what are implications for auditor's opinion on summary financial statements?

Answer:

When the auditor's report on the audited financial statements contains a qualified opinion, but the auditor is satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the auditor's report on the summary financial statements shall, in addition to the elements of auditor's report on summary financial statements described in SA 810: -

(a) State that the auditor's report on the audited financial statements contains a qualified opinion and

(b) Describe:

(i) The basis for the qualified opinion on the audited financial statements, and that qualified opinion; and

(ii) The effect thereof on the summary financial statements, if any

If the summary financial statements are not consistent, in all material respects, with or are not a fair summary of the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor shall express an adverse opinion on the summary financial statements.

Question 3 **(PYP May '24 4M)**

Mr. BK has been engaged by XYZ Ltd. to report on summary financial statements derived from the financial statements audited by him in accordance with SAs. Mr. BK wants to determine whether the applied criteria are acceptable before accepting such assignment. Guide him the factors affecting auditor's determination of the acceptability of applied criteria as per relevant Standard on Auditing.

Answer: Already covered in TYK Qn

Question 4 **(PYP Nov '24 5M)**

CA Rajni is appointed as the statutory auditor of STS Ltd. for the financial year 2023-24 for auditing complete set of financial statements. The company has also assigned the audit of Property, Plant and Equipment to CA Rajni as a separate engagement for the financial year 2023-24. While drafting the audit report of complete set of financial statements, CA Rajni decides to give an adverse opinion based on the audit observations noted during the course of audit. At the same time, she is also finalizing the audit report of the separate engagement where she wants to give an unmodified opinion.

Comment with reference to the relevant Standard on Auditing regarding the opinion to be given by CA Rajni in audit report of separate engagement of audit of Property, Plant and Equipment.

Answer:

Audit Report of Separate Engagement of Audit of PPE: As per SA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement", if the auditor undertakes an engagement to report on a single financial statement or on a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor shall express a separate opinion for each engagement. If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole but, in the context of a separate audit of a specific element that is included in those financial statements, the auditor nevertheless considers it appropriate to express an unmodified opinion on that element, the auditor shall only do so if:

i. The auditor is not prohibited by law or regulation from doing so;
ii. That opinion is expressed in an auditor's report that is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion; and
iii. The specific element does not constitute a major portion of the entity's complete set of financial statements.

In the given situation, CA Rajni is statutory auditor of STS Ltd. for the financial year 2023-24 for the complete set of financial statements and has also assigned the audit of PPE as a separate engagement for the same financial year. Considering the same, it can be concluded that CA Rajni can give separate opinion on separate engagement i.e. adverse opinion for statutory audit and unmodified opinion for separate engagement provided the above conditions are satisfied.

Test Your Understanding from ICAI SM

Test Your Understanding 1.

A company asks you to carry out the process of confirmation of its accounts receivables having balances in excess of Rs.10 lacs as per its books of accounts at the close of the year. The work to be performed only involves preparing and sending confirmation requests to such parties, analysis of variations on receipt of confirmations and submission of a report in accordance with professional standards. What points have to be kept in mind for inclusion in the report specifically for such engagement?

Answer:

The described engagement is an agreed-upon procedures engagement. Following points have to be kept in mind for being included in the report: -

- ✓ A statement that the procedures performed were those agreed-upon with the recipient
- ✓ A statement that the engagement was performed in accordance with the Standard on Related Services applicable to agreed-upon procedures engagements
- ✓ Identification of the purpose for which the agreed-upon procedures were performed
- ✓ A listing of the specific procedures performed
- ✓ A description of the auditor's factual findings including sufficient details of errors and exceptions found
- ✓ A statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed
- ✓ A statement that had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported
- ✓ A statement that the report is restricted to those parties that have agreed to the procedures to be performed
- ✓ A statement that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's financial statements taken as a whole

Test Your Understanding 2.

During the course of performing a compilation engagement in accordance with SRS 4410, it becomes known to you that the client had suffered a theft loss of Rs.100 lacs of its inventories over a period of time at a storage location visited infrequently. A claim was lodged by the client with the insurance company which was repudiated due to certain technical reasons relating to coverage of policy. The client has not preferred a complaint or an appeal against said repudiation. The amount is reflected under the head "current assets" in trial balance of the client. Discuss how you should proceed to deal with the matter?

Answer:

In this instant case, amount of Rs.100 lacs is reflected under the head "current assets" in trial balance. Since our client's claim has been repudiated and no appeal has been preferred, it is a loss for the client and should be dealt with accordingly. Therefore, amendments are required for the financial information not to be materially misstated.

If the practitioner becomes aware during the course of the engagement that amendments to the compiled financial information are required for the financial information not to be materially misstated or the compiled financial information is otherwise misleading, the practitioner shall propose the appropriate amendments to management.

If management declines or does not permit the practitioner to make the proposed amendments to the compiled financial information, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing.

If withdrawal from the engagement is not possible, the practitioner shall determine the professional and legal responsibilities applicable in the circumstances.

Integrated Case Scenario from ICAI SM

INTEGRATED CASE SCENARIO 1.

KM Limited has engaged your firm for compilation of financial statements in accordance with requirements of SRS 4410. You also come to know that company is setting up a new unit in Rourkela, Odisha. The company management has provided you with draft trial balance and requires assistance in preparation and presentation of its financial statements for year ended 31st March, 2024. The management requires such a preparation and presentation for its internal use.

During the course of engagement, it is noticed that: -

1. There are apparent errors in few opening balances brought forward from previous year relating to some outstanding incentives receivable from government authorities. These have been swapped with some other balances in trial balance. However, there are no credit transactions in such incentive accounts or accounts whose balances have been swapped during the year.
2. One of the team members suggests that it is one of the duties to ensure that revenue figures stated in trial balance, at least, are verified to ensure that all revenues required to be booked by the company have, in fact, been booked.
3. It is also suggested by this team member that even though it is a compilation engagement, quality control aspects like adhering to appropriate Standards needed to be followed.
4. Before signing and issuing report under SRS 4410, you once again read the financial information. It comes to your notice that figures relating to setting up of a new unit of the company coming up in Rourkela in Odisha have not been properly disclosed in compiled financial statements. The expenditure was incurred from a bank account maintained in Rourkela and was omitted to be shown under appropriate heads. You are vacillating regarding above considering scope of compilation engagement.
5. The team has prepared detailed documentation during the course of engagement.

Keeping in view above, answer the following questions: -

1. In respect of errors in some of opening balances noticed as described in case, which of the following statements is most appropriate?
   (a) Such errors should straight away lead to the qualification of a report to be issued.
   (b) Such errors should be brought to the knowledge of management.
   (c) Knowledge of such type of errors has no effect on compliance of ethical requirements by the firm.
   (d) The above said matter relates to SA 510 Initial Audit Engagements-Opening Balances and has no effect on reporting obligations in a compilation engagement.

2. As regards the suggestion of one of the team members regarding the verification of all revenues of the company, which of the following statements is most appropriate?
   (a) Suggestion of team member is proper as such verification is part and parcel of such an engagement.
   (b) Suggestion of team member is proper as the absence of such verification may make financial statements misleading.
   (c) Suggestion of team member is not proper as verifying the accuracy or completeness of the information provided by management is not required in such engagement.
   (d) Suggestion of team member is not proper as compliance with qualitative requirements is not required in such engagement.

3. In view of the team member's suggestion relating to adherence to appropriate Standards for quality control, which of the following statements is relevant in the context of above said engagement?
   (a) SA 220 is applicable in this engagement and has to be followed by the engagement partner meticulously.
   (b) SQC 1 is applicable in this engagement.
   (c) Both SA 220 and SQC 1 are applicable in this engagement.
   (d) SA 220 and SQC 1 are not applicable in this engagement. However, SRS 4410 lays down detailed quality control requirements for such type of engagement.

4. Which of the following statements is most appropriate as regards omission of expenditure under appropriate heads pertaining to the Rourkela unit in compiled financial statements?
   (a) The above-noted omission can be misleading. By disregarding such an omission, the fundamental principle of integrity is violated, and engagement cannot be performed in accordance with ethical requirements.
   (b) The above-noted omission can be misleading. By disregarding such an omission, the fundamental principle of objectivity is violated, and engagement cannot be performed in accordance with ethical requirements.
   (c) The above noted omission has no effect on performing such compilation engagement.
   (d) The above-noted omission has no effect on performing and issuing reports under such compilation engagement.

5. The detailed documentation is maintained during the course of compilation engagement. Which of the following statements is most appropriate regarding the assembly of the final engagement file?
   (a) Final engagement file should be assembled in not more than 60 days after the date of the report.
   (b) Final engagement file should be assembled in not more than 120 days after the date of the report.
   (c) Final engagement file should be assembled on a timely basis after the engagement report has been finalised in accordance with the time limits set by the firm.
   (d) There is no requirement of assembling of final engagement file in a compilation engagement.

Answers to Integrated Case Scenario

1.	(b)	2.	(c)	3.	(b)	4.	(a)	5.	(c)

Test Your Knowledge

Question 1.

List out few intended purposes of a "compilation engagement."

Answer: Refer to Goat Notes

Question 2.

A Chartered Accountant is offered appointment for a compilation engagement to be performed under SRS 4410. Is he required to comply with the ethical requirements of the Code of Ethics? Discuss briefly.

Answer: Refer to Goat Notes

Question 3.

How do "related services" differ from assurance engagements?

Answer: Refer to Goat Notes

Question 4.

Discuss main documentation requirements to be taken care of by a practitioner while performing a compilation engagement under SRS 4410.

Answer: Refer to Goat Notes

Question 5.

CA P has been appointed to compile the financial information of X Limited. CA P is confused whether he should apply the same procedures which are required to be applied to conduct an audit or there are some other procedures to discharge the duties under such an engagement. Define the characteristics of Compilation Engagement. What should be the approach of CA P for performing the Engagement?

Answer: Refer to Goat Notes

Question 6. Exceptional **Newly Added**

MNC Limited has engaged CA Lalit to help the company in compilation of the financial information. CA Lalit explained his team members, the scope of work and the responsibilities under this engagement. The team members have done mostly audit engagements and do not have exposure to compilation engagements. Discuss the key issues that CA Lalit should deliberate and guide his team members with respect to this engagement and the manner it differs from assurance engagements. Give your views on the applicability of SQC 1 to this engagement.

Answer:

As per SRS 4410, Compilation engagement is an engagement in which a practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information of an entity in accordance with an applicable financial reporting framework and issues a report. Management may request a professional accountant in public practice to assist with the preparation and presentation of financial information of an entity. Financial information that is the subject of a compilation engagement may be required for various purposes including: -

- ✓ To comply with mandatory periodic financial reporting requirements established in law or regulation, if any or
- ✓ For purposes unrelated to mandatory financial reporting under relevant law or regulation, including for example: -

- For management or those charged with governance, prepared on a basis appropriate for their particular purposes (such as preparation of financial information for internal use).
- For periodic financial reporting undertaken for external parties under a contract or other form of agreement (such as financial information provided to a funding body to support provision or continuation of a grant).
- For transactional purposes, for example to support a transaction involving changes to the entity's ownership or financing structure (such as for a merger or acquisition).

"Assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. It means that the practitioner gives an opinion about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.

A compilation engagement is not an assurance engagement. A compilation engagement does not require the practitioner to verify the accuracy or completeness of the information provided by management for the compilation, or otherwise to gather evidence to express an audit opinion or a review conclusion on the preparation of the financial information.

Further, SQC 1 is applicable to all Engagement and Quality Control Standards. Since SRS 4410 is also one of Engagement and Quality Control Standards, SQC 1 applies to firms in respect of firm's compilation engagements too which is covered in Related Services.

Question 7. Exceptional **Newly Added**

Brown Enterprises Limited has huge funds locked up in its trade receivables standing at around Rs.100 crores as on 31st December, 2023. The management of the company wants to evaluate the validity of the trade receivables to ensure reliability of financial reporting at the year end. The accounts department has provided a list of trade receivables to the management containing about 1000 names, their balances and contact/communication details spread in different parts of the country. The company's management has requested CA Kamna to take up this assignment and prepare a report for management in accordance with professional standards. Despite not being statutory auditor of the company, she decides to accept the above engagement.

a. By explaining the nature of engagement described above, discuss whether it was proper for her to accept such engagement.

b. While reporting, which precautions should be taken by her so that readers of the report do not misunderstand its scope?

Answer:

a. The above situation involves an engagement to perform agreed-upon procedures. In such an engagement, the auditor is engaged by the client to issue a report of factual findings based on specified procedures performed on specified subject matter of specified elements, accounts or items of a financial statement.

The management has requested CA Kamna to take up the assignment and prepare a report for management in accordance with professional standards. Such type of engagement and its reporting falls in purview of SRS 4400. The reference to auditor in SRS 4400 does not imply that a person performing related services need necessarily be the auditor of entity's financial statements. Hence, a person performing related services need not necessarily be auditor of entity's financial statements. Therefore, it was proper for CA Kamna to accept the above engagement.

b. While reporting, she should take following precautions so that readers of report do not misunderstand its scope: -
   - ✓ A statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed.
   - ✓ A statement that had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported.
   - ✓ A statement that the report is restricted to those parties that have agreed to the procedures to be performed.
   - ✓ A statement (when applicable) that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's financial statements taken as a whole.

Question 8. **Newly Added**

You have been appointed to compile the financial statements of Kings & Company (a partnership firm) for tax purposes. During the course of your work, you discover that the inventory is grossly understated, and the company has failed to apply applicable standards. On pointing out the same, the partners of Kings & Company inform you that it is outside your scope since you are not conducting an audit and the said figures duly certified by the firm should be accepted. Comment.

Answer:

As per SRS 4410, "Compilation Engagements", if the practitioner is unable to complete the engagement because management has failed to provide records, documents, explanations or other information, including significant judgments, as requested, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing.

If the practitioner becomes aware during the course of the engagement that:

a. The compiled financial information does not adequately refer to or describe the applicable financial reporting framework
b. Amendments to the compiled financial information are required for the financial information not to be materially misstated; or
c. The compiled financial information is otherwise misleading the practitioner shall propose the appropriate amendments to management.

If management declines or does not permit the practitioner to make the proposed amendments to the compiled financial information, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing.

If withdrawal from the engagement is not possible, the practitioner shall determine the professional and legal responsibilities applicable in the circumstances.

The practitioner shall obtain an acknowledgement from management or those charged with governance, as appropriate, that they have taken responsibility for the final version of the compiled financial information.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 2 Nov '24 4M)**

The practitioner shall not accept the compilation engagement unless the practitioner has agreed the terms of engagement with management, and the engaging party if different. In view of the above, mention the responsibilities of the management to be agreed on for the compilation engagement in accordance with SRS 4410.

Answer:

The practitioner shall not accept the compilation engagement unless the practitioner has agreed the terms of engagement with management, and the engaging party if different. In accordance with SRS 4410, "Compilation Engagement", the responsibilities of the management to be agreed on for the compilation engagement are that:

(i) The financial information, and for the preparation and presentation thereof, in accordance with a financial reporting framework that is acceptable in view of the intended use of the financial information and the intended users

(ii) Design, implementation and maintenance of such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error

(iii) The accuracy and completeness of the records, documents, explanations and other information provided by management for the compilation engagement and

(iv) Judgments needed in the preparation and presentation of the financial information, including those for which the practitioner may provide assistance in the course of the compilation engagement

Question 2 **(MTP 1 May '24 5M)**

You have been appointed to compile the financial statements of the Kings & Company (a partnership firm) for tax purposes. During the course of your work, you discover that the inventory is grossly understated, and the company has failed to apply applicable standards on accounting. On pointing out the same, the partners of the Kings & Co., inform you that it is outside your scope since you are not conducting an audit and the said figures duly certified by the firm should be accepted. Comment.

Answer: Already covered in TYK Qn

Question 3 **(PYP May '24 5M)**

MNC Limited has engaged CA Lalit to help the company in compilation of the financial information. CA Lalit explained his team members, the scope of work and the responsibilities under this engagement. The team members have done mostly audit engagements and do not have exposure to compilation engagements. Discuss the key issues that CA Lalit should deliberate and guide his team members with respect to this engagement and the manner it differ from assurance engagements. Give your views on the applicability of SQC 1 to this engagement.

Answer: Already covered in TYK Qn

Question 4 Exceptional **(PYP Nov '24 5M)**

ATP Limited, a large manufacturing company, is planning to invest funds in RS Ltd. with a future vision of taking over the company at a later stage. On studying the financial statements of RS Ltd, the investing company wants to get detailed status regarding the Accounts receivable and Inventory appearing in the Balance Sheet. ATP Limited approached you to perform agreed upon procedures for the two elements of financial statement of RS Ltd. and submit a detailed report for the same. As the engagement partner, you are responsible for drafting the engagement letter. Enumerate the key matters that need to be agreed to form a clear understanding regarding agreed upon procedures and the conditions of the engagement. What matters will you include in the engagement letter addressed to the management of ATP Ltd?

Answer:

As per SRS 4400 “Engagements to Perform Agreed-upon Procedures regarding Financial Information”, matter to be agreed and would be included in the engagement letter are given as under:

A. Matters to be agreed include the following:

(a) Nature of the engagement including the fact that the procedures performed will not constitute an audit or a review and that accordingly no assurance will be expressed.

(b) Stated purpose for the engagement.

(c) Identification of the financial information to which the agreed-upon procedures will be applied.

(d) Nature, timing and extent of the specific procedures to be applied.

(e) Limitations on distribution of the report of factual findings. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

B. Matters that would be included in the engagement letter include:

- A listing of the procedures to be performed as agreed upon between the parties.
- A statement that the distribution of the report of factual findings would be restricted to the specified parties who have agreed to the procedures to be performed.

Question 5 **(MTP M25 S2 5M)**

KSN and Co., Chartered Accountants, have been appointed by Nature Ltd. to assist management in the preparation and presentation of financial information in accordance with an applicable financial reporting framework and issuing a report. CA L has been appointed as the engagement partner for the assignment.

What are the responsibilities of CA L and which documentation requirements related to Engagement Level Quality Control should CA L ensure compliance with in such an engagement?

Answer:

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.

The practitioner shall include in the engagement documentation: -

(i) Significant matters arising during the compilation engagement and how those matters were addressed by the practitioner.

(ii) A record of how the compiled financial information reconciles with the underlying records, documents, explanations and other information, provided by management and

(iii) A copy of the final version of the compiled financial information for which management or those charged with governance, as appropriate, has acknowledged their responsibility, and the practitioner’s report.

The practitioner may consider also including in the engagement documentation a copy of the entity’s trial balance, summary of significant accounting records or other information that the practitioner used to perform the compilation.

Question 6 **(PYP May 25 4M)**

Coastal Ventures Ltd., a newly formed real estate development firm, is applying for a loan from a financial institution to fund a new residential project. The bank requires the submission of the company's financial statements for the year ending March 31, 2025. The company engages an independent practitioner, CA X to compile the financial statements based on its accounting records and other information provided. The financial statements will be prepared in accordance with Ind AS (Indian Accounting Standards). CA X intends to record the agreed terms of engagement in an engagement letter prior to performing the engagement.

CA X is of the view that independence requirements will not be applicable for the above assignment. Do you agree?

CA X is concerned with engagement acceptance and continuance. Suggest him focus points in respect of management responsibilities that will be recorded in the agreed terms of engagement in the engagement letter.

Answer:

In the given case, the company engages CA X, an independent practitioner, to compile the financial statements based on its accounting records and other information. Being in the nature of non-assurance engagement, independence requirements do not apply to compilation engagements as per SRS 4410, "Compilation Engagements". However, laws or regulations may specify requirements or disclosure rules pertaining to independence.

Thus, the view of CA X is correct that independence requirements will not be applicable for the compilation engagement discussed in the situation.

CA X should focus on the following points in respect of management responsibilities that will be recorded in the agreed terms of engagement in the engagement letter.

Already covered in Qn 1 in MRP Qns

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

Roma Limited has entered into a contract with Dorma Limited. There is a condition in the contract by virtue of which Roma Limited is required to get its financial statements reviewed for a year on a quarterly basis in accordance with the financial reporting provisions of the contract. Can Roma Limited get its financial statements reviewed from a professional accountant in practice?

Answer:

The above financial statements are prepared in accordance with the special purpose framework in accordance with requirements of a contract. Financial statements prepared in accordance with the special purpose framework can also be reviewed by a professional accountant in practice and review report may be issued in accordance with SRE 2400.

Test Your Understanding 2.

You are conducting a review of the financial statements of a company. It is gathered upon inquiry that there is a possibility of material misstatements in the financial statements. Discuss how you would proceed further in the matter under SRE 2400.

Answer:

If the practitioner becomes aware of matters that causes the practitioner to believe the financial statements may be materially misstated, the practitioner shall design and perform additional procedures sufficient to enable the practitioner to: -

(a) Conclude that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated or

(b) Determine that the matter(s) causes the financial statements as a whole to be materially misstated.

Additional procedures focus on obtaining sufficient appropriate evidence to enable the practitioner to form a conclusion on matters that the practitioner believes may cause the financial statements to be materially misstated. The procedures may be:

- ✓ Additional inquiry or analytical procedures, for example, being performed in greater detail or being focused on the affected items (i.e. amounts or disclosures concerning the affected accounts or transactions as reflected in the financial statements); or
- ✓ Other types of procedures, for example, substantive test of details or external confirmations.

Test Your Understanding 3. Exceptional

During review of the quarterly results of a company of which you are auditor, it is gathered on inquiries made that there has been a major fire in fabric processing plant of the company during the quarter. It has resulted in massive disruption in the operations of the company. Worse still, machinery and inventories of plant were uninsured due to carelessness of concerned staff leading to substantial losses. The matter has been disclosed in interim financial information appropriately. Discuss how you would proceed to deal with the same in the review report.

Answer:

Uninsured assets in a disaster are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. As a result of the fire, there is massive disruption in the operations of the company. Besides, the company would have to bear losses as its damaged assets are uninsured.

In accordance with SRE 2410, if, as a result of inquiries or other review procedures, a material uncertainty relating to an event or condition comes to the auditor's attention that may cast significant doubt on the entity's ability to continue as a going concern, and adequate disclosure is made in the interim financial information, the auditor modifies review report by adding an emphasis of matter paragraph.

Therefore, Emphasis of Matter paragraph should be added in review report.

Test Your Understanding 4.

CA Seerat is conducting review of the quarterly financial information of a company of which she is also auditor. She believes that it is necessary to make a material adjustment to the quarterly financial information for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework. She has communicated the matter to the CFO and the audit committee. However, no response was received even after waiting for a reasonable time. What are the options available to her?

Answer:

In such a case, options available to her in accordance with SRE 2410 are: -

(a) Whether to modify the report or

(b) The possibility of withdrawing from the engagement and

(c) The possibility of resigning from the appointment to audit the annual financial statements.

Integrated Case Scenario from ICAI SM

Integrated Case Scenario 1.

Below is given an incomplete draft text of the review report on the review of financial results of Fast Operations Limited, a listed company in accordance with SEBI regulations. The review is a compulsory requirement under SEBI (Listing Obligations and Disclosure Requirements) Regulations. The incomplete areas of the report have been marked as **XXXX**.

INDEPENDENT AUDITOR'S REVIEW REPORT ON REVIEW OF INTERIM STANDALONE FINANCIAL RESULTS

TO XXXX

1. We have reviewed the accompanying Statement of Standalone unaudited financial results of Fast Operations Limited ("the Company"), for the quarter and six months ended September 30, 2024 ("the Statement"), being submitted by the Company pursuant to the requirement of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended.
2. This Statement, which is the responsibility of the Company's Management and approved by the Company's Board of Directors, has been prepared in accordance with the recognition and measurement principles laid down in the Indian Accounting Standard 34 "Interim Financial Reporting" ("Ind AS 34"), prescribed under Section 133 of the Companies Act, 2013 read with relevant rules issued thereunder and other accounting principles generally accepted in India. Our responsibility **XXXXXXXXXXX**.
3. We conducted our review of the Statement in accordance with the Standard **XXXX**, issued by the Institute of Chartered Accountants of India (ICAI). A review of interim financial information consists of making inquiries, primarily of the company's personnel responsible for financial and accounting matters and applying analytical and other review procedures. A review is substantially **XXXXXXXXXXXXXXXXXXXXXXXX**.
4. Based on our review conducted as stated in paragraph 3 above, **XXXXXXXXXXXXXXXXXXXXX**

Using your knowledge, answer the following questions to complete the draft text of review report of Fast Operations Limited: -

1. The name of addressee is missing from text of draft review report. Identify the most appropriate option:
   (a) Audit Committee
   (b) Board of Directors
   (c) CFO
   (d) Stock exchange on which shares of company are listed

2. Under para 2 of the case study, choose the appropriate sentence beginning with "Our responsibility XXXX":
   (a) Our responsibility is to express an opinion on the Statement based on our review.
   (b) Our responsibility is to express a conclusion on the Statement based on our review.
   (c) Our responsibility is to provide a reasonable assurance on the Statement based on our review.
   (d) Our responsibility is to express a compliance statement on the Statement based on our review.

3. Given the description of case study, which of the following engagement standards is most appropriate to be stated in para 3?
   (a) SRE 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity'.

(b) SRE 2400 Engagements to Review Historical Financial Statements.
(c) SA 700 Forming an Opinion and Reporting on Financial Statements.
(d) SA 810 Engagements to Report on Summary Financial Statements.

4. Which of the following statements is most appropriate to be inserted in sentence beginning with "A review is substantially XXXX" in para 3?
   (a) A review is substantially broader in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in a review. Accordingly, we do not express an audit opinion.
   (b) A review is substantially broader in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.
   (c) A review is substantially narrower in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in a review. Accordingly, we do not express an audit opinion.
   (d) A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

5. Complete the paragraph 4 of case study from following options: -
   (a) Nothing has come to our attention that causes us to believe that the accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has not disclosed the information required to be disclosed in terms of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it contains any material misstatement.
   (b) Nothing has come to our attention that causes us to believe that the accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has disclosed the information required to be disclosed in terms of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it does not contain any material misstatement.
   (c) The accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has disclosed the information required to be disclosed in terms of Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it does not contain any material misstatement.
   (d) The accompanying Statement, prepared in accordance with the recognition and measurement principles laid down in the aforesaid Indian Accounting Standard and other accounting principles generally accepted in India, has disclosed the information required to be disclosed in terms of

Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, including the manner in which it is to be disclosed, or that it does not contain any material misstatement and gives a true and fair view of the state of affairs of the company as on date of interim financial statements.

Answers to Integrated Case Scenario

1.	(b)	2.	(b)	3.	(a)	4.	(d)	5.	(a)

Test Your Knowledge

Question 1

Discuss why "inquiry" is important as an audit procedure in an engagement to review financial statements.

Answer: Refer to GOAT Notes

Question 2

CA Aditya Jain is auditor of a listed company. He is also required to carry out a quarterly review of financial statements of company in terms of regulatory requirements. He is already well-versed with the business of the company and has a deep understanding of the company. Discuss any of the five procedures by which he can update his understanding of the company for carrying out quarterly review.

Answer: Refer to GOAT Notes

Question 3

What is significance of "date of report" in a review report?

Answer: Refer to GOAT Notes

Question 4

CA Pankaj Chaturvedi has issued a review report dated 28-07-2024 for the financial results of a company for quarter ending 30-06-2024. Describe his responsibility, if any, for events occurring from 01-07-2024 till date of review report in accordance with SRE 2410.

Answer:

The auditor should inquire whether management has identified all events up to the date of the review report that may require adjustment to or disclosure in the interim financial information.

Question 5

A review of financial statements includes consideration of the entity's ability to continue as a going concern. If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern. Enumerate the steps to be taken by the practitioner for the same.

Answer: Refer to GOAT Notes

Question 6 **Newly Added**

GAK Limited has compiled the interim financial information, as per the Listing agreement requirements, and submitted it to the auditors for their review. CA Reena has been assigned on the engagement to review the interim financial information of GAK Limited. Based on the inquiries and other review procedures carried out, CA Reena assessed that GAK Limited has been facing continuous working capital shortages. No financial institutions or banks are ready to lend additional funding limits to GAK Limited, since the company has been continuously incurring losses for over 3 years and the company has defaulted payment of loan instalments & interest over the last one year and operations have been curtailed significantly.

Under such circumstances CA Reena, who is doing the review for the first time, noted that GAK Limited has not disclosed any information in the interim financial information relating to material uncertainties. Given the situation, please advise CA Reena, what kind of review report is required to be issued? If, GAK Limited has disclosed information relating to material uncertainty, can CA Reena give a clean report? Discuss.

Answer:

Going Concern and Significant Uncertainties: As per SRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity", if, as a result of inquiries or other review procedures, a material uncertainty relating to an event or condition comes to the auditor's attention that may cast significant doubt on the entity's ability to continue as a going concern, and adequate disclosure is made in the interim financial information the auditor modifies the review report by adding an emphasis of matter paragraph.

The auditor may have modified a prior audit or review report by adding an emphasis of matter paragraph to highlight a material uncertainty relating to an event or condition that may cast significant doubt on the entity's ability to continue as a going concern.

If a material uncertainty that casts significant doubt about the entity's ability to continue as a going concern is not adequately disclosed in the interim financial information, the auditor should express a qualified or adverse conclusion, as appropriate. The report should include specific reference to the fact that there is such a material uncertainty.

In view of the above, in the given situation, GAK Limited has compiled the interim financial information, as per the Listing agreement requirements, and submitted it to the auditors for their review. CA Reena has been assigned on the engagement to review the interim financial information of GAK Limited. CA Reena noticed that GAK Limited has not disclosed any information in the interim financial information relating to material uncertainties that casts significant doubt about the entity's ability to continue as a going concern. Thus, the auditor should express a qualified or adverse conclusion, as appropriate. The report should include specific reference to the fact that there is such a material uncertainty.

If the material uncertainty still exists and adequate disclosure is made in the interim financial information, the auditor modifies the review report on the current interim financial information by adding a paragraph to highlight the continued material uncertainty. If GAK Limited has disclosed information relating to material uncertainties, CA Reena should modify the review report by adding an emphasis of matter paragraph.

Question 7 **Newly Added**

In a review engagement performed under SRE 2400, practitioner relies mainly on certain procedures. Naming such procedures, discuss the importance of these procedures in a review engagement.

Practitioner's report containing outcome of review engagement in form of "conclusion" also contains a description of a review of financial statements and its limitations. Which statements in this respect are to be included in the practitioner's report in accordance with SRE 2400?

Answer: Refer to GOAT Notes

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 2 Nov '24 4M)**

A review of financial statements includes consideration of the entity's ability to continue as a going concern. If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern. Enumerate the steps to be taken by the practitioner for the same.

Answer:

As per SRE 2400, "Engagements to Review Historical Financial Statements", a review of financial statements includes consideration of the entity's ability to continue as a going concern. If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern, the practitioner shall:

(i) Inquire of management about plans for future actions affecting the entity's ability to continue as a going concern and about the feasibility of those plans, and also whether management believes that the outcome of those plans will improve the situation regarding the entity's ability to continue as a going concern.

(ii) Evaluate the results of those inquiries, to consider whether management's responses provide a sufficient basis to: -

(1) Continue to present the financial statements on the going concern basis if the applicable financial reporting framework includes the assumption of an entity's continuance as a going concern or

(2) Conclude whether the financial statements are materially misstated or are otherwise misleading regarding the entity's ability to continue as a going concern.

(iii) Consider management's responses in light of all relevant information of which the practitioner is aware as a result of the review.

Question 2 **(MTP 2 Nov '24 5M)**

In a review engagement performed under SRE 2400, practitioner relies mainly on certain procedures. Naming such procedures, discuss importance of these procedures in a review engagement.

Practitioner's report containing outcome of review engagement in form of "conclusion" also contains a description of a review of financial statements and its limitations. Which statements in this respect are to be included in practitioner's report in accordance with SRE 2400?

Answer:

In a review engagement performed under SRE 2400, the practitioner performs primarily inquiry and analytical procedures to obtain sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole expressed in accordance with the requirements of SRE 2400.

In a review engagement, evidence obtained through inquiry is often the principal source of evidence about management intent. Application of professional skepticism in evaluating responses provided by management is important to enable the practitioner to evaluate whether there are any matters that would cause the practitioner to believe that the financial statements may be materially misstated. Performing inquiry procedures also assists the practitioner in obtaining or updating the practitioner's understanding of the entity and its environment, to be able to identify areas where material misstatements are likely to arise in the financial statements.

In a review of financial statements, performing analytical procedures assists the practitioner in: -

- ✓ Obtaining or updating the practitioner's understanding of the entity and its environment, including to be able to identify areas where material misstatements are likely to arise in the financial statements.

- ✓ Identifying inconsistencies or variances from expected trends, values or norms in the financial statements such as the level of congruence of the financial statements with key data, including key performance indicators.
- ✓ Providing corroborative evidence in relation to other inquiry or analytical procedures already performed.
- ✓ Serving as additional procedures when the practitioner becomes aware of matters that cause the practitioner to believe that the financial statements may be materially misstated. An example of such an additional procedure is a comparative analysis of monthly revenue and cost figures across profit centers, branches or other components of the entity, to provide evidence about financial information contained in line items or disclosures contained in the financial statements.

In a review engagement, practitioner's report contains a description of a review of financial statements and its limitations, and the following statements in this respect: -

(i) A review engagement under this SRE is a limited assurance engagement.

(ii) The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained and

(iii) The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Standards on Auditing (SAs), and, accordingly, the practitioner does not express an audit opinion on the financial statements.

Question 3 **(PYP May '24 5M)**

GAK Limited has compiled the interim financial information, as per the Listing agreement requirements and submitted to the auditors for their review. CA Reena, has been assigned on the engagement to review the interim financial information of GAK Limited. Based on the inquiries and other review procedures carried out, CA Reena, assessed that GAK Limited, has been facing continuous working capital shortages. No financial institutions or banks are ready to lend additional funding limits to GAK Limited, since the company has been continuously incurring losses for over 3 years and the company has defaulted payment of loan instalments & interest over the last one year and operations have been curtailed significantly.

Under such circumstances CA Reena, who is doing the review for the first time, noted that GAK Limited has not disclosed any information in the interim financial information relating to material uncertainties. Given the situation, please advise CA Reena, what kind of review report is required to be issued? If, GAK Limited has disclosed information relating to material uncertainty, can CA Reena give a clean report? Discuss.

Answer: Already covered in TYK Qn

Question 4 **(PYP May '24 4M)**

Best Textiles Ltd. makes an investment in Prime Textiles Ltd. with a view to expand its business, capture more market share and to earn higher returns. While forming an agreement for the same, Best Textiles Ltd. puts a clause in the contract that Prime Textiles Ltd. will get its financial statements reviewed on a quarterly basis for a period of 2 years from the commencement of the contract i.e. 01-04-2023. To comply with the provisions of the contract the management of Prime Textiles Ltd. appoints CA Sumit to conduct the quarterly review of financial statements for the first quarter of the financial year 2023-24. Discuss from the practitioner's point of view, the preconditions for accepting a review engagement in accordance with the relevant SRE.

Answer:

Preconditions for Accepting Review Engagement As per SRE: As per SRE 2400, Engagement to Review Historical Financial Statements, the preconditions for accepting a review engagement are:

(1) Determine whether the financial reporting framework applied in the preparation of the financial statements is acceptable including, in the case of special purpose financial statements, obtaining an understanding of the purpose for which the financial statements are prepared and of the intended users, and;

(2) Obtain the agreement of management that it acknowledges and understands its responsibilities:

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation.

(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(iii) To provide the practitioner with: -

(a) Access to all information of which management is aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;

(b) Additional information that the practitioner may request from management for the purpose of the review; and

(c) Unrestricted access to persons within the entity from whom the practitioner determines it necessary to obtain evidence.

Question 5 **(MTP M25 S1 5M)**

Adboot & Co., a firm of Chartered Accountants, has been approached by Mix Ltd. to conduct a review engagement of its financial statements for the year ending 31st March 2024. Before accepting the engagement, the engagement partner, CA Jai, wants to ensure that the necessary preconditions for a review engagement are met.

What preconditions should CA Jai evaluate before accepting the engagement? Discuss the responsibilities of Mix Ltd.'s management in this context and the necessary agreements that must be obtained from them.

Answer: Already covered in MRP Qns

Question 6 **(PYP May 25 4M)**

Glow management Ltd., a workspace operator, seeks to secure funding from investors. The funds will be used for repayment of debt and cost of capital for strengthening its Balance sheet. To support this, the company has prepared its financial statements for the year ended March 31, 2025. The investors request a limited assurance review rather than a full audit, to ensure the reliability of the financial statements. The management of Glow management Ltd. engages an independent practitioner CA Kishore to perform a review engagement under SRE 2400. During the review, CA Kishore identifies that there was significant increase in deferred revenue. On inquiry, CA Kishore found management's explanation unreasonable that it is related to advances received for upcoming projects and was unable to corroborate this with contracts.

Based on the evidence gathered and procedures performed, CA Kishore determines, that the financial statements are materially misstated. He is bound to express a qualified conclusion, as the effects of the matter(s) giving rise to the modification are material, but not pervasive to the financial statements.

In the above context, you are required to help CA Kishore to:

(i) State the phrases to be used in conclusion paragraph as appropriate.
(ii) State the matters to be included in the basis for conclusion paragraph.

Answer:

(i) As per SRE 2400, "Engagements to Review Historical Financial Statements", when the practitioner expresses a qualified conclusion on the financial statements because of a material misstatement, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate: -

(a) "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements do not give a true and fair view (or do not present fairly, in all material respects), in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework) or

(b) "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).

(ii) In the basis for conclusion paragraph, in relation to material misstatements that give rise to either a qualified conclusion or an adverse conclusion, the practitioner shall: -

(a) Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures), unless impracticable, in which case the practitioner shall so state;

(b) Explain how disclosures are misstated if the material misstatement relates to narrative disclosures; or

(c) Describe the nature of omitted information if the material misstatement relates to the non-disclosure of information required to be disclosed. Unless prohibited by law or regulation, the practitioner shall include the omitted disclosures where practicable to do so.

Test Your Understanding from ICAI SM

Test Your Understanding 1.

A company has approached CA. Hemant for an assurance report in respect of prospective financial information of a project. On going through the project details, it is noticed that depreciation reflected on proposed fixed assets to be acquired in prospective financial information has been calculated in accordance with provisions of the Income Tax Act. No disclosure is made in this respect too. How the matter should be proceeded with?

Answer:

In such types of engagements, it is the duty of a professional accountant to see that prospective financial information is based on a consistent basis with historical financial statements using appropriate accounting principles.

In the case of a company, historical financial statements are prepared considering the requirements of the Companies Act, and depreciation is calculated accordingly. However, in the given situation, depreciation has been calculated in accordance with the Income-tax Act,1961 which is not consistent with historical financial statements. Therefore, it is not proper.

The fact that the projection has not been prepared on a consistent basis with the historical financial statements, using appropriate accounting principles needs to be stated.

Further, when presentation and disclosure are not adequate, a qualified or adverse opinion should be given or withdrawal from engagement should be made as appropriate.

Test Your Understanding 2.

Bansi Group is a leading institution running prestigious postgraduate courses in the field of management. Its financial statements are audited by an independent auditor. Before the start of this academic session, the Board of the institution had outsourced its entire process of inviting student applications, submission of applications, and collection of application fees including late fees and such matters to Easy Solutions Limited. The auditors of Bansi Group want to be sure about the design and operating effectiveness of controls at Easy Solutions Limited. What should be the nature of the report to be provided by auditors of Easy Solutions Limited specifically for use by Bansi Group and its auditors in this regard in terms of SAE 3402?

Answer:

In such a case, the auditors of Bansi Group want to be sure about the design and operating effectiveness of controls at the organization which is providing services to their client. Type 2 report is a report on the description, design and operating effectiveness of controls operating at the service organization. Auditors of Easy Solutions Limited should provide such a report giving assurance on these matters. It should also include details of tests of controls performed and details of deviations, if any.

Test Your Understanding 3.

The management of S Ltd. requests you to accept an engagement to report on the compilation of pro forma financial information to be included in the prospectus. In light of SAE 3420, what factors will you consider regarding the company acknowledging and understanding its responsibility in this matter before accepting engagement?

Answer:

The company's responsibility has to be acknowledged for the following matters:-

i. Adequately disclosing and describing the applicable criteria to the intended users if these are not publicly available;

ii. Compiling the pro forma financial information on the basis of the applicable criteria; and

iii. Providing the practitioner with:-

   a. Access to all information (including, when needed for purposes of the engagement, information of the acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria;

   b. Additional information that the practitioner may request from the responsible party for the purpose of the engagement;

   c. Access to those within the entity and the entity's advisors from whom the practitioner determines it necessary to obtain evidence relating to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria; and

   d. When needed for purposes of the engagement, access to appropriate individuals within the acquiree(s) in a business combination.

Integrated Case Scenario from ICAI SM

Integrated Case Scenario 1.

Below is given draft text of the "Report on Examination of Prospective Financial Information" of Top Edge Limited in relation to the company's upcoming project prepared by a staff member in a CA firm unfamiliar with drafting such reports. The report has been drafted in a casual manner and may consist of omissions and errors.

Report on Examination of Prospective Financial Information

To

The Board of Directors

Top Edge Limited

We have examined the projection of the upcoming project to come up at Ratnagiri of Top Edge Limited for the period from April 2024 to March 2030 as given in the Prospective Financial Information from page 1 to 250 in accordance with Standard on Assurance Engagement 3400, "The Examination of Prospective Financial Information", issued by the Institute of Chartered Accountants of India.

The preparation and presentation of the projection is the responsibility of the Management and has been approved by the Board of Directors of the company.

Our responsibility is to examine the evidence supporting the assumptions (excluding the hypothetical assumption) and other information in the prospective financial information.

The projection has been prepared using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur.

We have carried out our examination of the prospective financial information thoroughly.

Further, in our opinion the projection is properly prepared on the basis of the assumptions as set out in Note 1 to 50 to the Prospective Financial Information and on a consistent basis with the historical financial statements, using appropriate accounting principles. Even if the events anticipated under the hypothetical assumptions described above occur, actual results are still likely to be different from the projection since other anticipated events frequently do not occur as expected and the variation may be material.

For PCK & Co.

Chartered Accountants

Signature

Designation

Membership number

Based on your knowledge and description of the case, answer the following questions: -

1. Whose responsibility is to list out assumptions underlying prospective financial information?
   (a) Professional Accountant issuing report on prospective financial information.
   (b) Auditor of Company issuing report on prospective financial information.
   (c) Management of company.
   (d) Banker of company.

2. Which of the following statements is most appropriate regarding "use of prospective financial information" to be included in such a report?
   (a) Intended use of projection is required to be disclosed. It is further necessary to caution the users regarding inappropriateness of projections for other purposes.
   (b) It is discretionary to state intended use of projection in such a report.

(c) Intended use of projection is required to be disclosed. It is not necessary to caution the users regarding inappropriateness of projections for other purposes.
(d) It is prerogative of management to use report in the manner it deems fit.

3. Which of the following statements is most appropriate regarding the examination of prospective financial information by a Chartered accountant in accordance with SAE 3400?
(a) Accuracy of projections is vouched for based upon performing procedures thoroughly.
(b) Projections can go haywire; It depends upon the professional judgment of the Chartered Accountant to vouch for the accuracy of projections.
(c) Accuracy of projections is not at all vouched for in an assurance report on prospective financial information.
(d) The matter of accuracy of projections or otherwise is not domain of such an examination. Therefore, there is no reporting requirement under SAE 3400.

4. Which of the following statements is most appropriate regarding UDIN in context of examination of prospective financial information by a Chartered Accountant?
(a) It is mandatory to state UDIN in such type of reports.
(b) It is desirable to state UDIN in such type of reports.
(c) It is not required to state UDIN in such type of reports as it is not an audit engagement.
(d) It is not required to state UDIN in such type of reports as it is not an engagement related to historical financial information.

Answers to Integrated Case Scenario

1.	(c)	2.	(a)	3.	(c)	4.	(a)

Test Your Knowledge

Question 1

Ayurda Ltd. is a fast-growing and award-winning SaaS software company which is headquartered in Mumbai. It also has offices in the UK and provides cloud-based professional services automation (PSA) software solutions to professional services organizations around the world. They want to engage you to provide an assurance report for one of its major clients over the controls it operates as a service organisation. Can you provide such an assurance report?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 2

Discuss the significance of Pro forma financial information included in prospectus of a company.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 3

Discuss the term "Pro forma adjustment" under SAE 3420.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 4

Discuss how a Chartered Accountant can be associated with prospective financial information without violating relevant provisions of the Chartered Accountants Act, 1949.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 5 **Newly Added**

The practitioner shall not accept the compilation engagement unless the practitioner has agreed to the terms of engagement with management, and the engaging party if different. In view of the above, mention the responsibilities of the management to be agreed on for the compilation engagement in accordance with SRS 4410.

Answer:

The practitioner shall not accept the compilation engagement unless the practitioner has agreed to the terms of engagement with management, and the engaging party if different. In accordance with SRS 4410, "Compilation Engagement", the responsibilities of the management to be agreed on for the compilation engagement are that:

i. The financial information, and for the preparation and presentation thereof, in accordance with a financial reporting framework that is acceptable in view of the intended use of the financial information and the intended users;
ii. Design, implementation and maintenance of such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
iii. The accuracy and completeness of the records, documents, explanations and other information provided by management for the compilation engagement; and
iv. Judgments needed in the preparation and presentation of the financial information, including those for which the practitioner may provide assistance in the course of the compilation engagement.

Question 6 **Newly Added**

STAR Limited has outsourced its payroll processing functions to a service organization - Little Solutions Private Limited. Little Solutions Private Limited is responsible for accurate preparation of payrolls and timely remittance of statutory dues to the government authorities on behalf of the company. Little Solution Private Limited's controls related to timely remittance of payroll deductions to government authorities are relevant to the company as late remittances could result in interest and penalties resulting in liabilities for the company.

The auditors of STAR Limited want to be sure about description, design and operating effectiveness of controls at Little Solutions throughout the year. In this regard, they require an assurance report from auditors of Little Solutions Private Limited.

a. Why the auditors of STAR Limited require an assurance report from the auditors of Little Solutions Private Limited? Which Engagement and Quality Control Standard casts such kind of responsibility upon the auditor?

b. Which type of report should be provided by the auditors of Little Solutions? Justify with reasons.

c. State matters on which opinion is to be provided by the auditors of Little Solutions.

Answer:

When the user entity uses the services of a service organisation, objectives of auditor of user entity are:

(a) To obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement and

(b) To design and perform audit procedures responsive to those risks.

Therefore, it is in line with the above requirements that auditors of STAR Limited require an assurance report from auditors of Little Solutions Private Limited. SA 402 casts such responsibility on user auditors.

In accordance with requirements of SAE 3402, auditors of Little Solutions Private Limited should provide a type 2 report to auditors of STAR Limited. As auditors of STAR Limited want to be sure about description, design and operating effectiveness of controls at Little Solutions Pvt. Ltd. throughout the year and type 2 report deals with such matters, type 2 report should be provided by the auditors of the Little Solutions Pvt. Ltd. Type 2 report is a report on the description, design and operating effectiveness of controls at a service organization whereas type 1 report is a report on the description and design of controls at a service organization.

(c) The opinion of auditors of Little Solutions Pvt. Ltd. would state whether, in all material respects, based on suitable criteria: -

- ✓ The description fairly presents the service organization's system that had been designed and implemented throughout the specified period;
- ✓ The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period and
- ✓ The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the specified period.

Question 7 Exceptional **Newly Added**

Mr. Vineet, an auditor, has been approached by Qub Ltd. to examine the prospective financial information of the company. What factors should an auditor consider before accepting an engagement to examine prospective financial information, and under what conditions should the auditor decline or withdraw from such an engagement? Additionally, what steps should be taken to formalize the terms of the engagement?

Answer:

Before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:

- ✓ The intended use of the information;
- ✓ Whether the information will be for general or limited distribution;
- ✓ The nature of the assumptions, that is, whether they are best estimates or hypothetical assumptions;
- ✓ The elements to be included in the information; and
- ✓ The period covered by the information.

The auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use. The auditor should consider the extent to which reliance on the entity's historical financial information is justified.

To formalize the terms of the engagement, it is essential to agree on the terms with the client by sending an engagement letter, like in other engagements.

Question 8 Exceptional **Newly Added**

SAE 3400 explains that prospective financial information can take the form of a forecast, a projection, or a combination of both. In this context, how do you differentiate a forecast from a projection? Also provide an example. Additionally, explain the nature of assurance provided by the practitioner regarding prospective financial information in accordance with SAE 3400.

Answer:

Prospective financial information can be in the form of a forecast, a projection, or a combination of both, for example, a one year forecast plus a five- year projection.

"Forecast" means prospective financial information prepared on the basis of:

- ✓ Assumptions as to future events which management expects to take place and
- ✓ The actions management expects to take as of the date the information is prepared (best-estimate assumptions- an assumption that reflects anticipated experience with no provision for risk of adverse deviation).

Example- In present market conditions, supply availability, historical buying patterns and seasonal trends, the CFO of X Ltd. expects sales to increase by 5% over the next quarter. Therefore, a 5% sales increase is his financial forecast for the period.

"Projection" means prospective financial information prepared on the basis of:

- ✓ Hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a start-up phase or are considering a major change in the nature of operations; or
- ✓ A mixture of best-estimate and hypothetical assumptions (imagined or suggested)

Example- X Ltd. may project a course of action to take when one or more hypothetical situations arise, such as creating a new product to meet the demand of expected market growth. As a result of assuming the possibility of different events occurring, financial projections typically serve as an outline for evaluating the desired outcomes X Ltd. expects to see, including its financial, cash flow and operational outcomes.

Prospective financial information relates to events and actions that have not yet occurred and might not occur. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future- oriented and, therefore, speculative in nature, as distinct from the evidence ordinarily available in the examination of historical financial information. Therefore, an opinion as to whether the results shown in the prospective financial information will be achieved cannot be expressed.

Question 9 **Newly Added**

You are engaged by M/s Viva Limited to examine and report on prospective financial information which the management of the company has prepared for presentation at an Investor meet program organized by a State Government to attract investment in their state.

The company in its vision document described various plans and proposals of the company with projected financial goals and means to achieve the same and various benefits accruing to the economic development of the State. What important matters will be considered by you while determining the nature, timing, and extent of examination procedure to be applied in the review of the same?

Answer:

As per SAE 3400, "The Examination of Prospective Financial Information", when determining the nature, timing and extent of examination procedures, the auditor should consider matters such as:

(i) the knowledge obtained during any previous engagements;

(ii) management's competence regarding the preparation of prospective financial information;

(iii) the likelihood of material misstatement;

(iv) the extent to which the prospective financial information is affected by the management's judgment;

(v) the sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;

(vi) the stability of entity's business; and

(vii) the engagement team's experience with the business and the industry in which the entity operates and with reporting on prospective financial information.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

You are engaged by M/s Viva Limited to examine and report on prospective financial information which the management of the company has prepared for presentation at an Investor meet program organized by a State Government to attract investment in their state.

The company in its vision document described various plans and proposals of the company with projected financial goals and means to achieve the same and various benefits accruing to the economic development of the State. What important matters will be considered by you while determining the nature, timing, and extent of examination procedure to be applied in the review of the same? **(5 Marks)**

Answer: Already covered in TYK Qn

Question 2 **(MTP 2 May '24 5M)**

SAE 3400 explains that prospective financial information can take the form of a forecast, a projection, or a combination of both. In this context, how do you differentiate a forecast from a projection? Also provide an example. Additionally, explain the nature of assurance provided by the practitioner regarding prospective financial information in accordance with SAE 3400.

Answer: Already covered in TYK Qn

Question 3 **(PYP Nov '24 5M)**

PQ Pharma Limited, a company dealing in research and development and manufacture of pharmaceuticals is coming up with an Initial Public Offer (IPO). PQ Pharma Ltd. has prepared the prospective financial statements for the next 3 years and included the same in the prospectus as part of its IPO. The prospective financial information includes projected balance sheets, statement of profit and loss and cash flow statements, which are prepared on the basis of several key assumptions like favourable government regulations, planned research and development of more effective medicines at reasonable prices, etc.

The company approaches CA Z to provide assurance on the prospective financial information and to assess the presentation and disclosure of the prospective financial information included in the IPO. List out the aspects that must be considered for making such assessment.

Answer:

When assessing the presentation and disclosure of the prospective financial information and the underlying assumptions, in addition to the specific requirements of any relevant statutes, regulations as well as the relevant professional pronouncements, it needs to be considered whether: -

i. the presentation of prospective financial information is informative and not misleading

ii. the accounting policies are clearly disclosed in the notes to the prospective financial information

iii. the assumptions are adequately disclosed in the notes to the prospective financial information. It needs to be clear whether assumptions represent management's best-estimates or are hypothetical and, when assumptions are made in areas that are material and are subject to a high degree of uncertainty, this uncertainty and the resulting sensitivity of results needs to be adequately disclosed

iv. the date as of which the prospective financial information was prepared is disclosed. Management needs to confirm that the assumptions are appropriate as of this date, even though the underlying information may have been accumulated over a period of time

v. the basis of establishing points in a range is clearly indicated and the range is not selected in a biased or misleading manner when results shown in the prospective financial information are expressed in terms of a range and

vi. if there is any change in the accounting policy of the entity from that disclosed in the most recent historical financial statements, whether reason for the change and the effect of such change on the prospective financial information has been adequately disclosed.

Question 4 **(PYP May 25 4M)**

Smart Technology Ltd. plans to issue a prospectus to raise capital through a public offering. Smart Technology Ltd. acquired Cloud Computing Ltd., a leader in cloud advisory services, to strengthen its capabilities in providing cloud solutions and this acquisition aligned for a digital transformation strategy. The prospectus includes pro forma financial information to demonstrate the financial effects of a significant acquisition completed recently. As the engagement practitioner, you are entrusted with providing an assurance report on the compilation of this pro forma financial information in accordance with relevant Standard on Assurance Engagement.

Smart Technology Ltd.'s management has provided the following details:

(1) The source of the unadjusted financial information includes unaudited financial statements for a subsidiary acquired during the year.

(2) Pro forma adjustments which include Fair value adjustments for acquired assets and liabilities.

(3) The applicable financial reporting framework is IFRS, with modifications specific to the jurisdiction of operation.

In the above context, answer the following:

(i) State the aspects you will consider during planning and performing the Engagement while evaluating the source from which the unadjusted financial information has been extracted.

(ii) As a practitioner you need to obtain evidence about the appropriateness of the pro forma adjustments. Explain what it includes.

Answer:

(i) As per SAE 3420, as a practitioner, while planning and performing the engagement, the following aspects must be evaluated regarding the source of the unadjusted financial information:

- ✓ The practitioner shall obtain evidence about the appropriateness of the source from which the unadjusted financial information has been extracted.
- ✓ If there is no audit or review report on the source from which the unadjusted financial information has been extracted, the practitioner shall perform procedures to be satisfied that the source is appropriate.
- ✓ The practitioner shall determine whether the responsible party has appropriately extracted the unadjusted financial information from the source.
- ✓ The practitioner shall obtain evidence about the appropriateness of the pro forma adjustments.

(ii) The practitioner shall obtain evidence about the appropriateness of the pro forma adjustments: In relation to unadjusted financial information, Pro forma adjustments include:

(a) Adjustments to unadjusted financial information that illustrate the impact of a significant event or transaction as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration, and

(b) Adjustments to unadjusted financial information that are necessary for the pro forma financial information to be compiled on a basis consistent with the applicable financial reporting framework of the reporting entity and its accounting policies under that framework.

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

Sukanya, a CA final student, is of the view that cyber risks are issues of IT and result only in information loss to an entity. She also feels that many cyber-attacks are not directly targeted at financial systems and do not pose risk of material misstatements to financial statements of an entity.

Is her view proper?

Answer:

Cyber risks are not an issue of IT alone. Rather, it is a business risk and has an effect on whole business organization. It affects entity's reputation and can lead to many other consequences which are listed below: -

- ✓ Regulatory costs
- ✓ Business interruptions causing an operational challenge for an organization.
- ✓ Data loss, reputational loss and litigation.
- ✓ Ransomware - more common these days where entire systems are encrypted
- ✓ Intellectual property theft which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
- ✓ Incident response cost which could be for investigations & remediations
- ✓ Breach of Privacy, if personal data of a consumer is hacked it could have a significant impact on the organization.
- ✓ Fines and penalties

It may happen that many cyber attacks are not directly targeted at financial systems. However, the access gained by the attackers may provide them the ability to:

- ✓ Manipulate or modify financial records
- ✓ Modify key automated business rules
- ✓ Modify automated controls relied upon by the management.

Further, auditor should consider whether cyber risk (like other business risks) represents a risk of material misstatement to the financial statement as part of the audit risk assessment activities. Focus should be on understanding the cyber risks affecting the entity and the actions being taken to address these risks.

Test Your Understanding 2. Exceptional

CA Y is planning to use CAATs extensively in audit of a company-be it for compliance tests or substantive tests. Can you list out examples of few situations (in brief) of tests performed by him using CAATs?

Answer:

i. Identify exceptions: Identify exceptional transactions based on set criteria. For example, cash transactions above Rs.10,000.

ii. Identify errors: Identify data, which is inconsistent or erroneous. For e.g.: account number which is not numeric.

iii. Verify calculations: Re-perform various computations in audit software to confirm the results from application software confirm with the audit software. For e.g.: TDS rate applied as per criteria.

iv. Existence of records: Identify fields, which have null values. For example: invoices which do not have vendor name.

v. Data completeness: Identify whether all fields have valid data. For example: null values in any key field such as date, invoice number or value or name.

vi. Data consistency: Identify data, which are not consistent with the regular format. For example: invoices which are not in the required sequence.

vii. Duplicate payments: Establish relationship between two or more tables as required. For example, duplicate payment for same invoice.

viii. Accounts exceeding authorized limit: Identify data beyond specified limit. For example, transactions entered by user beyond their authorized limit or payment to vendor beyond amount due or overdraft allowed beyond limit.

Test Your Understanding 3. Exceptional

A company is planning to use Robotics process automation (RPA) to streamline its hiring process. Earlier, the company used to hire from campuses of various management institutes leading to high recruitment costs, inefficient hire yield and resultant lack of diversity. How RPA can be used to automate the hiring process? List out tentative few such steps. What could be likely benefits of using RPA in hiring process?

Answer:

RPA can be used to streamline hiring process in a company. The tentative steps could include: -

- ✓ Place advertisements on social media/career advice sites.
- ✓ Link redirects candidate to a career site.
- ✓ Career site pulls information of candidate.
- ✓ An algorithm scans applicants for desired and suitable roles.
- ✓ Selected candidates may be asked to play online games to assess their skills.
- ✓ A certain percentage of those applicants are called for a video interview using an interview software.

The automated hiring process will reduce full time effort involvement, provide with a wider assessment range, reduce the impact of recruiter biases, increase the efficiency of mapping of interested candidates, reduce recruiting costs, increase hire yield, reduce time to hire, increase diversity.

Case Study from ICAI SM

Case study 1

What has happened:

The CEO of a hotel realized their business had become the victim of wire fraud when the accounts payable executive began to receive insufficient fund notifications for regularly recurring bills.

A review of the accounting records exposed a serious problem. Upon investigating it was noted that the CEO had clicked on a link in an email that he thought was from the trusted source. However, it wasn't and when he clicked the link and entered his credentials, the cyber criminals captured the CEO's login information, giving them full access to intimate business and personal details.

Type of Attack: Social engineering, phishing attack.

A phishing attack is a form of social engineering by which cyber criminals attempt to trick individuals by creating and sending fake emails that appear to be from an authentic source, such as a business or colleague. The email might ask you to confirm personal account information such as a password or prompt you to open a malicious attachment that infects your computer with malware.

Result: The hotel's cash reserves were depleted. The fraudulent transfers amounted to more than ₹1 million. The hotel also contacted a cybersecurity firm to help them mitigate the risk of a repeat attack.

Impact: The business lost ₹1 million, and the funds were not recovered. Further there was loss of business reputation too.

Lessons Learned:

- ✓ Train the staff about the dangers of clicking on unsolicited email links and attachments, and the need to stay alert for warning signs of fraudulent emails. Engage in regular email security training.
- ✓ Implement stringent wire transfer protocols and include a secondary form of validation (Multi Factor Authentication)
- ✓ Have a cyber incident response plan ready to implement.

Case study 2

XY Bank, headquartered in New York, offers a broad range of financial services including asset management, commercial banking, investment banking, and treasury and securities services.

The Five Indian banks in partnership with XY bank, provide a comprehensive range of banking services and products encompassing retail banking, corporate banking, international banking, and other financial services. All these banks have been significant contributors to the digitalization of banking services in India.

Under the pilot programme, the Indian banks will open on-chain Nostro accounts with XY Bank branch in Gift City. The blockchain-based system is expected to facilitate instant, 24×7 settlement between the accounts held at the US bank. Essentially, it will create a private intra-correspondent banking network, redefining the traditional banking hours and enabling seamless money transfer.

Following are the illustrative steps for performing audit of above said block chain:

(a) Obtain a comprehensive understanding of the blockchain-based pilot program, including its objectives, scope, and key processes involved.

(b) Review the partnership agreements, contracts, and legal documentation governing the relationship between the Indian banks and XY Bank.

(c) Identify the specific blockchain technology used, its functionalities, and the underlying smart contracts.

(d) ***Assess Internal Controls:***

Review policies and procedures related to the on-chain Nostro accounts, settlement processes, and money transfer mechanisms.

Assess the governance framework, risk management practices, and compliance procedures established by the Indian banks and XY Bank.

(e) Review Security Measures:

Assess encryption methods, cryptographic key management, and secure transmission protocols used for data protection.

Review measures taken to prevent unauthorized access, cyber threats, and potential vulnerabilities in the blockchain network.

(f) Test Transaction Validity and Accuracy:

Validate that transactions are recorded and settled accurately on the blockchain, ensuring adherence to relevant regulations and contractual obligations.

Perform reconciliations between on-chain Nostro accounts and the corresponding accounts held at XY Bank to confirm the accuracy of balances and transactions.

(g) Evaluate Compliance and Regulatory Requirements:

Review documentation and procedures related to customer due diligence, transaction monitoring, and reporting obligations.

Ensure that the pilot program adheres to industry-specific standards and best practices.

(h) Assess Business Continuity and Disaster Recovery:

Evaluate the adequacy of backup and recovery procedures, redundancy measures, and failover mechanisms to ensure uninterrupted operations.

Test the effectiveness of these plans by conducting simulations or examining historical incidents and response procedures.

(i) Report Findings and Recommendations:

Provide recommendations for improving internal controls, security measures, compliance procedures, and overall efficiency and effectiveness of the pilot program.

Communicate the audit results to the relevant stakeholders, highlighting areas of concern and suggesting remedial actions.

Case study 3

A large passenger carrier is having an AI bot for passenger ticket booking with following processes:

User Interaction: The bot interacts with passengers through various channels such as a website, mobile app, or messaging platforms. Passengers can initiate a conversation with the bot by providing their travel details, preferences, and other required information.

Natural Language Processing (NLP): The bot utilizes natural language processing techniques to understand and interpret the passenger's queries and requests. It can process text or voice inputs and extract relevant information to facilitate ticket booking.

Query Handling: The bot responds to passenger queries related to ticket availability, fares, train schedules, seat preferences, and other relevant information. It can provide real-time updates and answers to common passenger questions.

Booking Process: Upon receiving a booking request, the bot collects the necessary details from the passenger, including travel dates, destinations, class preferences, and passenger information.

It validates the inputs, checks seat availability, and calculates fares based on the carrier's pricing structure.

Integration with Booking Systems: The bot interfaces with the carrier's booking systems to check seat availability, reserve seats, and process payment transactions. It securely communicates with the backend systems to initiate the booking process.

Payment Processing: The bot facilitates secure payment transactions, allowing passengers to provide payment details and complete the booking. It may integrate with various payment gateways or services to process credit card payments, net banking, or other payment methods.

Confirmation and Ticket Generation: Once the booking is successfully processed, the bot generates a booking confirmation along with a unique ticket number. It provides the passenger with the necessary information, including the ticket details, train information, and any other relevant instructions.

Ancillary Services: The bot may offer additional services such as seat upgrades, meal selection, travel insurance, or other ancillary offerings. It can provide information and assist passengers in availing these services during the booking process.

Post-Booking Support: The bot can assist passengers with post-booking support, including itinerary changes, cancellations, or ticket modifications. It handles these requests, checks the carrier's policies, and processes the necessary changes as per the passenger's requirements.

Integration with Customer Support: The bot may be integrated with customer support systems to escalate complex queries or issues to human agents when necessary. It can provide a seamless transition from automated assistance to human interaction, ensuring a high level of customer service.

Following are the illustrative steps to audit ticket booking bot system:

- Identify the objectives and goals of auditing the IRCTC ticket booking bot.
- Determine the scope of the audit, including the specific aspects of the bot's functionality and operations to be evaluated.
- Review relevant regulatory and compliance standards applicable to the ticket booking process, such as data protection and privacy regulations, payment card industry standards, and any specific industry guidelines.
- Identify and assess potential risks associated with the ticket booking bot, such as unauthorized access to customer data, system failures, or inaccurate booking information.
- Develop a comprehensive set of audit procedures to assess the effectiveness, efficiency, and compliance of the ticket booking bot. This may include:
- Reviewing the system architecture, design, and documentation.
- Evaluating the security measures in place, including authentication, access controls, and encryption.
- Testing the bot's functionality by simulating booking scenarios and verifying the accuracy of the results.
- Assessing the performance of the bot, such as response times and scalability.
- nalyzing logs and audit trails to detect any unusual or suspicious activities.
- Examining the data handling processes, ensuring proper encryption, storage, and protection of customer data.
- Verifying compliance with relevant regulations, policies, and procedures.
- Conducting penetration testing or vulnerability assessments to identify potential weaknesses in the bot's security.
- Decide on the appropriate sampling methodology to evaluate the bot's performance and compliance. This may involve selecting a representative sample of booking transactions or data for analysis.
- Conduct the audit based on the defined procedures, following best practices and professional audit standards.
- Document your findings, including any issues or areas of improvement identified during the audit.

- Compile the audit findings into a comprehensive report, detailing the audit objectives, scope, procedures performed, and results.
- Provide recommendations for addressing any identified weaknesses, risks, or non-compliance issues.
- Present the report to relevant stakeholders, such as management, IT teams, and compliance officers.
- Track the implementation of recommended actions and ensure appropriate measures are taken to address any identified weaknesses.
- Periodically review and monitor the bot's performance, security, and compliance to ensure ongoing effectiveness.

Test Your Knowledge

Question 1

Briefly describe the advantages and challenges of Auditing digitally.

Answer:

Advantages – Improved efficiency, better quality, lower costs, improved risk assessment.

Challenges – Reluctance to change, challenges with data security and governance, choosing the right tool and automating the right process, ensuring standardisation and correct configurations to avoid error and bias, evaluating business benefits the organization wants to achieve with automation and the roadmap for digital strategy.

Refer Further to GOAT Notes

Question 2

What are the stages involved in understanding the IT environment and what key considerations auditors should consider?

Answer:

The stages involved in understanding of IT environment are:

Understand – Identify – Assess. Key considerations - Understand the flow of transaction, Identification of Significant Systems, Identification of Manual and Automated Controls, Identification of the technologies used and. Assessing the complexity of the IT environment.

Refer Further to GOAT Notes

Question 3

Auditor should scope in ITGCs to tests when there are IT dependencies identified in the system. Briefly describe the types of IT dependencies.

Answer: Refer to GOAT Notes

Question 4

What does cyber risk explain it with some examples.

Answer: Refer Further to GOAT Notes

Question 5

Briefly describe the cyber security Framework.

Answer: Refer Further to GOAT Notes

Question 6

In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for the preparation of management information system (MIS) reports and electronic dashboards that give a high-level snapshot of business performance. In view of the above you are required to briefly discuss the meaning of data analytics and example of such data analytics techniques.

Answer: Refer Further to GOAT Notes

Question 7

Enterprises are adopting emerging technologies at a rapid pace to create synergies and harness the latest technologies. Give 3 examples of automated tools used as a part of emerging technologies along with the risk and audit considerations associated with these tools.

Answer: Refer Further to GOAT Notes

Question 8

Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks. Give some examples of technology risks of digital system and the control considerations to consider while assessing technology risk.

Answer: Refer Further to GOAT Notes

Question 9

Give examples of emerging technologies available for Next Generation Audit along with the risks associated with it.

Answer: Refer Further to GOAT Notes

Question 10 — Newly Added

CA Kabir, an auditor assigned to conduct a remote audit of Beetal Limited. The audit will be conducted virtually using online platforms, with the client sharing documents and participating in video conferences. What key considerations should CA Kabir address to ensure the effectiveness and security of the remote audit?

Answer: Key considerations that CA Kabir should address for effectiveness and security of the remote audits are:

Feasibility and Planning

- ✓ Planning should involve agreeing on audit timelines, meeting platform (Zoom calls/ Microsoft Teams/Google Meet) to be used for audit sessions, data exchange mechanisms, any access authorization requests. Ensure feasibility is determining what
- ✓ competencies and that resources are available.
- ✓ The execution phases of a remote audit involve video/tele conferencing with auditees. The documentation for audit evidence should be transferred through a document sharing platform.

Confidentiality, Security and Data Protection

- ✓ To ensure data security and confidentiality, access to document sharing platform should be sufficiently restricted and secured by encrypting the data that is sent across the network. The information, once reviewed and documented by auditor is removed from the platform and stored according to applicable archiving standards and data protection requirements.
- ✓ Auditors should take into consideration legislation and regulations, which may require additional agreements from both sides (e.g., there will be no recording of sound and images, or authorizations to using people's images). Auditors should not take screenshots of auditees as audit evidence. Any screenshots of documents or records or other kind of evidence should be previously authorized by the audited organization. In case of accessing the auditee's IT system auditor should use VPN (Virtual private network). VPN is a service which creates safe and encrypted online connections. It prevents unauthorized users to enter into the network and allows the users to perform work remotely.

Risk assessment

- ✓ The communication from auditor as well as auditees need to clear and consistent, and this becomes crucial during remote audit. The risks for achieving the audit objectives are identified, assessed and managed. The assessment if remote audit would be sufficient to achieve the audit objectives should be done and documented for each audit involving all members of the audit team and the audited organization representative.

Question 11 **Newly Added**

Certain studies have suggested that the increase in cyber-attacks and rise in global payment processing cost have hit global banking and finance industries enormously. Therefore, such industries are going to place reliance on new technologies such as Blockchain. Blockchain is based on a decentralized and distributed ledger that is secured through encryption. Each transaction is validated by the blockchain participants, creating a block of information that is replicated and distributed to all participants. However, such technology comes with its weaknesses and associated risks. What are common risks for Blockchain technology? Also discuss probable audit implications where such technology can be used.

Answer: Refer Further to GOAT Notes

Question 12 **Newly Added**

IT dependencies also arise due to "system generated reports" and "interfaces". How do such IT dependencies arise? Why it is important to identify IT dependencies to develop an effective and efficient audit approach?

Answer:

IT dependencies are created when IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in the financial statements.

System generated reports are the information generated by the IT systems. These reports are often used in an entity's execution of a manual control, including business performance reviews, or may be the source of entity information used by us when selecting items for the testing, performing substantive tests of details or performing a substantive analytical procedure. e.g. (Vendor master report, customer ageing report).

Interfaces are programmed logic that transfer the data from one IT system to another. For example, an interface may be programmed to transfer data from a payroll subledger to the general ledger.

In this manner, IT dependencies arise due to "system generated reports" and "interfaces".

Identifying and documenting the entity's IT dependencies in a consistent, clear manner helps to identify the entity's reliance upon IT, understand how IT is integrated into the entity's business model, identify potential risks arising from the use of IT, identify related IT General Controls and enables us to develop an effective and efficient audit approach.

Question 13 **Newly Added**

Mr. Karan is a consultant tasked with helping a mid-sized manufacturing company modernize its operations by integrating Internet of Things (IoT) technology. The company wants to connect various devices such as manufacturing equipment, smart home security systems for their facility, and inventory management systems. They aim to leverage IoT to improve operational efficiency, predict equipment maintenance needs, and enhance overall security. However, they are concerned about the potential risks and the impact on their audit processes. Describe the key components and benefits of IoT, the risks associated with IoT implementation, and the implications for the company's audit processes. How should the company address these concerns to ensure a smooth transition?

Answer: Refer Further to GOAT Notes

Question 14 **Newly Added**

Gravity Ltd. is a medium-sized manufacturing company that is planning to implement a new digital system to streamline its production processes and improve efficiency. The company appointed Mr. Ravi as IT manager. However, he is aware that merging technologies can bring significant benefits but also pose various risks to the organization. In this context, he needs to identify examples of technological risks associated with the implementation of the new digital system and the control considerations necessary to mitigate these risks effectively.

Answer:

Some examples of technology risks where Mr. Ravi should test the appropriate controls for relying on the digital systems

- ✓ Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both
- ✓ Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database)
- ✓ The possibility of information technology personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby leading to insufficient segregation of duties
- ✓ Unauthorized or erroneous changes to data in master files
- ✓ Unauthorized changes to systems or programs
- ✓ Failure to make necessary or appropriate changes to systems or programs
- ✓ Inappropriate manual intervention
- ✓ Potential loss of data or inability to access data as required
- ✓ Risks introduced when using third-party service providers
- ✓ Cybersecurity risks

Further Mr. Ravi should focus on the following control considerations to mitigate risks effectively:

1. Auditors should gain a holistic understanding of changes in the industry and the information technology environment to effectively evaluate management's process for initiating, processing, and recording transactions and then design appropriate auditing procedures.
2. Auditors, as appropriate, should consider risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional, legacy systems.
3. Auditors should consider whether digital upskilling or specialists are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.

Question 15 **Newly Added**

Remote audit is an audit where the auditor uses online or electronic means to conduct the same. It could be partially or completely virtual, auditor engages using technology to obtain the audit evidence or to perform documentation review with the participation of the auditee. For example, an auditor might use video conferencing and cloud-based file sharing to review financial records remotely. What are the advantages and disadvantages of remote auditing?

Answer: Refer to GOAT Notes

Question 16 **Newly Added**

MNC Limited is engaged in manufacture & sale of FMCG products. It has manufacturing locations across various states in India and engages dealer channels to sell it products. One dealer is appointed for each district within the state and products are despatched from the nearest manufacturing location to the dealer. Considering the voluminous transactions, MNC Limited has a robust ERP network, for recording the transactions. As statutory auditors of MNC Ltd., your firm is about to commence the current year's audit. The audit team includes certain IT experts and discussions are underway amongst the team members. As an IT manager of the engagement team, explain the key areas for an auditor to understand IT environment.

Answer: Refer to GOAT Notes

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 4M)**

CA Kabir, an auditor assigned to conduct a remote audit of Beetal Limited. The audit will be conducted virtually using online platforms, with the client sharing documents and participating in video conferences. What key considerations should CA Kabir address to ensure the effectiveness and security of the remote audit?

Answer:

Question 2 **(MTP 2 Nov '24 4M)**

Remote audit is an audit where the auditor uses the online or electronic means to conduct the same. It could be partially or completely virtual, auditor engages using technology to obtain the audit evidence or to perform documentation review with the participation of the auditee. For example, an auditor might use video conferencing and cloud-based file sharing to review financial records remotely. What are the advantages and disadvantages of remote auditing?

Answer:

Advantages and Disadvantages of Remote Audit:

ADVANTAGES	DISADVANTAGES
Cost and time effective: No travel time and travel costs involved.	Due to network issues, interviews and meetings can be interrupted.
Comfort and flexibility to the audit team as they would be working from home environment,	Limited or no ability to visualize facility culture of the organization, and the body language of the auditees. Time zone issues could also affect the efficiency of remote audit session.
Time required to gather evidence can spread over several weeks, instead of concentrated into a small period that takes personnel from their daily activities.	The opportunity to present doctored documents and to omit relevant information is increased. This may call for additional planning, some additional/different audit procedures, security and confidentiality violation.
Auditor can get first-hand evidence directly from the IT system as direct access may be provided.	Remote access to sensitive IT systems may not be allowed. Security aspects related to remote access and privacy needs to be assessed
Widens the selection of auditors from global network of experts.	Cultural challenges for the auditor. Lack of knowledge for local laws and regulations could impact audit. Audit procedures like physical verification of assets and stock taking cannot be performed.

Question 3 Exceptional **(MTP 1 May '24 4M)**

IT dependencies also arise due to "system generated reports" and "interfaces". How do such IT dependencies arise? Why it is important to identify IT dependencies to develop an effective and efficient audit approach?

Answer: Already covered in TYK Qn

Question 4 **(MTP 2 May '24 4M)**

Gravity Ltd. is a medium-sized manufacturing company that is planning to implement a new digital system to streamline its production processes and improve efficiency. The company appointed Mr. Ravi as IT manager. However, he is aware that merging technologies can bring significant benefits but also pose various risks to the organization. In this context, he needs to identify examples of technological risks associated with the implementation of the new digital system and the control considerations necessary to mitigate these risks effectively.

Answer: Already covered in TYK Qn

Question 5 **(PYP May '24 5M)**

MNC Limited, is engaged in manufacture & sale of FMCG products. It has manufacturing locations across various states in India and engages dealer channels to sell it products. One dealer is appointed for each district within the state and products are despatched from the nearest manufacturing location to the dealer. Considering the voluminous transactions, MNC Limited has a robust ERP network, for recording the transactions. As statutory auditors of MNC Ltd., your firm is about to commence the current year audit. The audit team includes certain IT experts and discussions are underway amongst the team members. As an IT manager of the engagement team, explain the key areas for an auditor to understand IT environment.

Answer:

Key Areas for an Auditor to Understand IT Environment: Key Areas for an Auditor to Understand IT Environment are as follows:

1. Understand the flow of transaction: The auditor's understanding of the IT environment may focus on identifying and understanding the nature and number of the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing or storing those transactions or information.
2. Identification of Significant Systems: The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.
3. Identification of Manual and Automated Controls: An entity's system of internal control contains manual elements and automated elements (i.e., manual, and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement.
4. Identification of the technologies used: The need to understand the emerging technologies implemented and the role they play in the entity's information processing or other financial reporting activities and consider whether there are risks arising from their use.
5. Given the potential complexities of these technologies, there is an increased likelihood that the engagement team may decide to engage specialists and/or auditor's experts to help understand whether and how their use impacts the entity's financial reporting processes and may give rise to risks from the use of IT.
6. Assessing the complexity of the IT environment: Not all applications of the IT environment have

the same level of complexity. The level of complexity for individual characteristics differs across applications. Complexity is based on the following factors – automation used in the organization, entity's reliance on system generated reports, customization in IT applications, business model of the entity, any significant changes done during the year and implementation of emerging technologies.

7. After considering the above factors for each application the over complexity is assessed of the IT environment.

Question 6 **(PYP May '24 4M)**

TP Limited is a medium-sized company involved in manufacturing and retailing of home appliances to cater to the daily needs of a wide range of consumers. The company has in place proper cyber security policies, procedures and framework. Regular assessment of the same is also carried out by the management. The company faced a cyber attack incident of email phishing scam which resulted in inappropriate disbursals to various individuals posing as vendors arid caused a substantial financial loss. This incident highlighted the need for strong and updated internal controls to mitigate the cyber risks. As the statutory auditor of the company, how will you evaluate the controls around the vendor setup and modifications.

Answer:

Evaluation of the controls around the vendor setup and modifications: Certain cyber schemes exist in which changes to bank account or other critical vendor information are requested through email phishing scams by individuals purporting to be authorized vendor personnel.

Entities have inappropriately dispersed funds to these individuals and therefore inappropriately reduced the liability owed to the actual vendor, resulting in an impact to the financial statements (i.e., loss of cash and related expense)

- ✓ Who is responsible for making changes to vendor master data? Is the process centralized or decentralized?
- ✓ Are other communication channels, such as email, used to request changes to vendor master data? (If yes, consider if multi-factor authentication is enabled for email).
- ✓ What systems and technologies are used to initiate, authorize and process requests related to changes to vendor master data?
- ✓ Are authentication protocols defined to verify modifications to vendor master data (e.g., call back procedures, multi-factor authentication)?

Question 7 **(MTP M25 S1 5M)**

ABC Bank recently faced a cyber-attack where hackers attempted to steal customer data. This raised concerns about their cybersecurity measures. Regulators now require financial institutions to assess their cyber risk management and improve their defence against such threats.

To handle cyber risks effectively, it is important to understand its key stages. Elucidate the stages of cyber risks that any organisations should focus on?

Answer:

There are 3 Stage of cyber risk :

Stage 1 - Assessing the cyber risk: No organisation is completely immune to a cyber risk. Different clients will have different levels of risks, even with the same industry. Every organisation should consider at least the common threats-

- ✓ Ransomware disabling their organisation (including their plants and manufacturing facilities).

- ✓ Common criminals using email phishing and hacks for fraud and theft.
- ✓ Insiders committing malicious activities or accidental activities resulting in unintended discourse of information theft and frauds.

Stage 2 - Impact of cyber risk: Cyber-attack can impact one, two or more types of risks. The impact of the attack would vary from organisation to organisation and most importantly from attack to attack. Some of the indicative areas can be –

- ✓ Regulatory costs.
- ✓ Business interruptions causing an operational challenge for an organisation.
- ✓ Data loss, reputational loss and litigation.
- ✓ Ransomware - more common these days where entire systems are encrypted.
- ✓ Intellectual property theft which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
- ✓ Incident response cost which could be for investigations & remediations.
- ✓ Breach of Privacy, if personal data of a consumer is hacked it could have a significant impact on the organisation.
- ✓ Fines and penalties.

Stage 3 - Managing cyber risk: A strategic approach to cyber risk management can help an organisation to:

- ✓ Gain a holistic understanding of the cyber risks, threats facing their organisation and other financial institutions.
- ✓ Assess existing IT and cybersecurity program and capabilities against the relevant regulatory requirements.
- ✓ Align cybersecurity and IT transformation initiatives with strategic objectives and critical risks.
- ✓ Understand accepted risks & documented compensating controls.

Question 8 **(MTP M25 S2 5M)**

Focus Ltd. is a manufacturing company that is planning to implement a new digital system to streamline its production processes and improve efficiency. The company appointed Mr. Raman as IT manager. However, he is aware that merging technologies can bring significant benefits but also pose various risks to the
organisation. In this context, he needs to identify examples of technological risks associated with the implementation of the new digital system and the control considerations necessary to mitigate these risks effectively.

Answer:

Some examples of technology risks where Mr. Raman should test the appropriate controls for relying on the digital systems:

- ✓ Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- ✓ Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non- existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database).
- ✓ The possibility of information technology personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby leading to insufficient segregation of duties.
- ✓ Unauthorized or erroneous changes to data in master files.
- ✓ Unauthorized changes to systems or programs.

- ✓ Failure to make necessary or appropriate changes to systems or programs.
- ✓ Inappropriate manual intervention.
- ✓ Potential loss of data or inability to access data as required.
- ✓ Risks introduced when using third-party service providers.
- ✓ Cybersecurity risks.

Mr. Raman should focus on the following control considerations to mitigate risks effectively:

1. Auditors should gain a holistic understanding of changes in the industry and the information technology environment to effectively evaluate management's process for initiating, processing, and recording transactions and then design appropriate auditing procedures.
2. Auditors, as appropriate, should consider risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional, legacy systems.
3. Auditors should consider whether digital upskilling or specialists are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.

Question 9 **(PYP May 25 4M)**

Metaverse is the emerging 3-D digital space that uses virtual reality, augmented reality, and other advanced internet technology to allow people to have lifelike personal and business experiences online. It represents a convergence of digital technology to combine and extend the reach and use of Cryptocurrency, Artificial Intelligence (AI), Augmented Reality (AR) and Virtual Reality (VR).

State the key considerations for sustainable future of Metaverse.

Answer:

Considerations for sustainable future of the Metaverse:

- ✓ Beyond cryptocurrencies, coins, and exchanges, players in the Metaverse will need to consider how to build digital monetary systems and apply economic principles to things like digital land.
- ✓ Governance models will become ever more difficult to balance openness and user contribution with strategic direction and innovation.
- ✓ Identity in the digital world has historically been different based on the platform utilized. The practical challenge of identity will also have to be considered in the Metaverse (e.g., KYC).
- ✓ Synchronicity is the ability for aspects of the Metaverse to be multiplayer, simultaneous, and real-time. This includes transactions and actions happening in the Metaverse and are dependent on the infrastructure of digital economies, networking, and computing power required to operate a digital world.

Test Your Understanding from ICAI SM

Test Your Understanding 1.

CA. Mukund is in the second year of his term as statutory auditor of Style Marks Limited (Holding company), its subsidiaries and joint ventures. At the time of planning the audit, he wants to be sure that all the components have been included in the consolidated financial statements. List out some procedures he should perform to verify completeness of this information.

Answer:

The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion. In respect of completeness of this information, the auditor should perform the following procedures:

a. review his working papers for the prior years for the known components
b. review the parent's procedures for identification of various components
c. make inquiries of management to identify any new components or any component which goes out of consolidated financial statements
d. review the investments of parent as well as its components to determine the shareholding in other entities
e. review the joint ventures and joint arrangements as applicable
f. review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group
g. review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013
h. Also identify the changes in the shareholding that might have taken place during the reporting period.

Test Your Understanding 2.

CA. Kajal is nearing completion of the audit of consolidated financial statements of Rubic Paints and Chemicals Limited. She requires written representations from the parent's management on matters material to the consolidated financial statements. What specific matters can such written representations include?

Answer:

The auditor of the consolidated financial statements should obtain written representations from parent's management on matters material to the consolidated financial statements. Examples of such representations include:

a. Completeness of components included in the consolidated financial statements;
b. Identification of reportable segments for segment reporting
c. Identification of related parties and related party transactions for reporting
d. Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions.

Test Your Understanding 3. Exceptional

CA.M is auditor of consolidated financial statements of "D and D Limited" for year 2023-24. The consolidated financial statements consist of financial statements and financial information of 8 subsidiaries audited by other auditors. Such financial statements, financial information and auditor's reports of subsidiaries have been furnished by management of the "D and D Limited" to him. Following further information is also available in respect of these 8 subsidiaries for year 2023-24: - Total assets Rs.1500 crore,Total revenues Rs.1000 crore, Net cash outflows Rs.10 crore. Two of these subsidiaries are located outside India whose financial statements have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries. Where and how should such information be included in the independent auditor's report on consolidated financial statements of company? Also draft a suitable para by making necessary assumptions.

Answer:

In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, then as prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditors. This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

It should be included in Other Matter paragraph of independent auditor's report. The draft "Other Matter Paragraph" is as under :-

Other Matter Paragraph

We did not audit the financial statements and other financial information, in respect of eight (8) subsidiaries, whose financial statements include total assets of Rs.1500 crores as at March 31, 2023, and total revenues of Rs.1,000 crores and net cash outflow of Rs. 10 crores for the year ended on that date. These financial statements and other financial information have been audited by other auditors and such financial statements, other financial information and auditor's reports have been furnished to us by the management of the Holding Company.

Our opinion on the consolidated financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and joint ventures, and our report in terms of sub-sections (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries is based solely on the reports of such other auditors.

Two of these subsidiaries are located outside India whose financial statements and other financial information have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries. The Holding Company's management has converted the financial statements of such subsidiaries from accounting principles generally accepted in their respective countries to accounting principles generally accepted in India.

We have audited these conversion adjustments made by the Holding Company's management. Our opinion in so far as it relates to the balances and affairs of such subsidiaries is based on the report of other auditors and the conversion adjustments prepared by the management of the Holding Company and audited by us. Our opinion on the consolidated financial statements, and our report on Other Legal and Regulatory Requirements is not modified in respect of the above matters with respect to our reliance on the work done and the reports of the other auditors and the financial statements and other financial information certified by the Management.

Test Your Knowledge

Case Study - Consolidation of Financial Statement of a Subsidiary

Parent Ltd acquired 51% shares of Child Ltd during the year ended 31-3-2024. During the financial year 2023-24, 20% shares of Child Ltd were sold by Parent Ltd. Parent Ltd while preparing the financial statements for the year ended 31-3-2023 and 31-3-2024 did not consider the financial statements of Child Ltd for consolidation. As a statutory auditor how would you deal with it?

Provisions & Explanation:

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 of consolidated financial statements provided in Schedule III to the Act.

Conclusion: In the given case, Parent Ltd acquired 51% shares of Child Ltd during the year ended 31.03.2023 and sold 20% shares during the year ended 31.03.2024. Parent Ltd did not consolidate the financial statements of Child Ltd for the year ended 31.03.2023 and 31.03.2024.

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. Parent Ltd is required 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".

Test Your Knowledge

Question 1

Whether preparation of consolidated financial statements is mandatory? If yes, please elaborate on the requirements under the statute.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 2

Please elaborate on the situations wherein the requirement related to preparation of consolidated financial statements may not apply.

Answer:

The requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:

i. It is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

ii. It is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

iii. Its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Question 3

While doing the audit of Consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 4

Write a short note on:

(a) Responsibility of holding company for preparation of Consolidated Financial Statements.

(b) Permanent Consolidated Adjustments.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 5 Exceptional

R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?

Answer:

Consolidation of Financial Statement: 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. 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".

However, as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act. In the given case, R Ltd's intention is to dispose off the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is temporary, Therefore, R Ltd. is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110.

Question 6 Exceptional

A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd, what factors would be considered by you as the statutory auditors of A Ltd. for the audit of its consolidated financial statements prepared under Ind AS?

Answer:

10% Voting Power and Control over the composition of Board of Directors: In this case, A Ltd. holds only 10 percent of the voting power but has control over the composition of the Board of Directors of B Ltd.

In such a case, A Ltd. shall be considered as a parent of B Ltd and, therefore, it would consolidate B Ltd. in its consolidated financial statements as a subsidiary.

The auditor should verify A Ltd.'s management's assessment of having control in B Ltd. despite having only 10% voting power as per the requirements of Ind AS 110. Auditor would need to verify as to how A Ltd. controls the composition of the Board of Directors or corresponding governing body of B Ltd.

There can be various means by which such kind of control can be established. In this regard, the auditor may verify the minutes of Board meetings, shareholder agreement entered into by the parent, agreements with B Ltd. to which the parent might have provided any technology or know how, enforcement of statute, etc.

Further, the auditor should verify that the adjustments warranted by Ind AS 110 have been made wherever required and have been properly authorised by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments. The auditor should make plan, among other things, for the understanding of accounting policies of the A Ltd. and B Ltd. and determining and programming the nature, timing, and extent of the audit procedures to be performed etc.

Further, the duties of an auditor with regard to reporting of transactions with any other related parties are given in SA 550 on Related Parties. As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity are considered as Related Party.

In forming an opinion on the financial statements, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with Ind AS 110 and Schedule III and whether the effects of the related party relationships and transactions prevent the financial statements from achieving true and fair presentation (for fair presentation frameworks) or cause the financial statements to be misleading (for compliance frameworks).

Question 7

You are appointed as an auditor of Nawab Limited, a listed company who is a main supplier to the UK building and construction market. With a turnover of Rs.2.9 billion, the company operates through 11 business units and has nearly 180 branches across the countries.

As an auditor, how will you draft the report in case:

a. When the Parent's Auditor is also the Auditor of all its Components?

b. When the Parent's Auditor is not the Auditor of all its Components?

c. When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent?

d. When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?

e. Where the financial statements of one or more components not audited?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 8

M Ltd. acquired 51 % shares of S Ltd. on 01-04-2023 and sold 25% of these shares during the financial year 2023-24. M Ltd. did not prepare Consolidated Financial Statements for the financial year 2023-24 on the plea that the control was only temporary. Do you agree with the view of M Ltd.? Decide, assuming, that M Ltd. is required to prepare its financial statements under Ind AS.

Answer:

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

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".

In the given case, M Ltd. acquired 51% shares of S Ltd. on 01.04.2023 and sold 25% shares during the year ended 2023-24. M Ltd. did not consolidate the financial statements of S Ltd. for the year ended 31.03.2024 on the plea that control was only temporary. The intention of M Ltd. is quite clear that the control in S Ltd. is temporary as the former company disposed off the acquired shares in the same year of its purchase.

However, even though the intention of M Ltd. is for temporary holding of shares in S Ltd. as per Ind AS, M Ltd. is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110. However, "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". Here, due to sale of investment in S Ltd. up to 25%, M Ltd. loses control of S Ltd.

Accordingly, M Ltd. is required to prepare a consolidated statement till the date of disposal of the 25% shares to comply with the same.

Question 9 Exceptional

H Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your views.

Answer:

Consolidated Financial Statements: According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

However, an investment entity need not present consolidated financial statements if it is required, in accordance with Ind AS 110'Consolidated Financial Statements', to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

(An investment entity is an entity that(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.)

In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated, then list should be disclosed in notes to accounts with reason.

Question 10 Exceptional

Venus Ltd. is a company engaged in the manufacture of stainless steel items. The company operates through 5 business units and has 35 branches across India. Manglam & Associates are being appointed as the principal auditor of the company. While accepting the audit assignment as the principal auditor, what will be the points of consideration for the principal auditor of the company?

Answer:

Acceptance as Principal Auditor: The principal auditor, Manglam & Associates, should consider whether their own participation is sufficient to be able to act as the principal auditor. For this purpose, the auditor would consider:

(a) the materiality of the portion of the financial information which the principal auditor audits;

(b) the principal auditor's degree of knowledge regarding the business of the components;

(c) the risk of material misstatements in the financial information of the components audited by the other auditor; and

(d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

Question 11 **Newly Added**

R Limited is a listed company engaged in manufacture of round bars. The company is having investment in the following components:
(i) 2 Subsidiary Companies
(ii) 1 Joint Venture Company
(iii) 2 Associate Companies
(iv) 3 Business entities under common control
(v) Interest in assets, liabilities, revenues, and expenses in a joint operation with 1 Company
R Limited and all its components are required to present their accounts as per Ind AS. While preparing consolidated financial statements, R Limited consolidated its components on a line-by-line basis by adding together like items of assets, liabilities, income, expenses, and cash flows.
R Limited seeks your advice on the accounting treatment in respect of the above components for consolidation in accordance with the Companies (Indian Accounting Standards) Rules, 2015.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

In the given situation, R Limited is, a listed company having investment in the (i) 2 Subsidiary Companies, (ii) 1 Joint Venture Company, (iii) 2 Associate Companies, (iv) 3 Business entities under common control, (v) Interest in assets, liabilities, revenues, and expenses in a joint operation with 1 Company. R Limited and all its components are required to present their accounts as per Ind AS. In view of above, R Limited consolidated its components on a line-by-line basis by adding together like items of assets, liabilities, income, expenses, and cash flows while preparing its consolidated financial statements which is correct for the subsidiaries, however the treatment is not correct for other components as per above mentioned Companies (Indian Accounting Standards) Rules, 2015.

Question 12 **Newly Added**

CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India.
The Auditors are duly appointed for all the subsidiaries and branches. What should be the considerations of CA H regarding determination of materiality during the audit of consolidated financial statements? How he should deal in his report if there are observations (for instance modification and/or emphasis of matter paragraph in accordance with SA 705/706) made by component auditors?

Answer:

CA H should consider the requirement of SA 600, "Using the Work of Another Auditor", if he decides to use the work of another auditor in relation to the audit of consolidated financial statements and he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

i. The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.
ii. The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should

scope in additional components, and consider using the work of other auditors as applicable.

iii. The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS.

iv. The principal auditor also obtains certain confirmations from component auditors like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 need to be considered i.e. CA H (the parent auditor) should comply with the requirements of SA 600, “Using the Work of Another Auditor”.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 2 Nov '24 5M)**

Girdhar Ltd. owns 61% voting power in Meera Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. Girdhar Ltd. represents that while preparing Consolidated Financial Statements, Meera Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?

Answer: Similar to TYK Qn covered above

Question 2 Exceptional **(PYP May '24 5M)**

R Limited is a listed company engaged in manufacture of round bars. The company is having investment in the following components:

(i) 2 Subsidiary Companies

(ii) 1 Joint Venture Company

(iii) 2 Associate Companies

(iv) 3 Business entities under common control

(v) Interest in assets, liabilities, revenues, and expenses in a joint operation with 1 Company

R Limited and all its components are required to present their accounts as per Ind AS. While preparing consolidated financial statements, R Limited consolidated its components on a line-by-line basis by adding together like items of assets, liabilities, income, expenses, and cash flows.

R Limited seeks your advice on the accounting treatment in respect of the above components for consolidation in accordance with the Companies (Indian Accounting Standards) Rules, 2015.

Answer: Already covered in TYK Qn

Question 3 **(MTP M25 S2 5M)**

L & K Investments Ltd. is a company having paid up share capital of Rs. 1 Crore, it has a subsidiary, Wealth Fund Management Ltd. The primary business of L & K Investments Ltd. is to pool funds from investors on a collective basis and invest this money in various financial instruments. The company pooled Rs. 12 Crore from a number of clients, which represent the company's shareholders.

During the audit of L & K Investments Ltd., CA Shiv observed that whole amount of Rs. 12 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company.

CA Shiv raised an issue while auditing financial statements of L & K Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013? Analyse the above issue and give your opinion.

Answer: Already covered in TYK Qn

Applying the above to the given case of L & K Investment Ltd., which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 and 33 of Ind AS 110, it can be concluded that L & K Investment Ltd. is not required to consolidate as per Section 129 (3) of the Companies Act, 2013.

Exceptional Questions

Question 1.

A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd., what factors would be considered by you as the statutory auditors of A Ltd for the audit of its consolidated financial statements prepared under Ind AS?

Answer: Already covered in TYK Qn

Test Your Understanding from ICAI SM

Test Your Understanding 1.

CA Harshit is conducting statutory audit of branch of a public sector bank. On examining 20 large advances of the branch, he finds that in 5 examined cases, loan applications have been filled up incompletely with important details left out. In these cases, it is also noticed that cash credit limits to the borrowers were enhanced during the year but there are no records pertaining to assessment of enhanced working capital requirements in respective borrower files. The branch is unable to show such assessments/workings in system either. However, all the five accounts are operating satisfactorily. These accounts have been classified as standard assets by branch. Would the above information prompt auditor to suggest change in asset classification of above accounts? What does the depicted situation reflect?

Answer:

An account becomes NPA when it ceases to generate income for the bank. In the given situation, all the five accounts examined are operating satisfactorily. There is no reason for suggesting changes in their classification.

The matter of incompletely filling up loan applications and lack for record for assessment of enhanced working capital requirements shows that internal control over advances in branch is not proper. The above said situation shows deficiencies in "credit appraisal" at branch level. Such deficiencies need to be highlighted by the auditor in LFAR.

Test Your Understanding 2.

You are conducting a concurrent audit of a branch of a public sector bank. It is a large branch having advances of about Rs.500 crores including export advances of Rs.300 crores. Some borrowers also get LCs issued from branch for importing raw diamonds from diamond hubs of Belgium. You want to be sure that there is no revenue leakage in the branch. For the time being, you are focusing upon advances. Discuss any five areas pertaining to advances of the branch which you would verify to ensure no revenue leakage.

Answer:

The areas of advances which need to be verified are as under: -

i. Interest rates fed in the system need to be verified with respect to corresponding sanction letters. It would help ensure that correct rate of interest is fed into the system, and interest is applied properly at stipulated intervals on advances.

ii. Processing fees in respect of freshly sanctioned advances and renewed limits need to be levied in accordance with bank guidelines and these need to be verified. Any revision in processing fees from time to time has to be given effect to in accordance with circulars/manual of bank.

iii. Sanction of cash credit limits is generally accompanied with stipulation to submit stock statements. Non-submission of stock statements can involve levying penal interest. Verification of this aspect is required.

iv. Verification of overdue interest on export bills purchased and packing credit facilities for overdue period.

v. Verification of charges/commission in respect of letters of credit issued in accordance with Bank's circulars / manual.

Test Your Understanding 3.

CA Seema is appointed as stock auditor of Bhawani Rice Mills Pvt. Ltd. availing credit facilities from R.K. Puram Branch, Near Tamil Educational Society, New Delhi. The borrower is enjoying a cash credit limit of Rs.12 crore from branch against security of paid stocks and debtors up to 90 days against margin of 25%. She proceeds to visit the premises of Bhawani Rice Mills Pvt. Ltd. located on outskirts of Delhi. She verifies books of accounts and stock records of the company and also test checks quantity of paddy and rice of 20000 quintals and 8000 bags lying in premises of the company. The drawing power of Rs.12.05 crore is computed in stock audit report and report stands submitted to bank. After about a week, regular internal inspector appointed by Inspection department of bank also happened to visit premises of the borrower and found that rice contained in about 5000 bags included in stocks having approx. value of Rs.1.50 crore was fungus ridden. The company has been holding this stock for the last 15 months. How do you view the above situation? Discuss.

Answer:

The above situation reflects that the professional work of stock audit was not performed diligently by stock auditor. It is one of the important responsibilities of stock auditor to verify condition of stocks. The auditor's role is not limited to verifying physical quantities only.

In a given case, she should have got opened rice bags on test check basis. In the process, she could have come to know about fungus ridden condition of rice. The value of such rice should have been excluded while arriving at value of stocks for purpose of computation of drawing power. It shows that she has failed to perform her work diligently and drawing power calculated in the report submitted to bank is not proper.

Test Your Knowledge

Question 1

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. Your Audit Manager informed you that the bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year. Comment.

Answer:

Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This is also in accordance with AS 9. In this case the dividends have been declared after the financial year end. Therefore, the recognition of income by the bank on accrual basis is not in order.

In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government.

Question 2

As statutory central auditors of a Nationalized bank, what special points are to be borne in mind in the audit of compliance with "Statutory Liquidity Ratio" (SLR) requirements?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 3

Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India guidelines.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 4 Exceptional

In course of audit of Good Samaritan Bank as at 31st March, 24 you observed the following:

(a) In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government?

(b) The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write a suitable audit program to verify these advances.

Answer:

(a) Government Guaranteed Advance: If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized. However, for the purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not invoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by the State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

(b) The Audit Programme to Verify Advances against Life Insurance Policies is as under-

i. The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer.

ii. The auditor should also examine whether premium has been paid on the policies and whether they are in force.

iii. Certificate regarding surrender value obtained from the insurer should be examined.

iv. The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

Question 5 Exceptional

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The bank is a consortium member of Cash Credit Facilities of Rs.50 crores to X Ltd. Bank's own share is Rs.10 crores only. During the last two quarters against a debit of Rs.1.75 crores towards interest the credits in X Ltd's account are to the tune of Rs.1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing. The Bank follows financial year as accounting year. Advise your views on the issue which were brought to your notice by your Audit Manager.

Answer:

The bank is a consortium member of cash credit facilities of Rs.50 crores to X Ltd. Bank's own shares are Rs.10 crores only. During the last two quarters, against a debit of Rs.1.75 crores towards interest, the credits in X Ltd.'s account are to the tune of Rs.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.

Question 6

You have been appointed as an auditor of LCO Bank, a nationalized bank. LCO Bank also deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over storage and issue of credit cards. How will you evaluate the Internal Control System in the area of Credit Card operations of a Bank?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 7

You have been appointed as Concurrent Auditor of a nationalized bank branch. The main business at the branch is dealing in foreign exchange. Suggest the main areas of coverage with regard to foreign exchange transactions of the said branch under concurrent audit.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 8

While auditing FAIR Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks. Kindly guide.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 9

ABC Chartered Accountants have been appointed as concurrent auditors for the branches of Effective Bank Ltd. for the year 2023-24. You are part of the audit team for the Agra branch of the bank and have been instructed by your senior to verify the advances of the audit period. You are required to guide your assistant about the areas to be taken care of while doing verification during the concurrent audit.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 10

In the course of audit of Skip Bank Ltd., you found that the Bank had sold certain of its non-performing assets. Draft the points of audit check that are very relevant to this area of checking.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 11

Banks, because of certain characteristics, are distinguished from other commercial enterprises and hence it needs special audit consideration. As an auditor of a bank, specify the various peculiarities which may necessitate special audit consideration to be taken care by you?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 12 Exceptional

ABC Bank had sanctioned credit limits of Rs.100 lakh to M/s Volkart Ltd on 1st September 2021. The renewal of limits was due on 1st September 2023. While doing the statutory branch audit for the year ended 31st March 2024, you find that the renewal has not been done even though 180 days are over. The bank says that the renewal process has been initiated on time and most of the documents are received. The account is operated regularly and is in order; balance is maintained within drawing power. It also shows a letter from Volkart stating that due to a sudden death of their auditor, a new auditor had to be appointed. Procedure for appointment took some time and the new auditor was doing the audit all over again. The limit was not renewed till 31st March 2024. However, the audited financials are received on 10th April 2024 and the renewal letter was issued immediately. Your assistant is insisting that the account must be classified as NPA since the limit was not renewed as on 31st March 2024. What is your opinion?

Answer:

As per Guidelines of Reserve Bank of India the account should be classified as NPA if renewal is not done in 180 days. However, in the present case, operations in the account are excellent. The bank has shown a letter from that company that due to certain reasons the audited financial statements are delayed. Further, the limit has been renewed before signing the audit report.

Thus, even if the sanction was issued after the balance sheet date, it relates to the position as on the balance sheet date. Therefore, it is an adjusting event under AS 4, Contingencies and Events Occurring After the Balance Sheet Date. It is also a matter of substance over form.
The auditor would consider classifying the account as a standard asset.

Question 13 Exceptional

You are auditing a small bank branch with staff strength of the manager, cashier and three other staff S1, S2 and S3. Among allocation of work for other areas, S1, who is a peon also opens all the mail and forwards it to the concerned person. He does not have a signature book so as to check the signatures on important communications. S2 has possession of all bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.

Answer:

Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. Given below are examples of internal controls that are violated in the given situation:
In the instant case, S1 who is a peon opens all the mail and forwards it to the concerned person. Further, he does not have a signature book so as to check the signatures on important communications is not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.
All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery. In the given case, S2 has possession of all bank forms (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis.
Further, contention of bank that being a small branch with shortage of manpower they are not able to check the work and records on regular basis, is not tenable as such lapses in internal control pose risk of fraud.
The auditor should report the same in his report accordingly.

Question 14 Exceptional **Newly Added**

NRF Bank Ltd. is suffering from huge number of NPAs. During the month of April 2024, the management of the bank decided to sell some of its NPAs. Bank is doing this exercise for the first time. The management has selected following NPA accounts for sale:

Name	NPA since F.Y.	Amount (Rs. In Lakh)
Fin Pvt. Ltd.	2020-21	36.55
Dairy Works	2022-23	55.24
Book Store	2019-20	29.85
Fancy Corp.	2018-19	61.42
RSM and Associates	2021-22	19.25

Being internal auditor of the bank, you are required to scrutinize the proposal made by the branch and help them by providing specific points to be considered.

Answer:

In case of Sale of NPA by Bank, the auditor should examine that:

- ✓ The policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers including non- performing financial assets that may be sold, norms for such sale, valuation procedure and accounting policy.
- ✓ Only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- ✓ The assets have been sold "without recourse' only i.e., the entire credit risk associated with the non -performing asset should be transferred to the purchasing bank.
- ✓ Subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- ✓ The NPA has been sold at cash basis only. Under no circumstances, NPA can be sold to another bank at a contingent price. The entire sale consideration has to be received on upfront basis.
- ✓ The bank has not purchased an NPA which it had originally sold.
- ✓ On the sale of the NPA, the same has been removed from the books of the account of selling bank on transfer.
- ✓ If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.
- ✓ If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/ loss on account of sale of other non-performing financial assets.

In the given situation, management of NRF Bank Ltd. is considering to sell following NPAs, during the month of April, 2024:

Name	NPA since F.Y.	Amount (₹ in lakh)
Fin Pvt. Ltd.	2020-21	36.55
Dairy Works	2022-23	55.24
Book Store	2019-20	29.85
Fancy Corp.	2018-19	61.42
RSM and Associates	2021-22	19.25

In view of above-mentioned conditions, the auditor is required to ensure that only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.

Considering the facts given in the question all the NPAs, except for Dairy Works, are prior to April 2021 i.e., 2 years prior to April 2024. In view of the above provisions, management of NRF Bank Ltd. can sell all the NPAs except for NPA of 55.24 lakh rupees of Dairy Works as it has remained NPA in the books of the banks less than 2-year duration.

Question 15 Exceptional **Newly Added**

PDSJ & Associates are Statutory Auditors of a scheduled Commercial Bank for the year 2023-24. While evaluating internal control over advances, it came to their notice that classification of term loan borrower accounts into SMA as well as NPA is done in the system on the following lines:

- ✓ In case full dues are not received on a particular due date, a borrower account is immediately considered as overdue on the very next day. For example, if due date of loan account is 31st March, 2023 and dues are not received on 31st March, 2023, it shall be considered as overdue on 1st April, 2023.
- ✓ If it continues to remain overdue, then account is tagged as SMA-1 on 1st May, 2023.
- ✓ If it continues to remain overdue further, then account is tagged as SMA-2 on 31st May, 2023.

✓ If it continues to remain overdue even after being tagged as SMA-2, it is classified as NPA on 30th June, 2023.

Evaluate above control designed by bank in the system for the purpose of exercising control over such advances in compliance with regulatory guidelines.

Answer:

The design of the above control instituted by the bank in its system is not in accordance with the regulatory guidelines. Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date which is fixed by the bank, the borrower accounts are flagged as overdue by the banks as part of their day-end processes for the due date.

Classification of borrower accounts as SMA as well as NPA is done as part of day-end process for the relevant date. SMA or NPA classification date is the calendar date for which the day end process is run. In other words, the date of SMA/NPA reflects the asset classification status of an account at the day-end of that calendar date.

In the given situation, the due date of a loan account is March 31, 2024, and full dues are not received by the bank before it runs the day-end process for this date, the date of overdue shall be March 31, 2024, and not 1st April, 2024.

If it continues to remain overdue, then this account shall get tagged as SMA-1 upon running day-end process on April 30, 2024 [i.e. upon completion of 30 days of being continuously overdue]. Accordingly, the date of SMA-1 classification for that account shall be April 30, 2024.

Similarly, if the account continues to remain overdue, it shall get tagged as SMA-2 upon running day-end process on May 30, 2024, and if continues to remain overdue further, it shall get classified as NPA upon running day-end process on June 29, 2024.

Question 16 Exceptional **Newly Added**

RML & Associates are one of the joint auditors of IND Bank for the year 2023-24. While auditing IND Bank, they are analysing industry data relating to NPAs in select public sector banks as part of risk assessment procedures:

Name of Bank	Gross NPAs (in Rs.crore)	Net NPAs (in Rs.crore)	Ratio of Net NPAs to Net advances
BIC Bank	55,000	13,000	1.72%
ABD Bank	45,000	10,000	2.34%
RIN Bank	55,000	18,000	2.65%
IND Bank	28,000	6,500	3.97%
CRB Bank	35,000	8,800	2.27%

In the above context, what do you understand by "Gross NPAs" and "Net NPAs" as on reporting date in the context of financial statements of a Bank? As an auditor of IND Bank, what inference would you draw by comparing the "Ratio of net NPAs to net advances" with other public sector banks?

Answer:

Gross NPAs represent opening balances of NPAs as increased by fresh NPAs during the year and reduced by upgradations, recoveries and write-offs during the year.

Net NPAs are arrived at after deducting amounts on account of the total provision held against NPAs, balance in the interest suspense account to park accrued interest on NPAs and certain other adjustments.

The Net NPAs to Net advances ratio is higher in the case of IND Bank as compared to other public sector banks. This indicates that there is a risk that the bank may not have made the required provisions in accordance with RBI guidelines. A higher net NPAs to Net advances ratio indicates the probability and risk of under-provisioning. Keeping in view of the above, audit procedures have to be tailored towards the examination and verification of this crucial area.

Question 17 **Newly Added**

CA J is the statutory auditor of the branch of a nationalized bank. During the audit, he is also focusing upon verification of Current Accounts & Savings Accounts (CASA) maintained at the branch. Suggest a few audit procedures he should follow.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

CA J is the statutory auditor of branch of a nationalized bank. During the audit, he is also focusing upon verification of Current Accounts & Savings Accounts (CASA) maintained at the branch. Suggest a few audit procedures he should follow.

Answer:

Audit procedure to verify Current Accounts and Saving Accounts are:

- ✓ Verify on a sample basis current account and saving accounts opened during the year for adherence to KYC norms. Verify that saving accounts are opened in name of individuals, HUF, some approved institutions like trusts, educational institutes etc. Remember that saving accounts are not opened for business or professional concern. The business transactions are carried in current accounts which can be opened for all kind of customers like companies, individuals, partnership firms etc.
- ✓ Verify the balances in individual accounts on a sample basis.
- ✓ Check the calculations of interest on a test check basis. Remember that no interest is paid generally on current accounts by banks.
- ✓ Examine whether the procedure for obtaining balance confirmation periodically has been followed consistently. Examine, on a sampling basis, the confirmations received.
- ✓ Ensure that debit balances in current accounts are not netted out on the liabilities side but are appropriately included under the head 'advances'.
- ✓ Inoperative accounts (both current and saving) are a high-risk area of frauds in banks. As per RBI guidelines, a savings/ current transactions in the account for over a period of two years. Verify on a sample basis some of inoperative accounts revived/closed during the year. Ensure that inoperative accounts are revived only with proper authority. In this regard, cases where there is a significant reduction in balances of such accounts as compared to previous year, examine authorisation for withdrawals.

Question 2 **(Model TP 5M)**

CA. Ankit is conducting concurrent audit of branch of a public sector bank. It is a large branch having advances of about Rs.525 crores including export advances of Rs.450 crores. Some borrowers also get Letter of Credits issued from branch for importing gold from Dubai. He wants to be sure that there is no revenue leakage in branch. For the time being, he is focusing on advances. Discuss any five areas pertaining to advances of the branch.

Answer: Already covered in TYU Qn

Question 3 **(MTP M25 S1 4M)**

PMP Bank Ltd., received an application from a pharmaceutical company for the takeover of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. PMP Bank Ltd., requires CA Arpan to conduct due diligence for valuation aspect of assets of the pharmaceutical company. State the areas of analysis in order to ensure that the assets are not overvalued

Answer:

Areas of analysis in order to ensure that the assets are not stated at overvalued amounts Over-Valued Assets are:

- ✓ Uncollected/uncollectable receivables.
- ✓ Obsolete, slow non-moving inventories or inventories valued above NRV, huge inventories of packing

materials etc. with name of company.

- ✓ Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- ✓ Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- ✓ Litigated assets and property.
- ✓ Investments carried at cost though realizable value is much lower.
- ✓ Investments carrying a very low rate of income / return.
- ✓ Infructuous project expenditure/deferred revenue expenditure etc.
- ✓ Group Company balances under reconciliation etc.
- ✓ Intangible assets of no value.

Question 4 **(MTP M25 S2 5M)**

You have been appointed as Concurrent auditor of a branch of Silver Bank Ltd., which primarily deals in foreign exchange transactions. During the audit, you noticed discrepancies in certain inward and outward remittances, as well as unusual fluctuations in Nostro account balances. What audit procedures would you implement to verify the accuracy and compliance of foreign exchange transactions of this branch.

Answer:

Suggested audit procedure to be covered by the Concurrent Auditor to check the foreign exchange transactions of a branch of Silver Bank Ltd. is given hereunder:

- ✓ Check foreign bills negotiated under letters of credit.
- ✓ Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.
- ✓ Check whether inward/outward remittance have been properly accounted for.
- ✓ Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorized and necessary charges have been recovered.
- ✓ Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.
- ✓ Ensure that the overbought/oversold position maintained in different currencies is reasonable, considering the foreign exchange operations.
- ✓ Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations.
- ✓ Ensure verification/reconciliation of Nostro and Vostro account transactions/ balances.

Question 5 **(PYP May 25 5M)**

During the statutory audit of ELITE Bank Ltd., a leading private sector bank, for the financial year 2024-25, the following issue emerged to statutory central auditors. ELITE Bank Ltd. acquired a commercial property in satisfaction of a loan default by a borrower in Financial Year 2016-2017. The property was recorded at net book value of the loan. The bank plans to sell this property in the next fiscal year to recover its dues. A legal dispute has emerged over the ownership of the property, with a third party claiming partial rights. The matter is pending in court. The management has not disclosed this dispute in the financial statements but contends that a favourable court ruling is expected. The auditor's review reveals that the property's fair market value is significantly lower.

Based on the above facts, you are required to:

(i) Identify specific audit procedure the auditor should undertake to ensure compliance of the Banking

Regulation Act, 1949.

(ii) Under which head ELITE Bank Ltd. should record the above-mentioned property?

(iii) Suggest also other audit procedures that an auditor should focus upon.

Answer:

(i) The auditor should ensure compliance with Section 9 of the Banking Regulation Act, 1949, which restricts a banking company from holding any immovable property, regardless of how it is acquired, including in satisfaction of claims, for a period exceeding seven years from the date of acquisition, unless such property is required for the bank's own use.

(ii) Such property should be classified under the "Other Assets" head in the Schedule to the financial statements by Elite Bank, i.e., Non-Banking Assets Acquired in Satisfaction of Claims.

(iii) Other audit procedures the auditor should focus upon are to:

- ✓ Ensure that the heading includes those immovable properties/tangible assets which the bank has acquired in satisfaction of debts due or its other claims, and these are being held with the intention of being disposed off.
- ✓ Verify such assets with reference to the relevant documentary evidence, e.g., terms of settlement with the party, order of the Court, or the award of arbitration, etc.
- ✓ Check that the ownership of the property is legally vested with the bank. If there is any dispute or other claim about the property, the auditor should examine whether the recording of the asset is appropriate or not. In case the dispute arises subsequently, the auditor should examine whether a provision for liability or disclosure of a contingent liability is appropriate, keeping in view the requirements of AS 29, "Provisions, Contingent Liabilities and Contingent Assets".
- ✓ Ensure that the assets should be recorded at the lower of the net book value of the advance or the net realisable value of the asset acquired on the date of acquisition.

Learn Contextually

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

"Fin crazy" is a P2P online platform owned by Future Technologies Pvt. Limited which is registered with RBI as NBFC. Peer to Peer Platform (P2P) means an intermediary providing the services of loan facilitation via online medium or otherwise to the participants. Participants have to enter into an arrangement with NBFC-P2P to lend on its platform or avail loan facilitation services provided by it. It provides only as a medium connecting lenders and borrowers. It also carries out the credit assessment and risk profiling of the participants on the platform. It also provides services relating to loan documentation and loan recovery. The company falls outside purview of upper layer. Where does such NBFC fit in accordance with scale-based regulations? Suggest a few audit procedures for above NBFC-P2P.

Answer:

NBFC-P2P falls in base layer in accordance with scale-based regulations of RBI. Few audit procedures for NBFC-P2P are as under: -

➢ Gaining an understanding of business conducted by NBFC-P2P. It should be verified that the company undertakes only permissible activities applicable to such type of NBFCs like providing online market place to participants for lending and borrowing. It should not be engaged in the business of lending funds on its own.

- ✓ Verifying certificate of registration obtained from RBI for carrying business of P2P platform.
- ✓ Verifying Board approved policy setting out eligibility criteria for participants i.e lenders and borrowers.
- ✓ Verifying board approved policy for pricing of services provided by P2P platform
- ✓ Verification of adherence to lending and borrowing guidelines prescribed by RBI
- ✓ Verifying appropriate arrangements have been entered into among participants and NBFC-P2P.
- ✓ Compliance with reporting requirements of RBI
- ✓ Verifying board approved policy for grievance redressal and complaints

Test Your Understanding 2.

Sugam Housing Finance Limited is in the business of housing finance activities having asset size of Rs.800 crores. Its principal business is of providing finances for housing mainly to individuals. It is not identified by RBI in upper layer. Under scale-based regulations introduced by RBI, what should be appropriate classification for such a company? Is there any specific reporting requirement under CARO, 2020 for statutory auditor of a company engaged in housing finance activities?

Answer:

The said company is not identified in upper layer by RBI. Under scale-based regulations introduced by RBI, NBFCs undertaking housing finance activities constitute "middle layer". The asset size is not relevant in such a case. All housing finance companies not identified in upper layer would constitute middle layer due to nature of such activities undertaken by them.

There is specific reporting requirement under CARO, 2020 under clause 3 (xvi)(b) which requires auditor to report whether the company has conducted any non-Banking financial or housing finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.

Test Your Understanding 3.

You are auditor of a deposit taking NBFC (NBFC-D). The NBFC is identified by RBI in its upper layer and its financial statements are required to be prepared in accordance with requirements of Ind AS. The following is extract of statement of profit and loss for year ending 31St March, 2024 in accordance with Division III of Schedule III of the Companies Act, 2013. Previous year figures are ignored.

Particulars	Note No.	Figures for year ended 31st March, 2024 (in Rs. Crores)
Revenue from Operations		
(i) Interest income	15	9500
(ii) Dividend income		-
(iii) Rental Income		150
(iv) Fees and commission income	16	100
(v) Net gain on fair value changes	17	150
(vi) Net gain on derecognition of financial instruments under amortised category		
(I) Total revenue from operations		9900
(II) Other Income	18	100
(III) Total Income		10000

On going through details of head "other expenditure" in expenses side of statement of profit and loss, it is noticed that there is an expenditure relating to manpower outsourcing cost amounting to Rs.99.50 crores included under "other expenditure". Does it meet the requirements of Division III of Schedule III of the Companies Act, 2013?

Answer:

An NBFC is preparing financial statements in accordance with requirements of Division III of Schedule III of the Companies Act, 2013 has to separately disclose by way of note any item of "other expenditure" exceeding 1% of total income.

The said expenditure of Rs.99.50 crore does not exceed 1% of total income. Hence, it meets requirements of Division III of Schedule III of the Companies Act, 2013.

Test Your Knowledge

Question 1

Define NBFC. Also give a brief description about types of NBFCs covering any five NBFCs.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 2

Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the requirements related to registration and regulation of NBFCs which an auditor needs to keep in his mind while planning the audit of NBFC which would help this firm.

Answer:

An auditor should know following points regarding registration and regulation of NBFCs: Under Section 45-IA of the RBI Act, 1934, no NBFC shall commence or carry on the business of a non-banking financial institution without

- ✓ obtaining a certificate of registration issued by the RBI; and
- ✓ having a net owned fund (NOF) of Rs.25 lakhs (₹ Two crore since April 1999) not exceeding two hundred lakhs rupees, as the RBI may, by notification in the Official Gazette, specify.

(The RBI (Amendment) Act (1997) provided an entry point norm of Rs.25 lakh as the minimum NOF which was revised upwards to Rs.2 crore for new NBFCs seeking grant of certificate of registration (CoR) on or after 21 April 1999).

A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45-IA of the RBI Act, 1934 can apply to the RBI in prescribed form along with necessary documents for registration. The RBI issues CoR after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.

However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock Broking Companies registered with SEBI, Insurance Company holding a valid CoR issued by IRDA, Nidhi Companies as notified under Section 406 of the Companies Act, 2013, Chit Companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank.

The RBI has issued directions to NBFCs on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.

Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders.

Question 3

Satyam Pvt Ltd is a company engaged in trading activities, it also has made investments in shares of other Companies and advanced loans to group companies amounting to more than 50% of its total assets. However, trading income constitutes majority of its total income. Whether the Company is an NBFC?

Answer:

In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) AND income from financial

assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by Reserve Bank of India.
In the given case, though Satyam Pvt Ltd is fulfilling the criteria on the asset side, but however is not fulfilling the criteria on the income side, the company cannot be classified as a deemed NBFC.

Question 4

Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to the audit of NBFC - Investment and Credit Company (NBFC-ICC).

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 5

You are appointed as the auditor of an NBFC registered with the RBI and which is accepting and holding public deposits. You are considering your reporting requirement in addition to your report made under Section 143 of the Companies Act, 2013 on the accounts of this NBFC as per the prescribed Directions. Please explain what points are required to be known in respect of the separate report to be given by you to the Board of Directors of this NBFC.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 6

Kamna & Co LLP, a firm of Chartered Accountants, was appointed as auditor of an NBFC. The audit work has been completed. The audit team which was involved in the fieldwork came across various observations during the course of audit of this NBFC and have also limited understanding about the exceptions which are required to be reported in the audit report. They would like to understand in detail regarding the obligations on the part of an auditor in respect of exceptions in his report so that they can conclude their work. Please explain.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 7

The Statutory Auditor of the NBFC company is required to give a report to the Board of Directors. What shall be the content of the Auditor's Report to the Board.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

The statutory auditor of Karma Pvt Ltd, being NBFC is required to submit separate report to the Board of Directors on the matters as specified as below:

I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the RBI's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI.

II. In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.

III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.

Apart from the aspects enumerated above, the auditor shall include a statement on the following matters, namely: -

i. Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;
ii. Whether the company has accepted any public deposits during the relevant period/year;
iii. Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023;

Where, in the auditor's report, the statement regarding any of the items referred to matters specified above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred above, his report shall indicate such fact together with reasons thereof.

Question 8

Krishna Pvt Ltd is primarily into the business of selling computer parts. However, the company is fulfilling the Principal Business Criteria as at the balance sheet date i.e. Financial Assets are more than 50% of total assets and Financial Income is more than 50% of Gross Income. What shall be the obligation of the Statutory Auditor in such a scenario?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

In the given case, Krishna Pvt Ltd is fulfilling the Principal Business Criteria i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50 % of Gross Income. The company which fulfils both these criteria shall qualify as an NBFC and hence is required to obtain Certificate of Registration (CoR) with Reserve Bank of India. In such a scenario, the statutory auditor has an obligation to submit exception report to the RBI on the following matters :

I. Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 of the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016, is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:
   a. the provisions of Chapter III B of RBI Act (Act 2 of 1934); or
   b. Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
   c. Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.

   It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

II. The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph

(1) and such report shall not contain any statement with respect to compliance of any of those provisions.

Question 9

Mr. G. has been appointed as an auditor of LMP Ltd., an NBFC company registered with RBI. Mr. G is concerned about whether the format of financial statements prepared by LMP Ltd. is as per notification issued by the Ministry of Corporate Affairs (MCA) dated October 11, 2018. The notification prescribed the· format in Division III under Schedule III of the Companies Act, 2013 applicable to NBFCs complying with Ind-AS. Mr. G wants to know the
differences in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Guide Mr. G.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 10

Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company had net owned funds of Rs.1,50,00,000/-(one crore fifty lakhs) and was not having registration certificate from RBI and applied for it on 30th March 2024. The company appointed Mr. Kabra as its statutory auditor for the year 2023-24. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?

Answer:

As per Clause (xvi) of Paragraph 3 of CARO 2020, the auditor is required to report that "whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained."

The auditor is required to examine whether the company is engaged in the business which attract the requirements of the registration. The registration is required where the financing activity is a principal business of the company. The RBI restricts companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.

Audit Procedures and Reporting:

i. The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
ii. The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
iii. Whether the company has net owned funds as required for the registration as NBFC.
iv. Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.
v. The auditor should report incorporating the following:-
    1. Whether the registration is required under section 45-IA of the RBI Act, 1934.
    2. If so, whether it has obtained the registration.
    3. If the registration not obtained, reasons thereof.

    In the instant case Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of Rs.1,50,00,000/-(one crore fifty lakhs) which is less in comparison to the prescribed limit i.e. 2 crore rupees and was also not having registration certificate from RBI (though applied for it on 30th March 2024). The auditor is required to report on the same as per Clause (xvi) of Paragraph 3 of CARO, 2020.

Question 11 **Newly Added**

Yo-Yo Finance Limited is NBFC-ML as per the revised categorisation of NBFC done by RBI. YAK & Associates, a firm of chartered accountants, are appointed as Statutory Auditors of the Company for the year 2023-24.

The audit team consists of CA Y, 1 Audit Manager and 3 junior assistants. The Audit Manager has been recently appointed, who does not have much exposure in the field of Auditing of NBFCs. During the engagement team meeting, the Audit Manager asked CA Y, regarding the audit procedures to be undertaken to verify whether the aforesaid Company has followed Prudential Norms? As an Engagement partner suggest any four procedures to the Audit Manager.

Answer: Audit procedures to be undertaken by YAK & Associates to verify that Yo-Yo Finance Limited has followed NBFC Prudential Norms:

i. Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans and investments for failure to repay public deposits and norms for concentration of credit/investments.
ii. An auditor should ensure that the Board of Directors of every NBFC granting/intending to grant demand/call loans shall frame and implement a policy for the company.
iii. An auditor should assess on the basis of examinations conducted by him whether the NBFC has complied with the prudential norms. In particular, he should verify that advances and other credit facilities have been properly classified as standard/substandard/doubtful/loss and that proper provision has been made in accordance with the Directions.
iv. In respect of Non-Performing Assets, an auditor should check whether the unrealized income in respect of such assets has not been taken to the Profit & Loss Account on an accrual basis. Income from NPAs should be accounted for on realization basis only.
v. Check whether all accounts which have been classified as NPAs in the previous year also continue to be shown as such in the current year also. If the same is not treated as an NPA in the current year, the auditor should specifically examine such accounts to ascertain whether the account has become regular and the same can be treated as performing as per the Directions.

Question 12 **Newly Added**

Singh Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by government or local authorities. For the year ended 31st March 2024, the following are some extracts from the financial statements:

i. Paid-up share capital Rs.50 Cr.
ii. Non-Current Assets - Loans & Advances Rs.61.75 Cr.
iii. Current Assets - Loans and advances Rs.312.25 Cr.
iv. Total assets of the company Rs.620 Cr.
v. Intangible assets Rs.12 Cr.
vi. Profit for the Year Rs.7.25 Cr.
vii. Income from interest and dividends Rs.68 Cr.

viii. Gross income Rs.118.75 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise.

Answer:

In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the audited balance sheet of the previous year to decide its principal business. The company will be treated as NBFC when

i. Financial assets of the company constitute more than 50 percent of the total assets (netted off by intangible assets) and

ii. Income from financial assets of the company constitutes more than 50 percent of the gross income.

A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

In the given case of Singh Ltd, its financial assets are ₹ 374 Crore i.e., (₹ 61.75 + ₹ 312.25)

Total Assets (netted off by intangible assets)	= ₹ 608 Crore
Income from financial assets	= ₹ 68 Crore
Gross Income	= ₹ 118.75 Crore

From the above, it can be concluded that financial assets of Singh Ltd. constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets of Singh Ltd. constitutes more than 50 per cent of the gross income. Hence, Singh Ltd. fulfills both the criteria to qualify as an NBFC.

Thus Singh Ltd. can apply for registration under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

Singh Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by government or local authorities. For the year ended 31st March 2024 following are some extracts from the financial statements:

i. Paid-up share capital Rs.50 Cr.
ii. Non-Current Assets - Loans & Advances Rs.61.75 Cr.
iii. Current Assets - Loans and advances Rs.312.25 Cr.
iv. Total assets of the company Rs.620 Cr.
v. Intangible assets Rs.12 Cr.
vi. Profit for the Year Rs.7.25 Cr.
vii. Income from interest and dividends Rs.68 Cr.
viii. Gross income Rs.118.75 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise

Answer: Already covered in TYK Qn

Question 2 **(MTP 2 Nov '24 5M)**

Manu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2019. The company was having net owned funds of Rs. 1,75,00,000/-(one crore seventy-five lakhs) and was not having registration certificate from RBI and applied for it on 29th March 2024. The company appointed Mr. Yuvan as its statutory auditors for the year 2023-24. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?

Answer: Already covered in TYK Qn

Question 3 Exceptional **(MTP 1 May '24 5M)**

RML & Associates are one of the joint auditors of IND Bank for the year 2022-23. While auditing IND Bank, they are analysing industry data relating to NPAs in select public sector banks as part of risk assessment procedures:

Name of Bank	Gross NPAs (in Rs. crore)	Net NPAs (in Rs. crore)	Ratio of Net NPAs to Net advances
BIC Bank	55,000	13,000	1.72%
ABD Bank	45,000	10,000	2.34%
RIN Bank	55,000	18,000	2.65%
IND Bank	28,000	6,500	3.97%
CRB Bank	35,000	8,800	2.27%

In the above context, what do you understand by "Gross NPAs" and "Net NPAs" as on reporting date in the context of financial statements of a Bank? As an auditor of IND Bank, what inference would you draw by comparing the "Ratio of net NPAs to net advances" with other public sector banks?

Answer: Already covered in Bank Audit Chapter

Question 4 **(MTP 2 May '24 5M)**

NRF Bank Ltd. is suffering from huge number of NPAs. During the month of April 2023, the management of the bank decided to sell some of its NPAs. Bank is doing this exercise for the first time. The management has selected following NPA accounts for sale:

Name	NPA since F.Y.	Amount (Rs. In Lakh)
Fin Pvt. Ltd.	2019-20	36.55
Dairy Works	2021-22	55.24
Book Store	2018-19	29.85
Fancy Corp.	2017-18	61.42
RSM and Associates	2020-21	19.25

Being internal auditor of the bank, you are required to scrutinize the proposal made by the branch and help them by providing specific points to be considered.

Answer: Already covered in Bank Audit Chapter

Question 5 **(PYP May '24 4M)**

Yo-Yo Finance Limited is a NBFC-ML as per revised categorisation of NBFC done by RBI. YAK & Associates, firm of chartered accountants, are appointed as Statutory Auditors of the Company for the year 2023-24.

The audit team consist of CA Y, 1 Audit Manager and 3 junior assistants. The Audit Manager is recently appointed, who is not having much exposure in the field of Auditing of NBFCs. During the engagement team meeting, the Audit Manager asked CA Y, regarding the audit procedures to be undertaken to verify whether the aforesaid Company has followed Prudential Norms? As an Engagement partner suggest any four procedures to the Audit Manager.

Answer: Already covered in TYK Qn

Question 6 Exceptional **(PYP May '24 4M)**

CA M is appointed as the Statutory auditor of Fincorp Limited for the financial year 2023-24. This company is an NBFC covered under Non-Banking Financial Company - Systemically Important Non-Deposit-taking company. To comply with the RBI Prudential Norms for asset classification, Fincorp Limited has made the following provisioning in respect of loans, advances and other credit facilities as on 31st March, 2024:

Particulars	Balance outstanding as on 31st March, 2024	Provision for the Financial year 2023-24
Standard Assets	Rs. 200 crores	NIL
Sub-standard Assets	Rs. 15 crores (Fully secured)	Rs. 1.50 crores
Doubtful Assets (one to three years)	Rs. 8 crores (Fully secured)	Rs. 2.00 crores
Loss Assets	Rs. 2 crores	Rs. 2.00 crores
	Total Provision for NPA	Rs. 5.50 crores

CA M is of the opinion that the company has not done the provisioning correctly. Is the opinion of CA M correct? In this context, explain the provisioning requirements applicable to this NBFC and comment on the provision for NPA made by the company.

Answer:

Provisioning Requirements: The provisioning requirement in respect of loans, advances and other credit facilities including bills purchased and discounted shall be as under:

Categories of Non-Performing Assets:	Provision

	required (%)
Standard Assets: Every NBFC (covered under Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016) shall make provisions for standard assets at 0.40 per cent by the end of March 2018 and thereafter, of the outstanding, which shall not be reckoned for arriving at net NPAs.	0.40%
Substandard Assets	10%
Doubtful Assets (upto 1 to 3 Years)	30%
Loss Assets	100%

In the given situation, CA M is appointed as Statutory Auditor of Fincorp Limited, an NBFC covered under NBFC (covered under Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016) for the financial year 2023-24. The Fincorp Limited has made the following provisioning in respect of loans, advances and other credit facilities as under:

Categories of Non-Performing Assets:	Balance outstanding as on 31st March, 2024	Provision required (%)	Provision required (in Rs.)	Provision made by the Co.
Standard Assets	Rs. 200 crores	0.40%	Rs. 80 lakhs	NIL
Substandard Assets	Rs. 15 crores	10%	Rs. 1.5 crores	Rs. 1.5 crores
Doubtful Assets (upto 1 to 3 Years)	Rs. 8 crores	30%	Rs. 2.4 crores	Rs. 2 crores
Loss Assets	Rs. 2 crores	100%	Rs. 2 crores	Rs. 2 crores
Total Provision for NPA			Rs. 6.7 crores	Rs. 5.5 crores

From the above, it can be concluded that provisioning for Substandard Assets and Loss Assets is in accordance with the prescribed RBI Prudential Norms whereas in case of Standard Assets and Doubtful Assets it is not as per provisioning norms. Thus, CA M is correct in his opinion that the company has not done the provisioning correctly.

Question 7 **(MTP M25 S1 5M)**

Qura Capital Ltd., a Non-Banking Financial Company (NBFC) classified under the Scale-Based Regulation framework, is required to maintain a minimum capital ratio of 15% of its aggregate risk-weighted assets (RWA) and risk-adjusted off- balance sheet items. The company has provided the following financial data for computing of its Tier 1 and Tier 2 capital as per the RBI Master Directions:

Particulars	Amount in Rs.
Owned Fund	Rs. 1,000 crore
Investment in shares of other NBFCs and in group companies (exceeding 10% of owned fund)	Rs. 150 crore
Perpetual Debt Instruments issued by Qura Finance Ltd.	Rs. 120 crore
Preference Shares (not compulsorily convertible into equity)	Rs. 80 crore
Revaluation Reserves	Rs. 200 crore
General Provisions & Loss Reserves	Rs. 50 crore
Hybrid Debt Capital Instruments	Rs. 90 crore
Subordinated Debt	Rs. 140 crore
Risk-Weighted Assets (RWA)	Rs. 8,000 crore

Considering that Qura Finance Ltd. is neither an NBFC-MFI nor primarily engaged in lending against gold jewellery, compute the following:

- Tier 1 capital of Qura Finance Ltd. as per RBI guidelines.
- Tier 2 capital, ensuring it does not exceed the Tier 1 capital.

Also, determine whether Qura Finance Ltd. meets the minimum capital adequacy requirement of 15% of RWA.

Answer:

To determine whether Qura Capital Ltd. meets the capital adequacy requirement, we need to compute its Tier 1 Capital, Tier 2 Capital and compare the total capital ratio against the required 15% of Risk-Weighted Assets (RWA).

Step 1: Computation of Tier 1 Capital

Tier 1 Capital = Owned Fund – Investments in Group Entities + Eligible Perpetual Debt Instruments.

Tier 1 Capital = 1,000 - 150 + 120 = Rs. 970 crore

Note: The perpetual debt instruments are limited to 15% of the previous year's Tier 1 capital. Assuming ₹120 crore qualifies, we include it in Tier 1 capital.

Step 2: Computation of Tier 2 Capital

Tier 2 Capital = Sum of:

- Preference Shares = ₹ 80 crore
- Revaluation reserves at discounted rate of 55 percent = ₹ 90 crore (₹200 crore × 55% = ₹ 110 crore i.e ₹ 200- ₹110= ₹ 90)
- General Provisions (Limited to 1.25% of RWA) = 1.25% of ₹ 8,000 crore = ₹ 100 crore (Since actual general provisions are ₹ 50 crore, we take ₹ 50 crore)
- Hybrid Debt Capital Instruments = ₹ 90 crore
- Subordinated Debt = ₹ 140 crore
- Perpetual Debt Instruments exceeding Tier 1 Limit = ₹ 0 crore (As ₹ 120 crore is already within Tier 1 limit)

  Tier 2 Capital = 80 + 90 + 50 + 90 + 140 + 0 = ₹ 450 crore.

  Note: Tier 2 Capital cannot exceed Tier 1 Capital. Since ₹ 450 crore is within the ₹ 970 crore Tier 1 limit, it is fully eligible.

Step 3: Compute Capital Adequacy Ratio (CAR)

Total Capital = Tier 1 Capital + Tier 2 Capital. Total Capital=970 + 450 = Rs. 1,420

Capital Adequacy Ratio (CAR) = (Total Capital/Risk-Weighted Assets) × 100

=1420/8000*100 =17.75%

Step 4: Conclusion

- Minimum required capital ratio = 15%
- Actual Capital Adequacy Ratio (CAR) = 17.75%

Since Qura Capital Ltd.'s CAR (17.75%) is higher than the minimum requirement of 15%, it meets the regulatory capital adequacy norms.

Question 8 **(PYP May 25 5M)**

Instant Finance Ltd. is a Non-Banking Financial Company (NBFC-BL) primarily engaged in providing loans to small businesses and individuals. As per its audited financials for the year ending March 31, 2025, the following information was observed:

1. Instant Finance Ltd. has an aggregate risk-weighted asset base of Rs. 1,000 crore.
2. The company has reported Tier 1 capital of Rs. 130 crore, which includes Rs. 15 crore raised through perpetual debt instruments.
3. Instant Finance Ltd. has investments in shares and bonds of other NBFCs totalling Rs. 10 crore, which amounts to 12% of its owned fund.
4. The company's primary business involves lending against gold jewellery, with such loans comprising 60% of its financial assets.

As a statutory auditor, you are entrusted with assessing compliance with the prudential norms prescribed under the Master Direction - Reserve Bank of India (Non-Banking Financial Company - Scale Based Regulation) Directions, 2023, regarding capital adequacy.

You are required to:

(i) Evaluate whether Instant Finance Ltd. complies with the minimum Tier I capital requirements as per the RBI prudential norms.

(ii) Discuss the treatment and impact of perpetual debt instruments in the calculation of Tier I capital for NBFCs primarily engaged in lending against gold jewellery.

(iii) Analyse the adjustment required in Tier 1 capital for Instant Finance Ltd. due to its investments in other NBFCs.

Answer:

Compliance with Minimum Tier 1 Capital Requirements: As per RBI norms, Instant Finance Ltd. must maintain a minimum capital adequacy ratio of 15 % of aggregate risk-weighted assets. Since 60 % of its financial assets are loans against gold, it must maintain a Tier 1 Capital of at least 12% (Rs. 120 Crore) of its risk-weighted assets.

(i) In the given situation, Instant Finance Ltd. has reported Tier 1 Capital of Rs. 130 crore. However, NBFC-BL are not eligible to include perpetual debt instruments in their Tier 1 capital. Thus, the amount of Tier 1 Capital will be 115 crores (Rs. 130-Rs. 15 = Rs. 115 crores).

Since, Instant Finance Ltd.'s primary business involves lending against gold jewellery, with such loan comprising of 60% of its financial assets which is exceeding the criteria of 50% or more, thus, Instant Finance Ltd. is required to maintain a minimum Tier 1 capital of 12 percent of aggregate risk weighted assets of on-balance sheet and of risk adjusted value of off-balance sheet items.

Considering the Rs. 120 crore (Aggregate Risk Weighted assets 1000*12% =120 crore) as Tier 1 Capital, it can be concluded that Instant Finance Ltd. has not complied with the minimum Tier 1 Capital requirements as per the RBI Prudential Norms.

Alternative Answer:

i. As per the facts, Instant Finance Ltd. has investment in shares and bonds of other NBFCs totalling of Rs. 10 crore, which amount to 12% of its owned fund.

"Tier 1 capital" for NBFCs (except NBFCs-BL) is the sum of (i) Owned fund as reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund; and (ii) Perpetual debt instruments issued by a non-deposit taking NBFCs in each year to the extent it does not exceed 15 percent of the aggregate Tier 1 capital of such company as on March 31 of the previous accounting year. However, NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 1 capital.

Since Owned Fund = 83.33 crore [i.e., = 10 crore /12%] – 1.667 [in excess of 10% of owned fund] = 81.667 crore

In the given situation, Instant Finance Ltd. has reported Tier 1 Capital of Rs. 130 crore. However, NBFC BL are not eligible to include perpetual debt instruments in their Tier 1 capital. Thus, amount of Tier 1 Capital will be Rs. 113.333 crore =130 crore – 15 crore – 1.667 (i.e., Tier 1 Capital -Perpetual Debt Instrument - excess of 10% of owned fund)

Considering the Rs. 120 crore = (Aggregate Risk Weighted assets 1000*12%) as Tier 1 Capital, it can be concluded that Instant Finance Ltd. has not complied with the minimum Tier 1 Capital requirements as per the RBI Prudential Norms.

ii. Perpetual debt instruments issued by a non-deposit taking NBFCs in each year to the extent it does not exceed 15 percent of the aggregate Tier 1 capital of such company as on March 31 of the previous accounting year are included while calculating Tier 1 capital. However, NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 1 capital.

In the instant case, Instant Finance Ltd. falls under the category of NBFC-BL, hence, perpetual debt instruments will not be included in Tier I Capital.

iii. While computing Tier I capital, Owned fund shall be reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund.

In the given case, Tier I capital of Instant Finance Ltd should be reduced by investment in shares of other NBFCs, exceeding in aggregate ten percent of the owned fund. In the current scenario, the investment in shares and bonds of other NBFCs totaling to Rs. 10 Crore is 12% of owned funds, hence, the excess of 2% of owned funds should be adjusted to arrive at Tier I Capital.

Alternative Answer:

iii. While computing Tier I capital, Owned fund shall be reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund.

In the given case, Tier I capital of Instant Finance Ltd should be reduced by investment in shares of other NBFCs, exceeding in aggregate ten percent of the owned fund. In the current scenario, the investment in shares and bonds of other NBFCs totaling to Rs. 10 Crore is 11.33% of owned funds, hence, the excess of 1.33% of owned funds should be adjusted to arrive at Tier I Capital.

Test Your Understanding from ICAI SM

Test Your Understanding 1.

PGC & Associates are statutory auditors of BNPC Limited, a PSU in power sector. It is engaged in building large sized thermal power stations to accelerate development of power sector in the country. One of the financial committees of Parliament has decided to examine its physical and financial performance. It has also examined the audit findings of C&AG in respect of which action is yet to be taken by the said PSU. The committee also proposes to include in its report the performance of the company in various operational matters.

Which financial committee of Parliament deals with such matters? Outline its main functions.

Answer:

The said matters are dealt by Committee on Public Undertakings (COPU). The functions of the Committee are -

i. to examine the reports and accounts of public undertakings.

ii. to examine the reports of the C&AG on public undertakings.

iii. to examine the autonomy and efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.

iv. to exercise such other functions vested in the PAC and the Estimates Committee as are not covered above and as may be allotted by the Speaker from time to time.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

Test Your Understanding 2.

PS & Associates are statutory auditors of a Central Government owned company for a particular year. The statutory auditors were required to examine the following areas mandatorily, provide their specific replies and also their impact on financial statements for that particular year in their audit report.

1. Whether the company has system in place to process all the accounting transactions through IT system? If yes, the implications of processing accounting transactions outside IT system on the integrity of the accounts along with the financial implications, if any, may be stated.
2. Whether there is any restructuring of an existing loan or cases of waiver / write-off of debts / loans/ interest etc. made by a lender to the company due to the company's inability to repay the loan? If yes, the financial impact may be stated. Whether such cases are properly accounted for?
3. Whether funds (grants/subsidy etc.) received / receivable for specific schemes from Central Government or its agencies were properly accounted for / utilized as per its term and conditions? List the cases of deviation.

Can you determine the likely nature of such responsibility thrust upon auditors of above PSU?

Answer:

The given areas for which statutory auditors of PSU were required to examine, report and indicate impact of these matters in financial statements are likely to relate to directions issued by C&AG to statutory auditors under section 143(5) of the Companies Act, 2013.

In terms of section 143(5), in case of a government company, the C&AG has the power to direct the auditor the manners in which accounts of company are required to be audited and auditor shall submit audit report which among other things, include the directions, if any, issued by the C&AG the action taken thereon and its impact on the accounts and financial statements of the company.

Learn Contextually

Test Your Knowledge

Question 1

The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 2

ABG & Co., a Chartered Accountant firm has been appointed by C & AG for performance audit of a Sugar Industry. What factors should be considered by ABG & Co., while planning a performance audit of Sugar Industry?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 3

Sunlight Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Goa with a new technology for a cost of Rs. 5,750 crore. The project had seen delay in commencement and cost overrun. State the matters that a Comprehensive Audit by C&AG may cover in reporting on the performance and efficiency of this project.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 4

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

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 5

BT Ltd., a company wholly owned by the Central Government was disinvested during the previous year, resulting in 40% of the shares being held by public. The shares were also listed on the BSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the BSE etc.

Sam, the FM of the company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

Answer:

Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them.

The listing of company's shares on a stock exchange is irrelevant for this purpose and hence Sam's opinion is not correct.

Question 6

You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 7 Exceptional

Comptroller & Auditor General appointed Verma & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG.

Answer:

In the given scenario, C&AG appointed Verma & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit.

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is not performance audit in all aspects.

Question 8

The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:

(i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;

(ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;

(iii) metering, billing and collection was managed efficiently and effectively;

(iv) monitoring and internal controls were efficient.

What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 9 Exceptional **Newly Added**

During the course of an audit of a state government department, the Office of the Comptroller & Auditor General of India (CAG) observed that the prescribed law in the state defined a "flat" based on the following two criteria in a premises:

- ✓ Dwelling units exceeding a threshold limit
- ✓ Buildings with a total area surpassing a threshold limit

However, it was noted during the audit that the relevant database did not include a column for entering the area of the building. Consequently, a certain number of buildings were identified as flats even though they had fewer dwelling units than the threshold limit. In the absence of data regarding the area, the audit team directed physical verification of these flats. The physical verification confirmed that these buildings were incorrectly classified as flats, resulting in the department undercollecting water charges. Identify type and nature of audit being performed by Office of Comptroller & Auditor General of India. To whom report of such audit was likely to have been submitted.

Answer:

In the given case, it is a "Compliance Audit" performed by Office of Comptroller & Auditor General of India. Compliance audit is the independent assessment of whether a given subject matter is in compliance with the applicable criteria.

This audit is carried out by assessing whether activities, financial transactions and information comply in all material respects with the regulatory and other rules which govern the audited entity. Compliance auditing is concerned with: -

(a) Regularity- adherence of the subject matter to the formal criteria emanating from relevant laws, regulations, and agreements applicable to the entity.

(b) Propriety- observance of the general principles governing sound financial management and the ethical conduct of public officials.

While regularity is emphasized in compliance auditing, propriety is equally pertinent in the public sector context, in which there are certain expectations concerning financial management and the conduct of officials.

Under Article 151, audit reports of the C&AG relating to the accounts of the Central/ State Government should be submitted to the President/Governor of the State who shall cause them to be laid before Parliament/State Legislative Assemblies.

In the given situation, the report relates to the State Department. Therefore, report was likely to have been submitted to Governor of state to be laid before State legislative assembly.

Question 10 Exceptional **Newly Added**

Direct Benefit Transfer (DBT) is a major reform initiative of the Government of India to ensure better and timely delivery of benefits from Government to people. It marks a paradigm shift in the process of delivering benefits like wage payments, fuel subsidies, food grain subsidies, etc. directly into the bank accounts of the beneficiaries removing leakages and enhancing financial inclusion.

The office of C & AG of India is likely to undertake a performance audit for a block of years in a state of some selected social security pension schemes and scholarship schemes under DBT. What are likely to be objectives of such performance audit? Explain the meaning of "audit criteria" and also discuss how these can be determined in above case.

Answer:

The likely objectives of performance audit to be conducted by office of C & AG of India of some selected social security pension schemes and scholarship schemes in a state could be: -

- ✓ Whether proper planning and process were in place to capture data of beneficiaries under above schemes
- ✓ Whether necessary steps were taken for implementation of DBT like preventing delay in payments to the intended beneficiaries and pilferage and duplication
- ✓ Whether the infrastructure, organization and management of DBT were adequate and effective.

"Audit criteria" are standards used to determine whether a programme meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit criteria are reasonable and attainable standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed.

In the above situation, various documents issued by Government of India and state government like circulars, instructions, Standard operating procedure manuals, guidelines of schemes on identification and authentication of beneficiaries etc, general management and subject matter literature can be used to determine "audit criteria".

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 2 Nov '24 5M)**

Abhinandan Ltd., a company wholly owned by Delhi government was disinvested during the previous year, resulting in 38% of the shares being held by public. The shares were also listed on the NSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the NSE etc.

Paras, the Finance Manager of the company is of the opinion that now the company is subject to stringent control by NSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act, 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

Answer:

Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them.

In the given situation, Abhinandan Ltd. is a company wholly owned by Delhi Government was disinvested during the previous year, resulting in 38% of the shares being held by public. The shares were also listed on the NSE. The listing of company's shares on a stock exchange is irrelevant for this purpose and hence, opinion of finance manager Paras is not correct.

Question 2 **(MTP 1 May '24 5M)**

Direct Benefit Transfer (DBT) is a major reform initiative of the Government of India to ensure better and timely delivery of benefits from Government to people. It marks a paradigm shift in the process of delivering benefits like wage payments, fuel subsidies, food grain subsidies, etc. directly into the bank accounts of the beneficiaries removing leakages and enhancing financial inclusion.

The office of C & AG of India is likely to undertake a performance audit for a block of years in a state of some selected social security pension schemes and scholarship schemes under DBT. What are likely to be objectives of such performance audit? Explaining meaning of "audit criteria", discuss how these can be determined in above case.

Answer: Already covered in TYK Qn

Question 3 **(MTP 2 May '24 5M)**

During the course of an audit of a state government department, the Office of the Comptroller & Auditor General of India (CAG) observed that the prescribed law in the state defined a "flat" based on the following two criteria in a premises:

- ✓ Dwelling units exceeding a threshold limit
- ✓ Buildings with a total area surpassing a threshold limit

However, it was noted during the audit that the relevant database did not include a column for entering the area of the building. Consequently, a certain number of buildings were identified as flats even though they had fewer dwelling units than the threshold limit. In the absence of data regarding the area, the audit team directed physical verification of these flats. The physical verification confirmed that these buildings were incorrectly classified as flats, resulting in the department under collecting water charges.

Identify type and nature of audit being performed by Office of Comptroller & Auditor General of India. To whom report of such audit was likely to have been submitted

Answer: Already covered in TYK Qn

Question 4 Exceptional **(PYP Nov '24 4M)**

The Government of India launched a rural development scheme to undertake projects aimed at improving infrastructure, healthcare and education in the rural areas. To execute the projects the Central Government provided funds to the state government. The Comptroller and Auditor General of India wants to ensure that the funds provided to the State Governments have been utilized for the identified purposes and that public interest has not been harmed. You are appointed by C & AG to conduct the propriety audit and report on the funds utilized by the state government for building hospitals, school buildings and roads and submit a report on the wastefulness in public administration and cases of improper, avoidable and infructuous expenditures, if any, has been done. What functions as an auditor will be performed by you?

Answer:

Function of Auditor in case of Propriety Audit:

The functions of Auditor in the context of Propriety Audit may be specified as under as to:

- ✓ see that all expenditure incurred are properly planned.
- ✓ see that the size and channels of expenditure are rightful and expected to give maximum results.
- ✓ appraise whether those expenditure are likely to give optimum result.
- ✓ see that any substitute plan of action can bring about an improvement on current operation and as well as return from capital expenditure.
- ✓ examine the actions and decisions of the management to see that they are conductive to public interests and that they meet the standards of conduct.

Question 5 **(MTP M25 S1 4M)**

DBH & Associates are the statutory auditors of MBPC Limited, a public sector undertaking in the power sector. It is engaged in constructing large sized thermal power stations to accelerate development of the power sector in the country. One of the financial committees of Parliament has decided to examine its physical and financial performance. It has also examined the audit findings of C&AG in respect of which action is yet to be taken by the said PSU. The committee also proposes to include in its report the performance of the company in various operational matters.

Which financial committee of Parliament deals with such matters? Outline its main functions.

Answer: Already covered in TYU Qn

Question 6 **(MTP M25 S2 5M)**

The Comptroller and Auditor General of India has appointed a Chartered Accountant firm to conduct the comprehensive audit of Saras Company Limited, a listed government company, handling major Railway project of the metropolitan city for the period ending 31-03-2024. The work to be conducted under Project A handled by the Saras Company Limited was of laying down railway line of 130 kilometers.

During the audit, the firm reviewed the internal audit report and observed the shortcoming reported about the performance of Project A regarding the understatement of the Current liabilities and Capital work in progress by Rs. 75.32 crore.

What key aspects should the chartered accountant firm focus on while conducting the comprehensive audit of Saras Company Limited?

Answer:

Matters to be undertaken by the CA Firm while conducting the comprehensive audit of Saras Company Limited are:

i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?

ii) Have the accepted production or operational output been achieved? Has there been under-utilisation of installed capacity or shortfall in performance and, if so, what has caused it?

iii) Has the planned rate of return been achieved?

iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?

v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?

vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?

vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?

viii) If the enterprise has an adequate system of repairs and maintenance?

ix) Are procedures effective and economical?

x) Is there any poor or insufficient or inefficient project planning?

Test Your Understanding from ICAI SM

Test Your Understanding 1.

After an illustrious career in Indian Audit & Accounts Service for about 25 years, Parteek, a postgraduate in law, has taken voluntary retirement from government service. Being in fine spirits, he wants to take responsibility as Chief internal auditor in the corporate sector. On looking at attractive compensation packages, he applied for such position in a leading listed company engaged in oil refining business. The Board of company is keen on him due to his impressive credentials. Can he be appointed in this leading position of said company?

Answer:

As per section 138 of the Companies Act, 2013 the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company. The Board can appoint any professional as may be decided by it. The applicant in question is a law post graduate and he has spent 25 years of his career in Indian Audit & Accounts Service. Therefore, he has got the necessary experience and skills required for the said vacancy. The Board would be in a position to appoint such a competent and experienced person in the field of auditing as its Chief Internal auditor.

Test Your Understanding 2. Exceptional

CA Deva is an internal auditor of a listed company. The company wants to make sure that it is in compliance with SEBI requirements at all times and it is never on the wrong side of the law. It asks its internal auditor to manage its compliance tracking system including directly corresponding with regulator in this regard. The profile and scope of internal audit agreed at time of appointment included "compliance with laws and regulations."

Can he perform such type of activities in capacity of internal auditor of company?

Answer:

The Internal Auditor does not assume any responsibility to manage or operate the compliance framework or to take compliance related decisions. It is not responsibility of the Internal Auditor to execute or resolve compliance related risks (e.g., engaging directly with regulators, etc.).

Although internal audit function provides independent assurance to enhance governance (which includes compliance with laws and regulations), it does not assume operational responsibility of its compliance framework. It is the responsibility of the management. He is responsible for auditing the compliance framework and not managing it. Similarly, he does not accept compliance related risks like directly engaging with regulator.

Test Your Understanding 3. Exceptional

Up Down Limited is concerned about the decline in demand for its products in the last two years. The statutory auditor is of the view that the situation has put into question going concern assumption of the company. Its internal auditor has helped management in devising a strategy to deal with such risks and come out of the situation. The plan includes venturing into different product lines using the same plant with minor modifications. Further, the internal auditor has also prepared estimates of revenue generation along with cash flows.

Can statutory auditor place total reliance on work performed by internal auditor in this regard?

Answer:

The greater the judgment needed to be exercised in planning and performing the audit procedures and evaluating the audit evidence, the external auditor will need to perform more procedures directly because using the work of the internal audit function alone will not provide the external auditor with sufficient appropriate audit evidence.

The appropriate use of going concern assumption requires significant judgment on part of statutory auditor.

Therefore, statutory auditor cannot place total reliance on internal auditor's work in this regard and he should perform more procedures directly.

Illustrations from ICAI SM

Illustration 1. Exceptional

The Managing Director of X Ltd. is concerned about high employee attrition rate in his company. As the internal auditor of the company, he requests you to analyze the causes for the same. What factors would you consider in such analysis?

Solution:

The factors responsible for high employee attrition rate are as under:

i. Job Stress & work life imbalance;
ii. Wrong policies of the Management;
iii. Unbearable behaviour of Senior Staff;
iv. Safety factors;
v. Limited opportunities for promotion;
vi. Low monetary benefits;
vii. Lack of labour welfare schemes;
viii. Whether the organization has properly qualified and experienced personnel for the various levels of works?
ix. Is the number of people employed at various work centres excessive or inadequate?
x. Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?

Case Studies from ICAI SM

CASE STUDY 1

JKT Pvt. Ltd. is having Rs.40 lacs paid-up capital, Rs.9.50 crores reserves and turnover of the last three consecutive financial years, immediately preceding the financial year under audit, being Rs.49 crores, Rs.145 crores and Rs.260 crores, but does not have any internal audit system. In view of the management, the internal audit system is not mandatory. Comment.

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, read with rule 13 of the Companies (Audit and Auditors) Rules, 2014, every private company shall be required to appoint an internal auditor or a firm of internal auditors, having

i. turnover of two hundred crore rupees or more during the preceding financial year; or
ii. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

Conclusion: In the instant case, JKT Pvt. Ltd. is having a turnover of Rs.260 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the company has the statutory requirement to appoint an Internal Auditor and mandatorily conduct an internal audit.

Test Your Knowledge

Question 1

Write a short note on the Internal Audit Report.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 2 Exceptional

State the important aspects to be considered by the External auditor in the evaluation of the Internal Audit Function.

Answer:

Evaluation of Internal Audit Functions by External Auditor:

The external auditor's general evaluation of the internal audit function will assist him in determining the extent to which he can place reliance upon the work of the internal auditor. The external auditor should document his evaluation and conclusions in this respect. The important aspects to be considered in this context are:

a. Organisational Status - Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself, the internal auditor reports to the management. In an ideal situation, his reports to the highest level of management and are free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.

b. Scope of Function - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate, acts upon internal audit recommendations.

c. Technical Competence - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.

d. Due Professional Care - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.

Question 3

AB Pvt. Ltd. company has outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint an internal auditor. Please guide him for the applicability of the same and who can be appointed as an internal auditor and what work would be reviewed by him.

Answer:

Applicability of Internal Audit: Section 138 of the Companies Act, 2013 states that every private limited company is required to conduct internal audit if its outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In view of the above provisions, AB Pvt. Ltd. is mandatorily required to conduct an internal audit as its loans or borrowings are falling under the prescribed limit.

Who can be appointed as Internal Auditor- The internal auditor shall either be a Chartered Accountant

or a Cost Accountant, whether engaged in practice or not, or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the companies.
The internal auditor may or may not be an employee of the company.
Work to be reviewed by Internal Auditor- Refer GOAT Notes

Question 4

Moon Ltd., of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 5 Exceptional

Mr. A is appointed as a statutory auditor of XYZ Ltd. XYZ Ltd. is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

a. Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.
b. Will your answer be different if Mr. A asks direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

Answer:

a. Direct Assistance from Internal Auditor: As per SA 610, "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that Involve making significant judgments in the audit.
   Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.
   Significant judgments include the following:
   - ✓ Assessing the risks of material misstatement;
   - ✓ Evaluating the sufficiency of tests performed;
   - ✓ Evaluating the appropriateness of management's use of the going concern assumption;
   - ✓ Evaluating significant accounting estimates; and
   - ✓ Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

   In view of the above, Mr. A cannot ask for direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.
b. Direct Assistance from Internal Auditor in case of External Confirmation Procedures: SA 610, "Using the Work of Internal Auditor", provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned.
   Further, in accordance with SA 505, "External Confirmation" the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal

auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

Question 6 Exceptional

The XYZ Ltd. has to appoint Mr. A as Chief Internal Auditor to lead the internal audit function for the Company. The Managing Director of the Company has asked the HR head to define the reporting structure of the Chief Internal Auditor, so that he can discharge his duties objectively? Suggest the ideal reporting structure of the Chief Internal Auditor that HR head may propose to the Managing Director?

Answer:

HR Head needs to evaluate multiple options and identify the most suitable option in light of the relevant provisions, guidance and overall governance of the organization. HR head also needs to evaluate different options for his administrative reporting and various options for functional reporting of Chief Internal Auditor. The possible options to be considered and evaluated include the Board of Directors, Audit Committee, Managing Director of the Company and Chief Executive Officer or Chief Financial Officer.

As per section 138 of the Companies Act 2013, the internal auditor shall either be a Chartered Accountant or a Cost Accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

As per the revised definition of the term 'Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, "Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives"

The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

As per the requirement of the above stated provision, Chief Internal Auditor needs to be independent of the operational activities and report of Audit Committee / Board of Directors to enjoy his true status of independent auditor. He may administratively report to CEO or Managing Director for his administrative reporting purpose or any other similar authority till the time it is approved by Board of Directors, and it does not impact his independence to be able to perform his duties and report to audit committee / Board of Director independently.

Question 7 Exceptional

Daksh Ltd. has appointed Mr. Gopal to conduct their internal audit for the new financial year. The Audit committee requested Mr. Gopal to present their Internal Audit plan for next financial year? What approach would Mr. Gopal follow to prepare the internal audit plan for next year?

Answer:

Refer GOAT Notes - Straight Concept Question and hence ignore here

The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.

Internal audit plans should be developed in such a manner that all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle. Also, ensuring that appropriate consideration is made, and adequate balance is ensured to the following:

- ✓ Risk underlying the business process
- ✓ Value that the internal audit can provide to the organization
- ✓ Effort involved in conducting the internal audit for a particular business process
- ✓ Risk Appetite of the organization
- ✓ Coverage of all auditable areas within the defined time range

Question 8

Zero Ltd. has appointed Mr. Shubh to conduct their internal audit for the new financial year. The Audit committee requested Mr. Shubh to perform a detailed analysis of their expenses in the previous year and report on all risks and underlying gaps. Elucidate the steps Internal Auditor should take to identify such gaps?

Answer: Straight Concept Question and hence ignore here tes - Straight Concept Question and hence ignore here

Question 9

Kishore Ltd. has appointed Mr. Anand to conduct their internal audit for the new financial year. The Audit committee requested Mr. Anand to present a detailed report on their findings and areas where immediate action is needed to mitigate critical risks. What should be the content of the internal audit report to address this requirement of the Audit Committee?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

- ✓ At the end of a particular audit assignment, an "Internal Audit Report" covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.
- ✓ On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

Accordingly, a typical internal audit report should include the following:

- ✓ Audit Scope performed;
- ✓ Audit period Covered;
- ✓ Executive Summary;
- ✓ Summary of the critical findings;
- ✓ Detailed audit findings with elaboration on business impact and root cause of such issues;

- ✓ Rating of the highlighted issues (E.g High / Medium / Low) in accordance to the rating criteria approved by Audit Committee;
- ✓ Audit recommendation to improve control environment and address the highlighted finding;
- ✓ Response received from the responsible functional authority containing action plan and target timelines for action

Question 10

June Ltd. has appointed Mr. Gaurav to conduct their internal audit for the new financial year. The Audit committee requested Mr. A to present their analysis on the implementation of recommendations of previous audit report and highlight critical areas which need immediate attention of the Audit Committee? What should be the steps followed by internal auditor to
address this requirement of the Audit Committee?

Answer:

Refer GOAT Notes - Straight Concept Question and hence ignore here

As per SIA 390 Monitoring and Reporting of Prior Audit Issues, the Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance. The responsibility to implement the action plans remains with the management.

In monitoring and reporting of prior audit issues, the responsibility of the Internal Auditor is usually in the form of an "Action Taken Report (ATR) of previous audits".

To address the requirement of Audit Committee in the given situation, Internal Auditor should assess the action taken against the previous audit findings and report a summary of the action taken by the management. Typical Action Taken Report may include the following:

- ✓ Reference to the previous audit reporting containing the reported issues
- ✓ Implementation Action agreed by the management along with target implementation date
- ✓ Status of action taken by management. The same may be classified under Implemented / Not Implemented
- ✓ Residual risk and rating for any unimplemented action
- ✓ Audit findings not implemented for long period of time
- ✓ Any critical audit finding that requires immediate action for action or implementation.

Question 11 **Newly Added**

One of the independent directors sought information regarding the appointment of internal auditors for the following Group Companies in accordance with the Companies Act, 2013 of which certain financial information is given below:

Figures are in Rs. crore and correspond to the previous year.

Name	Nature	Equity Share Capital	Turnover	Loan from Bank and PFI	Public Deposits
XYX Limited	Listed	100	230	20	48
MNM Limited	Unlisted Public	60	100	50	24
GFG Limited	Unlisted Private	70	180	80	-

You are required to evaluate the requirements regarding the appointment of internal Auditors for the Group Companies. Discuss.

Answer:

As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of the Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

A. every listed company;

B. every unlisted public company having-

   1. paid up share capital of fifty crore rupees or more during the preceding financial year; or
   2. turnover of two hundred crore rupees or more during the preceding financial year; or
   3. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
   4. outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

C. every private company having-

   1. turnover of two hundred crore rupees or more during the preceding financial year; or
   2. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, XYX Limited is a listed company. As per section 138 of the Companies Act, 2013, every listed company is required to appoint an internal auditor or a firm of internal auditors. Thus, in view of the above, XYX Limited is required to appoint an internal auditor.

Further, MNM Limited is unlisted public company. The company is having ₹ 60 crore as equity share capital which is exceeding the prescribed limit of rupees fifty crore as per section 138. Thus, MNM Limited is required to appoint an internal auditor as per section 138 of the Companies Act, 2013.

GFG Limited is unlisted private company and having ₹ 70 crore as equity share capital, ₹ 180 crore as turnover and ₹ 80 crore loan from Bank and PFI. In view of provisions of section 138 of the Companies Act, 2013 discussed above, all the limits are below the prescribed limit for a private company. Therefore, GFG Limited is not required to appoint an internal auditor.

It can be concluded that XYX Limited and MNM Limited are required to appoint the internal auditor as per the provisions of the Companies Act, 2013 whereas GFG Limited is not required to do the same.

Question 12 Exceptional **Newly Added**

Rishi is appointed as internal auditor for SPOM Limited, a medium-sized manufacturing company, while CA Nitin is the statutory auditor of SPOM Limited.

a. During the review, Rishi notices several discrepancies in the disbursement records and suspects there might be weaknesses in the internal control system.

   Additionally, there have been recent changes in the company's business policies that he was not informed about. Rishi is concerned about maintaining his independence and objectivity while ensuring that management is aware of these issues. What are the responsibilities of Rishi as an Internal Auditor with respect to the accounting function and financial records of the organisation?

b. CA Nitin asked Rishi to provide direct assistance to him regarding evaluating the appropriateness of management's use of the going concern assumption. In view of Standards on Auditing, whether Nitin can ask direct assistance from Rishi as stated above?

Answer:

a. In the given case, Rishi notices several discrepancies in the disbursement records and suspects there might be weaknesses in the internal control system. He is concerned about maintaining his independence and objectivity while ensuring that management is aware of these issues.

Responsibilities of Rishi as an Internal Auditor with respect to the accounting function and financial records of the organisation include:

- ✓ to ascertain adequacy of system of internal control by a continuous examination of accounting procedures, receipts and disbursements, and to provide adequate safeguards against misappropriation of assets.
- ✓ to operate independently of the accounting staff and must not in any way divest any of the responsibilities placed upon him.
- ✓ not to involve in the performance of executive functions in order that the objective outlook does not get obscured by the creation of the vested interest.
- ✓ to observe facts and situations and bring them to notice of authorities who would otherwise never know them; also, critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected.
- ✓ to associate closely with management and keep knowledge up to date by being informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies.
- ✓ at all times, the internal auditor must enjoy an independent status.

b. As per SA 610, "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make significant judgments in the audit engagement.

Significant judgments include the following:

- ✓ Assessing the risks of material misstatement;
- ✓ Evaluating the sufficiency of tests performed;
- ✓ Evaluating the appropriateness of management's use of the going concern assumption;
- ✓ Evaluating significant accounting estimates; and
- ✓ Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of the above, CA Nitin cannot ask direct assistance from internal auditors regarding evaluating the appropriateness of management's use of the going concern assumption in accordance with SA 610.

Question 13 **Newly Added**

CA Sanjana has recently joined as Chief Internal Auditor of Up Scale Limited, a listed company. Her subordinate staff in the internal audit department brings to her knowledge many prior audit issues highlighted in the previous internal audit reports which are still open. Does she have any responsibilities in this regard? How should she proceed in this situation?

Answer:

In the given situation, CA Sanjana has recently joined as Chief Internal Auditor in Up Scale Limited, a listed company. As a Chief Internal Auditor, CA Sanjana is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance. The responsibility to implement the action plans remains with the management. In monitoring and reporting of prior audit issues, the responsibility of the CA Sanjana as internal auditor is usually in the form of an "Action Taken Report (ATR) of previous audits". The term "Monitoring and Reporting" refers to the periodic tracking of issues raised during prior audits and evaluation of the corrective actions undertaken by the auditee to resolve them and to report any open and pending matters to the management and those charged with governance.

CA Sanjana should review whether follow-up action is taken by the management on the basis of his report. If no action is taken within a reasonable time, she should draw the management's attention to it. Where the management has not acted upon the suggestions or not implemented the prescribed recommendations, she should ascertain the reasons thereof.

Where the management has accepted recommendations of the CA Sanjana and initiated the necessary action, she should periodically review the manner and the extent of implementation of the recommendations and report to the management highlighting the recommendations which have not been implemented fully or partly.

Question 14 Exceptional **Newly Added**

STU & Associates have been the statutory auditors of the listed company "First and Last Ltd.," operating in the petrochemical industry, for the past three years. CA K, the engagement partner, had designed certain substantive procedures on some selected assertions in response to the assessed risk of material misstatements for the year under audit. These assertions were not examined by him in previous years due to materiality or risk considerations.

Mr. X leads the internal audit department of the company and reports to the company's audit committee. During the audit, a senior member of the engagement team decides to engage Mr. X to provide direct assistance in performing the above substantive procedures. Comment with respect to the relevant Standards on Auditing.

Also, indicate the activities to be performed by the statutory auditor prior to using internal auditor for providing direct assistance.

Answer:

SA 610, "Using the Work of Internal Auditor" states that in determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned. Examples of activities and tasks that would not be appropriate to use internal auditors to provide direct assistance include the discussion of fraud risks, determination of unannounced audit procedures as addressed in SA 240 etc.

In the above case, engagement partner had designed certain substantive procedures on some selected assertions in response to assessed risk of material misstatements in year under audit. Such assertions were not tested by him in the previous years due to materiality or risk considerations. It is being done now for incorporating an element of unpredictability in audit procedures to be performed as individuals within the company who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting.

Therefore, in such matters, using an internal auditor to provide direct assistance could prove to be counter-productive and defeat the very purpose of designing such substantive procedures. Hence, decision of senior engagement team member to use Mr. X to provide direct assistance on above said matters is not in accordance with SA 610 and is not proper.

Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall: -

(a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and

(b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

Question 15 **Newly Added**

The management of High Limited is concerned with the reporting requirement cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 for the financial year 2023-24 with regard to the Audit Trail (edit log). Audit trails may be enabled at the accounting software level depending on the features available in such software or same may be captured directly in the database underlying such accounting software. Consequently, the management of the company approached CA J and asked him to suggest them list of internal controls which may be required to be implemented and operated to demonstrate that the Audit trail (or Edit Log) feature was functional, operated and was not disabled. Guide CA J.

Answer:

In order to demonstrate that the audit trail feature was functional, operated and was not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors, as appropriate. An illustrative list of internal controls which may be required to be implemented and operated are given below:

- ✓ Controls to ensure that the audit trail feature has not been disabled or deactivated.
- ✓ Controls to ensure that User IDs are assigned to each individual and that User IDs are not shared.
- ✓ Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.
- ✓ Controls to ensure that access to the audit trail (and backups) is disabled or restricted and access logs, whenever the audit trails have been accessed, are maintained.

Controls to ensure that periodic backups of the audit trails are taken and archived as per the statutory period specified under the provisions of the Act.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24)**

One of the independent directors sought information regarding the appointment of internal auditors for the following Group Companies in accordance with the Companies Act, 2013 of which certain financial information are given below:

Figures are in Rs. crore and correspond to the previous year.

Name	Nature	Equity Share Capital	Turnover	Loan from Bank and PFI	Public Deposits
XYX Limited	Listed	100	230	20	48
MNM Limited	Unlisted Public	60	100	50	24
GFG Limited	Unlisted Private	70	180	80	-

You are required to evaluate the requirements regarding the appointment of internal Auditors for the Group Companies. Discuss.

Answer: Already covered in TYK Qn

Question 2 **(PYP May '24 4M)**

The management of High Limited is concerned with the reporting requirement cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 for the financial year 2023-24 with regard to the Audit Trail (edit log). Audit trails may be enabled at the accounting software level depending on the features available in such software or same may be captured directly in the database underlying such accounting software. Consequently, the management of the company approached CA J and asked him to suggest them list of internal controls which may be required to be implemented and operated to demonstrate that the Audit trail (or Edit Log) feature was functional, operated and was not disabled. Help CA J.

Answer: Already covered in TYK Qn

Question 3 **(PYP May '25 5M)**

Footwear Ltd., a manufacturing company has recently appointed you as its Internal Auditor to review its financial and operational controls. You have to conduct the internal audit in compliance with the standards of Internal Audit, within the framework governing Internal Audits. During the audit, you have identified misappropriation of inventories and suspected fraudulent activities by a procurement manager. You thought it would be more appropriate to bring the same immediately to the attention of the management. As per the principles outlined in Standard on Internal Audit, you need to prepare an internal audit report covering the audit findings. Explain the stages of internal audit reporting results as per relevant Standard on Internal Audit and state the key elements to be included while issuing a clear, well documented Internal Audit Report by you as an internal auditor.

Answer:

As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

- ✓ At the end of a particular audit assignment, an "Internal Audit Report" covering a specific area, function, or part of the entity is prepared by the Internal Auditor, highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.

- ✓ On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of an external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g., Quarterly) report shared with the Audit Committee.

On the basis of the internal audit work completed, the Internal Auditor shall issue a clear, well-documented Internal Audit Report which includes the following key elements:

i) An overview of the objectives, scope, and approach of the audit assignments;

ii) The fact that an internal audit has been conducted in accordance with the Standards of Internal Audit;

iii) An executive summary of key observations covering all important aspects, and specific to the scope of the assignment;

iv) A summary of the corrective actions required (or agreed by management) for each observation; and

v) Nature of assurance, if any, which can be derived from the observations.

Test Your Understanding from ICAI SM

Test Your Understanding 1. Exceptional

CA Y is employed with a leading private sector BDFP Bank posted in Noida branch. One of the existing borrowers has approached the branch with a proposal to sanction fresh term loan of Rs.5 crore with commensurate increase in working capital credit facilities relating to expansion of its garment manufacturing unit. While performing due diligence, he notices that the company was formed just two years ago and had availed term loan of Rs.10 crore and cash credit facilities of Rs.5 crore respectively. Its sales have increased from Rs.25 crores in the first year to Rs.45 crores in the year just ended. It is generating cash profits and is timely servicing its debts.

The borrower was catering to the domestic market earlier. However, now it is in the process of procuring export orders and working diligently in this regard. The expansion plans are in line with development in the area of marketing relating to exports.

However, there are a large number of units catering to domestic and export market of garments in Noida, Delhi and surrounding areas. There is also a demand slump in the biggest US market.

Besides, the unit is family-based and relies upon the marketing skills of its main promoter. There is lack of well-paid qualified staff with the borrower to deal effectively with its customers both domestic as well as foreign.

He starts jotting down and elaborating above points. Identify what he is trying to do as part of due diligence.

Answer:

As a part of due diligence exercise, he is performing SWOT analysis of borrower. He is making analysis of strengths, weaknesses, opportunities and threats (SWOT) pertaining to borrower. Features such as rise in sales, generation of cash profits and timely service of debts represent borrower strengths. Lack of well-paid qualified staff to deal effectively with its domestic and foreign customers is an area of weakness. Entering into export market presents an opportunity for borrowers and the presence of large number of competitors and demand slump in the US market reflect threats.

Test Your Understanding 2.

A company has installed an Effluent treatment plant (ETP) in compliance with pollution control regulations of the state government. The authority structure in the company is fairly decentralized and top management of the company has given considerable leeway to different departments for meeting their manpower requirements in accordance with emerging and changing needs from time to time. Recently, the top management became concerned about the growing manpower expenditure in section maintaining and beautifying area around ETP. There is a system in the company where timecards are punched by all employees to mark attendance.

Suggest any one procedure you would perform as an investigator to bring out the facts.

Answer:

The attendance record of employees pertaining to that section can be analysed with regards to in and out time. Further, surprise visit to the site can be conducted to see the actual number of workers at a point of time. It may reveal ghost workers. Discrepancies in attendance records vis-à-vis actual number of workers present could reveal dummy workers. Such a visit would also give indication of actual work done in the area and give an inkling of productivity of employees.

Test Your Understanding 3. Exceptional

Limited engaged in manufacturing of floor coverings has taken a Product Liability Insurance policy (PLI). Such a policy covers risk of liabilities for damages for bodily injury resulting from sale and distribution of floor coverings by vendors of X Limited's products. The policy is also subject to "claim series" clause. A Claims Series event is a series of two or more claims arising from one specific common cause which are attributable to the same fault in design or manufacture of products or to the supply of the same products showing the same defect. A claim series event is deemed to be one claim under the terms & conditions of PLI policy.

The company has been asked to shell out damages of Rs.5 crore due to supply of faulty products to one of its vendors. The vendor had sold floor coverings to a 5-star hotel which has alleged that harmful chemicals used in dyeing of floor coverings have resulted in skin ailments to some of its guests.

Being in capacity of Forensic Professional appointed by insurance company, what special issues you would keep in mind while dealing with claims involving PLI policy covering such matters?

Answer:

i. In claims involving product liability insurance policies, many documents are required from third parties. The third party may be unwilling to provide relevant documents to Forensic Professional concerning the very organization responsible for causing damages.

ii. Independence of Forensic Professional become paramount in such types of assignments because it involves engagement with parties who are not directly claiming from insurance company. Forensic Professional needs to resist any pressure or interference in establishing the scope of the assignments or the manner in which the work is conducted and reported.

iii. The company might be willing to negotiate it to salvage its reputation. It can lead to additional complexities.

iv. Quantification of legal liability under the policy can prove to be a challenging task and it has to be determined in accordance with policy terms & conditions.

v. Careful analysis of date of loss when first claim occurred in accordance with "claim series" clause and whether the same falls under the policy

Learn Contextually

Test Your Knowledge

Question 1

Sri Rajan is above 80 years old and wishes to sell his proprietary business of manufacture of specialty chemicals. Ceta Ltd. wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business.

What procedures you would adopt before you could render any advice to Ceta Ltd.?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 2

An American Company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of more than 65% of the industrial gas business in India. It requests you to conduct a "Due Diligence" of this Indian Company and submit your Report. List out the contents of your Due Diligence Review Report that you will submit to your USA based Client.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 3

KDK Bank Ltd., received an application from a pharmaceutical company for takeover of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. KDK Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 4

"Due diligence is different from audit" – Explain the difference between due diligence and audit.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 5 Exceptional

PB Ltd. entered into a deal with SV Ltd. for buying its business of manufacturing wooden products/goods. PB Ltd. has appointed your firm for conducting due diligence review and they want to know the cash generating abilities of SV Ltd. What points will you check in order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally?

Answer:

In order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally, one is required to verify:

a. Is the company able to honor its commitments to its trade payables, to the banks, to the government and other stakeholders?
b. How well is the company able to convert its trade receivables and inventories?
c. How well the Company deploys its funds?
d. Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
e. What is the investment pattern of the company and are they easily realizable?

Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 6 Exceptional

CA Sanjana is acting as Credit manager in branch of DFC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth Rs.10 crore for meeting usual business requirements. It is a prospective new client. She checks past history of the company, background of promoters & directors, shareholding pattern and nature of business.

Assessment of financial results of past years and future projections is also undertaken. She also carries out SWOT analysis of the company.

Besides, assessment of net worth of directors is also undertaken. Status of CIBIL score and position of name of promoters/directors in RBI defaulter list is also verified.

She also makes discreet inquiries from few clients of the branch engaged in similar line of activity regarding credit worthiness of company, its promoters and directors.

Based on above-

a. Identify activity being performed by CA Sanjana and discuss its nature.

b. Would your answer be different if this activity was to be performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.

c. Name any three other areas where identified activity can be undertaken.

Answer:

a. The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.

   Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.

   Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

b. There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.

c. The areas where due diligence may be undertaken are: -

   i. Corporate restructuring
   ii. Venture capital financing
   iii. Public offerings

Question 7

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

List out the points you will cover in your investigation before submitting your report to the General Manager.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 8

What are the important steps involved while conducting Investigation on behalf of an Incoming Partner?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 9

Mr. Clean who proposes to buy the proprietary business of Mr. Perfect, engages you as investigating accountant. Specify the areas which you will cover in your investigation.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 10

In a Company, it is suspected that there has been embezzlement in cash receipts. As an investigator, what are the areas that you would verify?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 11 Exceptional

J Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd., what factors would you consider in assessing the future maintainable turnover?

Answer:

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

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

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

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

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

Question 12

MF Ltd., engaged in the manufacturing of various products in its factory, is concerned with shortage in production and there arose suspicion of inventory fraud. You are appointed by MF Ltd. To evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 13

In a Public Limited Company, it is suspected by the Management that there has been embezzlement in supplier's ledger. As an auditor of the Company, you have been asked to investigate the matter. What are the major areas that you would verify in this regard?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 14

General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose.

In view of the above, you are required to brief out the difference between Audit and Investigation.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 15

Enumerate the steps to be undertaken in case of forensic accounting process.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 16

Briefly discuss the key content of Forensic Accounting and Investigation Report.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 17

ABC Ltd. is a listed company having turnover of Rs.50 crores & plans expansion by installation of new machines at new building-having total additional project cost of Rs.20 crore.

Rupees (In crore)	Purpose
10.0	- for Building
8.5	- for Machinery
1.5	- for Working Capital
20 Crore	Total

Project gets implemented in 2022-23 and one of the accountants report to the Managing Director that some suspicious transactions are noticed in the purchase of building material.

But the Management is confused as to whether they should get an audit or Forensic Accounting done for the same. Advise Management about the difference in forensic accounting and audit.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 18 Exceptional

CA Rajpal is performing a forensic accounting engagement involving gathering of evidence in relation to suspected fraud of substantial amount in a company. He has been appointed under the terms of a contractual agreement with the company.

The company operates in an electronic environment. While performing engagement, his team has gathered evidence from electronic records in Enterprise Resource Planning system (ERP), messages in company's e-mail system and also from system logs and audit trails generated by company's computer systems. However, while doing so, the team has failed to take care of aspects such as keeping records of each person in team gathering relevant evidence, date and time of collection and storage of such evidence. What implications may it have on forensic accounting engagement as such?

Answer:

In a forensic accounting engagement, professional undertakes a scrutiny and detailed examination of all transactions and balances relevant to the mandate so that evidence gathered is suitable in a Court of Law i.e. in compliance with legal requirements where it can be challenged through cross-examination by the defending party.

It is important that team is skilled in collecting evidence that can be used in a court case keeping a clear chain of custody till evidence is presented in court. If there are gaps in chain of custody, then the evidence may be challenged in court or even become inadmissible.

In the given case, team has failed to keep record of matters such as persons gathering relevant evidence, date and time of collection and storage of evidence. Therefore, team has failed to maintain the chain of custody.

It can, therefore, defeat the objective of forensic accounting engagement as evidence may be challenged in Court of law by defending parties and may become inadmissible.

Question 19

Mr. Rajat, while reviewing the anti-fraud controls for a construction company, found that the company has witnessed a few frauds in the past mainly in the nature of material theft from the sites and fake expense vouchers.

Mr. Rajat is evaluating options for verifying the process to reveal fraud and the corrective action to be taken in such cases. As an expert in fraud prevention, you have been asked to brief Mr. Rajat about the inventory fraud and verification procedure with respect to defalcation of inventory.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 20

Sid is a financial analyst working for a large corporation that is considering the acquisition of a mid-sized manufacturing company. The initial financial statements provided by the target company appear to be in order, showing profits and a solid asset base. However, his team is concerned about potential risks that may not be immediately visible in the financial documents provided.

Guide Sid on what specific aspects should be focused during due diligence to ensure that there are no hidden liabilities in this deal?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 21

Quality Ltd. is engaged in the business of manufacturing and distribution of various Ready to cook products like vegetables, Noodles etc. The government made certain changes in rules and regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor who can fund some part of the proposed expansion. Mr. Aman is interested in the venture and appoints you to act as an advisor to the proposed investment in the business of Quality Ltd. You have to investigate the audited financial statements and ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking and can reliance be placed on the already audited statement of accounts?

Answer:

In the instant case, Quality Ltd. is engaged in the business of manufacturing and distribution of various ready-to-cook products like vegetables, noodles etc. Further, management was looking for some financial investor to fund some part of the proposed expansion. Aman is interested in funding; therefore, he initiated investigation of audited financial statements to ensure the appropriateness of the valuation of the shares. For initiating the same it may be considered that if the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh.

- ✓ If the statements of account produced before the investigator were not audited by a qualified accountant, then of course there arises a natural duty to get the figures in the accounts properly checked and verified.
- ✓ However, when the accounts produced to the investigator have been specially prepared by a professional accountant, who knows or ought to have known that these were prepared for purposes of the investigation, he could accept them as correct relying on the principle of liability to third parties.
- ✓ It would be prudent to see first that such accounts were prepared with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared.

Question 22

Core Limited submitted a credit proposal XYZ Bank Limited for the sanction of a Term Loan of Rs.150.00 crore required for procuring and installing a latest Plant and machinery for their upcoming project. Based on the application, XYZ Bank Limited approached CA P to investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by Core Limited, 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. Elucidate the steps that should be undertaken by CA P?

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Learn Contextually

Questions From RTP'S, MTP'S, QP'S

Question 1 Exceptional **(MTP 1 Nov '24 4M)**

Vicky is a financial analyst working for a large corporation that is considering the acquisition of a mid-sized manufacturing company. The initial financial statements provided by the target company appear to be in order, showing profits and a solid asset base. However, his team is concerned about potential risks that may not be immediately visible in the financial documents provided.

Guide Vicky on what specific aspects should be focused during due diligence to ensure that there are no hidden liabilities in this deal?

Answer:

The objective of the Due Diligence exercise will be to look specifically for any hidden liabilities or over-valued assets.

Example of Hidden Liabilities:

- The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
- The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
- Tax liabilities under direct and indirect taxes.
- Long pending sales tax assessments.
- Pending final assessments of customs duty where provisional assessment only has been completed.
- Agreement to buy back shares sold at a stated price.
- Future lease liabilities.
- Environmental problems/claims/third party claims.
- Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
- Huge labour claims under negotiation when the labour wage agreement has already expired.
- Unresolved labour litigations.

Question 2 **(MTP 2 Nov '24 5M)**

Quality Ltd. is engaged in the business of manufacturing and distribution of various Ready to cook products like vegetables, Noodles etc. The government made certain changes in rules and regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor who can fund some part of the proposed expansion. Mr. Aman is interested in the venture and appoints you to act as an advisor to the proposed investment in the business of Quality Ltd. You have to investigate the audited financial statements and ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking and can reliance be placed on the already audited statement of accounts?

Answer: Already covered in TYK Qn

Question 3 **(MTP 1 May '24 4M)**

CA. Puranjay is performing a forensic accounting engagement involving gathering of evidence in relation to suspected fraud of substantial amount in a company. He has been appointed under terms of a contractual agreement with the company.

The company operates in an electronic environment. While performing engagement, his team has gathered evidence from electronic records in Enterprise Resource Planning system (ERP), messages in company's e-mail system and also from system logs and audit trails generated by company's computer systems. However, while doing so, team has failed to take care of aspects such as keeping record of each person in team gathering relevant evidence, date and time of collection and storage of such evidence. What implications it may have on forensic accounting engagement as such?

Answer: Already covered in TYK Qn

Question 4 **(MTP 2 May '24 5M)**

Mr. Rajat, while reviewing the anti-fraud controls for a construction company, found that the company has witnessed a few frauds in the past mainly in the nature of material theft from the sites and fake expense vouchers.

Mr. Rajat is evaluating options for verifying the process to reveal fraud and the corrective action to be taken in such cases. As an expert in fraud prevention, you have been asked to brief Mr. Rajat about the inventory fraud and verification procedure with respect to defalcation of inventory?

Answer:

Inventory frauds are many and varied but we are concerned with misappropriation of goods and their concealment.

i. Employees may simply remove goods from the premises.
ii. Theft of goods may be concealed by writing them off as damaged goods, etc.
iii. Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.
iv. Inflating the quantities issued for production is another way of defalcating raw materials and store items.
v. Stocks actually dispatched but not entered in sales / debtor's account.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and dispatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

(a) a system of inventory control, and existence of detailed record of the movement of inventory, or

(b) availability of sufficient data from which such a record can be constructed. The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book. Investigating accountant should ascertain the exact duties of persons handling the stocks received in and issued from store for production/ sale or any other purpose. Identify the excessive control in the hands of a single person, without any supervision as it will widen the scope of investigation.
Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of

returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

Question 5 Exceptional **(PYP May '24 5M)**

Core Limited submitted a credit proposal XYZ Bank Limited for the sanction of a Term Loan of Rs. 150.00 crore required for procuring and installing a latest Plant and machinery for their upcoming project. Based on the application, XYZ Bank Limited approached CA P to investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by Core Limited, 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. Elucidate the steps that should be undertaken by CA P?

Answer:

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:

(1) 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.

(2) 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.

(3) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

Question 6 **(PYP Nov '24 4M)**

CEP Ltd., a manufacturing company, has a diverse range of suppliers for raw materials and components. Several new suppliers have been added during the past year. It is the responsibility of the Accounts payable department for managing the Suppliers' Ledger, processing invoices and making payments. The management of CEP Ltd. has experienced unexpected financial discrepancies, and they suspect fraudulent activities within the Suppliers' Ledger. The management assigns CA K to conduct a detailed investigation to identify any potential fraud that might have occurred. Discuss the ways in which frauds can be committed through Suppliers' Ledger. Explain the procedures that CA K will adopt to investigate the potential fraud.

Answer:

Ways in which fraud can be committed through suppliers' ledger are-

(i) Adjusting fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.

(ii) Suppressing the credit notes issued by suppliers and withdrawing the corresponding amounts not claimed by them.

(iii) Withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same has been paid to them.

(iv) Accepting purchase invoices at prices considerably higher than their market prices and collecting the excess amount paid in cash, from the suppliers.

CA K will ensure that the following procedures are adopted to investigate potential fraud:

- That the Purchase Journal should be vouched by reference to entries in the Goods Inward Book and the suppliers' invoices to confirm that amounts credited to the accounts of suppliers were in respect of goods, which were duly received, and the suppliers' accounts had been credited correctly.
- All the suppliers should be requested to furnish statements of their accounts to see whether or not any balance is outstanding or due so as to confirm that allowances and rebates given by them have been correctly adjusted and were duly authorized by the authorized person/ officer.
- Examine the system of internal control in relation to purchase orders issued and identify possibilities of collusion with suppliers.

Question 7 **(PYP May '25 4M)**

KLIM Ltd., a construction company, engaged in constructing and selling residential or commercial properties, having suspected potential fraud of substantial amount, engaged CA J, a forensic accountant, to investigate the matter. During the course of performing a forensic accounting engagement in relation to suspected fraud, which aspects CA J should take care of while undertaking the process of obtaining relevant evidence?

Answer:

During the course of performing a forensic accounting engagement in relation to suspected fraud, while undertaking the process of obtaining relevant evidence, CA J should take care of the following aspects:

1. Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event.
2. In order to gather detailed evidence, the investigator must understand the specific type of fraud

that has been carried out and how the fraud has been committed.

3. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered.
4. It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court.
5. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged, or destroyed by the suspect(s).

Test Your Understanding from ICAI SM

Test Your Understanding 1.

You have recently joined a listed company after qualifying CA final exams through campus placement programme conducted by CMI&B at ICAI. Although the company you have joined in is not amongst top 1000 listed companies in the country, it wants to include "Sustainability reporting" in accordance with Global Reporting Initiative framework (GRI) in its annual report on voluntary basis. "Sustainability reporting" seems to be new buzzword in corporate circles and you are assigned responsibility for collating all the information required for such reporting.

In the above context, dwell upon what is your understanding of "Sustainability reporting"? Can you list some of its expected benefits?

Answer:

Sustainability reporting is an organization's practice of reporting publicly on its economic, environmental, and/or social impacts and hence its contributions – positive or negative – towards the goal of sustainable development

Sustainability reporting refers to the information that companies provide about their performance to the outside world on a regular basis in a structured way. It is the comprehensive mechanism of measuring and disclosing sustainability data with performance indicators and management disclosures.

Expected Benefits: It can help stakeholders to understand organizations performance vis a vis sustainability and impacts. The reporting process emphasizes the link between financial and non-financial performance.

Such reporting can help entities to focus on long-term value creation, by addressing environmental, social and governance (ESG) issues. Since investors are increasingly recognising that environmental and social issues provide both risks and opportunities in respect of their investments and are seeking disclosures on the environmental and social performance of businesses, they can use ESG performance of companies to make investment decisions.

Investing in social and environmental issues will not only improve own business continuity of companies but also put them in a better position with their B2B (Business to Business) customers as well as enable them to acquire new ones.

Test Your Understanding 2.

Trustworthy Industries Limited (a listed company) has already been preparing and disclosing its sustainability report based upon internationally accepted reporting framework of "Integrated Reporting" on a voluntary basis even some years before BRSR reporting became mandatory.

Even after BRSR reporting became mandatory, it is cross-referencing disclosures made under such reporting to disclosures sought under BRSR. The key thrust of "Integrated Reporting" is how company creates value over short, medium and long term.

Following further information is provided in respect of the above company: -

i. It has increased the number of customers using digital customer mobile app of the company from 2 lac users to 4 lac users. There is 100% increase in digital collection. It has benefitted customers of the company and resulted in use of digital methods for business operations of the company.

ii. It has increased the number of beneficiaries under its flagship CSR programmes from previous 10000 to 75000. It has provided value for communities and provided sustainable livelihood to them.

Discussing above information, identify which of the capitals of "Integrated Reporting" are being referred to at [i] and [ii] respectively?

Answer:

The information at [i] states that company has increased the number of customers using digital mobile app. Besides, it has led to a 100% increase in digital collection. Therefore, it involves the use of technology for deriving business benefits. It has invested in innovation deriving business benefits from digitization. The capital referred to at [i] is "Intellectual Capital".

An increase in number of beneficiaries under flagship CSR programmes providing value for communities and sustainable livelihood is an example of relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being. The capital referred to at [ii] is "Social and Relationship Capital."

Case Studies from ICAI SM

Case Study 1.

The agrochemical sector is about a $35 billion industry in India. The Indian agrochemicals market is segmented by product type (fertilizers, pesticides, adjuvants, and plant growth regulators) and application (crop-based and non-crop-based). India is one of the most prominent exporters of agrochemicals in the world and is being keenly looked at as an ideal hub for export-oriented production of agrochemicals. There has been a recent surge in the production of agrochemicals to overcome problems such as lack of right nutritious elements required for proper growth of crops, etc. While there is low awareness about the use and impact of agrochemicals, there is also a push from the industries to use more agrochemicals, linking it to better yield. The continuous and increased use of agrochemicals seems to have an adverse effect on humans, animals, and nature in whole.

The toxicity levels of the agrochemicals are harmful, not only to the workers in the manufacturing process but also to farmers, the soil, and the end consumers. The Central Insecticide Board (CIB) of India has categorized agrochemical toxicity levels based on a labeling system—using red, yellow, blue, and green labels—where red is the most toxic and green is the least. Most of the red-labeled products are banned abroad but are being sold in India due to the lack of a strong regulatory environment.

In India, it is estimated that almost 25% of the total amount of agrochemicals sold are counterfeit products. The quality and the efficacy of these counterfeit products differ from the original products, which can lead to reputational damages for the companies. Agrochemical companies need to add barcodes or other identifying technologies to their product packaging, to allow endues consumers to check for authenticity. Also, since India is a multilingual country, the companies will have to publish the usage instructions in multiple languages.

Company A and B are both listed companies and part of top 1000 listed companies. They are engaged in the production of agrochemicals. Company A has been looking for opportunities to comply with the recently launched and evolving guidelines for ESG in India while Company B on the other hand is just focused to increase revenue and profits. In December 2023, Company A made a decision to eliminate red-labeled products from its portfolio and to increase its research and development (R&D) spending to safeguard itself from the market shift due to the new regulatory norms; in 2023, it also discontinued yellow-labeled products. Company A is also planning to incur a small expenditure to improve their backend systems and provide for all its products a unique labelling system that is user friendly and interactive. At the other end of the spectrum, 14% of Company B's top-selling products are derived from red- and yellow labeled products.

Initially, Company A's phasing out of its toxic products negatively affected its revenues by 8%. But as the country's regulatory landscape evolves toward more stringent norms, Company A will be cushioned for regulatory changes and thus, would not face potential future downsides.

Company B has recently witnessed a 9% year on year growth in revenue from the last financial year and is planning to increase the production of its bestselling product, an insecticide DDT, categorized as red labelled by the Central Insecticide Board. Company B has recently been approached by the regulatory authority for an investigation for its products which include performing additional tests and studies to testify that its products have no adverse effects.

Question 1

What would be the reporting requirements for each of the two companies?

Answer:

Both Companies A and B are among part of top 1000 listed companies. Hence, these companies have to mandatorily provide BRSR reporting (Business responsibility and Sustainability reporting) in accordance with 9 principles of NGBRC as mandated by SEBI.

Question 2

Which Company has absorbed the impacts of possible future regulatory changes? What are the steps taken by that Company for complying with the regulatory standards?

Answer:

Company A has absorbed impact of regulatory changes. It has decided to eliminate red-labelled and yellow-labelled products from its portfolio which are toxic in nature. Besides, it has increased its expenditure on R & D to meet with new regulatory norms. It has also incurred expenditure for improving its labelling system which would help end users to know about the nature of the product. All these steps have been taken by Company A for complying with regulatory standards.

Company A is trying to meet with requirements of Principle 2 by making R & D expenditure. Further, it has also eliminated red-labelled/yellow-labelled products from its portfolio. Principle 2 relates to the requirement that businesses should provide goods and services in a manner that is sustainable and safe. Besides, by adopting a friendly bar-coded packaging labelling system, company is adhering to requirements of Principle 9 which states that businesses should engage with and provide value to their consumers in a responsible manner. Steps taken by a company to inform its consumers about safe and responsible usage of products fall in its domain.

Since toxic agrochemicals are also harmful to workers engaged in their manufacturing process, their discontinuation bodes well for workers in the company A in line with Principle 3 which states that businesses should respect and promote the well-being of all employees including those in their value chains. By discontinuing products which are harmful to soil, company A is meeting requirements of Principle 6 which states that businesses should respect and make efforts to protect and restore the environment.

Question 3

What would be the consideration by the auditors of Company A and B in the audit of financial statements?

Answer:

Company A is complying with regulatory norms whereas 14% of company B's revenue are derived from red and yellow labelled products. In fact, company B is planning to increase production of its red labelled product i.e., insecticide DDT which has been categorized as such by Central Insecticide Board. The auditor of Company B would have to keep in mind requirements of SA 250 in this regard. Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements. It can result in material misstatements. Central Insecticide Board has already launched its investigation into products of company. All these factors would be taken into consideration by auditor of Company B.

Auditors of Company A and Company B need to obtain audit evidence regarding compliance with laws and regulations and audit procedures have to be designed accordingly. Auditor of Company A can obtain assurance from regulatory compliance by the company. Fall of revenue by 8% in one year is not a matter of concern to them as it is a transitory phase.

However, auditors of Company B would also have to take into consideration requirements of SA 570 as non-compliance with regulatory requirements could result into claims from such proceedings which the company may not be able to satisfy.

Test Your Knowledge

Question 1

What type of companies are required to mandatorily furnish the Business Responsibility and Sustainability Report (BRSR) as per the SEBI circular with effect from FY 2022-23?

Answer: Refer GOAT Notes- Straight Concept Question and hence ignore here

Question 2

What are the nine principles of BRSR? How are the nine principles of BRSR linked with the 17 UN Sustainable Development Goals?

Answer: Refer GOAT Notes- Straight Concept Question and hence ignore here

Question 3

What are the global trends in sustainable reporting?

Answer: Refer GOAT Notes- Straight Concept Question and hence ignore here

Question 4

What are the 6 C's of Integrated reporting?

Answer: Refer GOAT Notes- Straight Concept Question and hence ignore here

Question 5

What is the methodology of providing assurance in BRSR?

Answer: Refer GOAT Notes- Straight Concept Question and hence ignore here

Question 6

What is the auditor's role on ESG aspects in an audit of financial statements of the Company?

Answer: Refer GOAT Notes- Straight Concept Question and hence ignore here

Question 7 **Newly Added**

CTO Limited is engaged in the fintech business. It is a member of few prominent industry chambers and trade associations and has come under mandatory purview of Business Responsibility and Sustainability Reporting (BRSR) for year 2022-23.

The company had submitted inputs on draft digital personal data protection bill to concerned Ministry during year 2022-23. It had also submitted to one of the industry chambers during the same year certain key inputs on leveraging India's digital public infrastructure for creating solutions by banks and fintechs together as its taskforce member on the subject. Considering the above, discuss how above information would likely be disclosed by company in "Principle-wise performance disclosures" as part of BRSR for year 2022-23?

Whether information discussed above would require to be disclosed mandatorily?

Answer:

The given case highlights that CTO Limited, engaged in Fintech business, is a member of Chamber of Commerce/associations. Such information needs to be disclosed under Principle 7 of Principle-wise Performance Disclosures.

Principle 7 recognizes that businesses, when engaging in influencing public and regulatory policy, operate within the framework of statutory and legislative policies of the governing authority. Collective associations such as trade groups and industry chambers have to be utilized when moving ahead with policy advocacy and formulation.

The information under each principle is to be disclosed under Essential indicators (mandatory disclosures) and Leadership indicators (optional disclosures).

Information relating to membership of Chamber/Associations is in the nature of Essential Indicators and requires Mandatory disclosures.

Information relating to inputs provided by company to the Ministry on a legislative bill and inputs provided to one of the prominent chambers on leveraging India's digital public infrastructure for creating solutions by Banks and Fintechs together as a taskforce member on the subject are in nature of leadership positions taken by the company. These are in the Nature of Leadership Indicators and are Optional Disclosures.

Question 8 **Newly Added**

SEBI has made Business Responsibility and Sustainability Report (BRSR) mandatory for certain listed companies. It is an evolutionary step in Environment, Social and Governance (ESG) reporting. Discuss the nature of ESG reporting. How can corporates contribute to Sustainable Development Goals (SDGs)?

Answer:

ESG reporting can be both quantitative and qualitative in nature. Qualitative reports tend to describe a company's strategy or policy around the relevant topics, while a quantitative approach includes metrics, and key performance indicators (KPIs) linked to each area in order to measure progress against goals and report on achievements. Naturally, a mixed approach that makes use of both qualitative and quantitative information tends to add the maximum value to the quality of disclosures.

United Nations members states adopted Sustainable Development to provide a blueprint which mentioned the Sustainable Development Goals (SDGs). They recognized that ending poverty and other deprivations must go hand in hand with strategies that improve health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests.

Corporates can contribute to SDGs due to their capacity to provide solutions necessary for meeting SDGs. Companies can lead in innovation and contribute to achievement of Sustainable Development Goals

Question 9 **Newly Added**

SU Limited is amongst the top 1000 listed entities. With the introduction of new reporting requirements by SEBI on ESG parameters called the Business Responsibility and Sustainability Report (BRSR), it requires SU Limited to make disclosures on their performance against the various principles of the "National Guidelines on Responsible Business Conduct". One of the principles emphasizes that the business decisions in an organization should be open to disclosure and accessible to the relevant interested parties. Elucidate the essence of core elements associated with the aforesaid principle.

Answer: Refer GOAT Notes

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 2 Nov '24 4M)**

Consistent Enterprises Ltd., a listed company, has been voluntarily preparing and disclosing its sustainability report based on the internationally accepted "Integrated Reporting" framework for some years, even before BRSR reporting became mandatory. Even after BRSR reporting became mandatory, it is cross-referencing disclosures made under such reporting to disclosures sought under BRSR. The key focus of Integrated Reporting is how the company creates value over the short, medium, and long term.

Following further information is provided in respect of the above company:

(i) It has secured a loan to expand its operations and invests the funds in purchasing raw materials and machinery. The loan, along with revenue generated from existing sales, contributes to the pool of resources available for production.

(ii) It has increased the number of beneficiaries under its flagship CSR programmes from previous 10000 to 75000. It has provided value for communities and provided sustainable livelihood to them.

Discussing the above information, identify which of the capitals of "Integrated Reporting" are being referred to at [i] and [ii] respectively?

Answer: Already covered in TYU Qn

Question 2 **(MTP 1 May '24 4M)**

CTO Limited is engaged in the fintech business. It is a member of few prominent industry chambers and trade associations and has come under mandatory purview of Business Responsibility and Sustainability Reporting (BRSR) for year 2022-23.

The company had submitted inputs on draft Digital personal data protection bill to concerned Ministry during year 2022-23. It had also submitted to one of the industry chambers during the same year certain key inputs on leveraging India's digital public infrastructure for creating solutions by banks and fintechs together as its taskforce member on the subject. Considering the above, discuss how above information would likely be disclosed by company in "Principle-wise performance disclosures" as part of BRSR for year 2022-23?

Whether information discussed above would require to be disclosed mandatorily? **(4 Marks)**

Answer: Already covered in TYK Qn

Question 3 **(MTP 2 May '24 4M)**

You have recently joined a listed company after qualifying CA final exams through campus placement programme conducted by ICAI. The company you have joined is not amongst top 1000 listed companies in the country. However, it wants to include "Sustainability reporting" in accordance with Global Reporting Initiative framework (GRI) in its annual report on voluntary basis. "Sustainability reporting" seems to be new buzzword in corporate circles and you are assigned responsibility for collating all the information required for such reporting.

In above context, dwell upon what is your understanding of "Sustainability reporting"? You are also required to list its expected benefits.

Answer:

Sustainability reporting is an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development

Sustainability reporting refers to the information that companies provide about their performance to the outside world on a regular basis in a structured way. It is a comprehensive mechanism of measuring and disclosing sustainability data with performance indicators and management disclosures.

Expected Benefits: It can help stakeholders to understand organizations performance vis a vis sustainability and impacts. The reporting process emphasizes the link between financial and non-financial performance.

Such reporting can help entities to focus on long-term value creation, by addressing environmental, social and governance (ESG) issues. Since investors are increasingly recognizing that environmental and social issues provide both risks and opportunities in respect of their investments and are seeking disclosures on environmental and social performance of businesses, they can use ESG performance of companies to make investment decisions.

Investing in social and environmental issues will not only improve own business continuity of companies but also put them in a better position with their B2B (Business to Business) customers as well as enable them to acquire new ones.

Question 4 **(PYP May '24 4M)**

SU Limited is amongst the top 1000 listed entities. With the introduction of new reporting requirements by SEBI on ESG parameters called the Business Responsibility and Sustainability Report (BRSR), it requires SU Limited to make disclosures on their performance against the various principles of the "National Guidelines on Responsible Business Conduct". One of the principles emphasizes that the business decisions in an organization should be open to disclosure and accessible to the relevant interested parties. Elucidate the essence of core elements associated with the aforesaid principle.

Answer:

Principle 1 – Ethics, Transparency and Accountability: The first principle emphasizes that the business decisions in an organisation should be open to disclosure and accessible to the relevant interested parties.

The essence of the core elements associated with the first principle are:

i. The entities' governing structure should develop policies, procedures, and practices for their offices, factories, and work areas, ensuring that ethics is not compromised.
ii. The information relating to the policies, procedures, and practices along with the performance should be made available to the stakeholders.
iii. In case of adverse effects, more care has to be taken for transparent disclosures.
iv. The entities in the value chain should be encouraged to adopt these principles by the governance structure.
v. The entities should proactively respond to the outside entities that violate the nine principles of the BRSRs. This includes their suppliers, distributors, sub-contractors, or regulatory officers that may engage with the business concern.

Question 5 **(PYP Nov '24 4M)**

ESG disclosure and reporting is mandatory for top 1000 listed companies in form of Business Responsibility and Sustainability Reports (BRSR). As reporting of sustainability information becomes the trend being observed globally, the demand for independent assurance of sustainability information is anticipated to grow as entities around the globe look to enhance the integrity of their sustainability reporting. In developing the understanding of an entity, the auditor should include the consideration of climate - related risks and how these risks may be relevant to the audits. Many investors and stakeholders are seeking information from auditor's report about how climate-related risks are addressed in the audit.

In the context of the above, describe the role of auditor in an audit of financial statements of the company.

Answer:

Role of Auditor - Consideration of climate-related risks in an audit of financial statements:

- ✓ The role of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, to report whether the financial statements are prepared and presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
- ✓ The auditor should include the consideration of climate-related risks and how these risks may be relevant to the audits.
- ✓ The auditor's reports must follow the requirements of applicable auditing standards.
- ✓ The auditor's report provides information about auditor's responsibilities and an understanding of the matters of most significance in an audit and how they were addressed.
- ✓ The auditor in his audit report may include Emphasis of Matter paragraph to draw attention to disclosures that are of fundamental importance to users' understanding of the financial statements.
- ✓ The auditor should determine whether the entity has appropriately disclosed relevant climate-related information in the financial statements in accordance with the applicable FRF.
- ✓ The auditor should read the other information for consistency with information disclosed in the financial statements and information that may be publicly communicated to stakeholders outside the financial statements as required under ISA 720 and SA 720, The Auditor's Responsibilities Relating to Other Information.

Question 6 **(Model TP 4M)**

The nine principles in BRSR are categorized into the ESG components of Environment, Social and Governance with two of the nine in Environment, three in social and four in Governance.

One of the principle relates to all the initiatives an entity has to take for the benefit of its employees from the point of view of their dignity, health, well-being. Elucidate the essence of core elements associated with the aforesaid principle. (4 Marks)

Answer:

Principle 3 – Promote well-being of all employees including those in the value chain:

The third principle relates to all the initiatives an entity has to take for the benefit of its employees from the point of view of their dignity, health, well-being.

The essence of the core elements associated with the principle is:

a) The entity should ensure compliance with all regulatory requirements as far as employees are concerned.

b) The entities are to respect the dignity of employee as a human being and should not restrict their freedom of associations, unions, and other participatory mechanism for collective bargaining of their rights and redressal of issues they face at the workplace.

c) The entities should prevent all kinds of child labour, bonded labour, and any other forms of involuntary labour.

d) The entities should have a system in which the work-life balance of the employees is not compromised.

e) The businesses have to ensure timely payment of the worker's wages and compensation.

f) The payment of the wages has to be as per the living wages, that can take care of the basic needs and provide economic security to the employees.

g) The entities are responsible to create a workplace and work environment that is safe, hygienic, and comfortable for people to work for long durations.

h) The skill development, career development and training of the workforce is another responsibility of the entities employing them.

i) The creation of a workplace which is free of harassment and violence is also a responsibility of the entity.

Question 7 **(MTP M25 S1 5M)**

Pink Ltd., a leading manufacturing company, is expanding its operations globally. However, the company has received multiple complaints from stakeholders regarding misleading advertisements and a lack of transparent grievance redressal mechanisms.

As part of its Business Responsibility and Sustainability Reporting (BRSR) compliance, which principle is the company required to adhere to? This principle emphasizes engaging with and providing value to consumers responsibly and transparently.

What are the key consumer protection aspects that Pink Ltd. should focus on under this principle of BRSR?

Answer:

Pink Ltd. shall adhere to Principle 9 of BRSR which focuses on Providing Value to the Consumers in a Responsible Manner.

The primary purpose of any business is to create or provide useful products and services to the customer in exchange of reasonable profits.

The core elements associated with the principle are:

i. Entities should put in their efforts to reduce the negative impacts of their products and services on consumers, natural environment, and society at large.

ii. When conceptualizing, designing, and marketing their products, the organisation should not in any manner prevent the freedom of choice and fair competition.

iii. The entities should transparently and accurately disclose all kinds of adverse impacts to the user, planet, society, on the biodiversity from their products.

iv. When handling customer data, the right to privacy of the customer needs to be maintained.

v. Entities should inform the customers on the safe and responsible ways of usage, reuse, recycling, and disposal of their products, and ways to eliminate over-consumption.

vi. When advertising about their products, the organisations should ensure that misleading and confusing information is not exposed to the customers about their products or its usage.

vii. Business enterprises should make available transparent and accessible grievance redressal and feedback management system for their customers to raise their voices or to seek clarifications.

viii. Entities, when in the business of providing essential goods and services (e.g., Utilities), should enable universal access, including to those whose services have been discontinued for any reason, in a non-discriminatory and responsible manner.

Question 8 **(MTP M25 S2 5M)**

Miger Ltd. is a multinational corporation that prides itself on sustainable business practices and holistic value creation. During a recent board meeting, the CEO emphasised the importance of disclosing not just financial performance but also non-financial aspects that contribute to long-term success. The company's sustainability team highlighted their investments in cutting-edge research, employee skill development, strong supplier relationships, and eco-friendly infrastructure.

To ensure a well-rounded and transparent report, the company's Chief Financial Officer (CFO) suggests adopting Integrated Reporting. The board members, however, are unfamiliar with the concept and ask for a clear breakdown of its key elements.

As a consultant, how would you explain the essential components of Integrated Reporting to the board

Answer:

There are 6 Cs of Integrated Reporting – also known as 6 capitals:

i) Financial Capital:
- ✓ Pool of funds that is available to the organization for use in the production of goods or provision of services.
- ✓ Obtained through financing, such as debt, equity, or grants, or generated through operations or investments.

ii) Manufactured Capital:
- ✓ Seen as human-created, production-oriented equipment and tools.
- ✓ Available to the organization for use in the production of goods or the provision of services, including buildings, equipment, infrastructure (such as roads, ports, bridges & waste, and water treatment plants).

iii) Natural Capital:
- ✓ Is an input to the production of goods or the provision of services.
- ✓ An organization's activities also impact, positively or negatively, on natural capital.
- ✓ Includes water, land, minerals and forests, biodiversity, and ecosystem health.

iv) Human Capital:

People's skills and experience, their capacity, and motivations to innovate, including their:
- ✓ Alignment with and support of the organization's governance framework & ethical values such as its recognition of human rights.
- ✓ Ability to understand and implement an organization's strategy.
- ✓ Loyalties and motivations for improving processes, goods, and services, including their ability to lead and to collaborate.

v) Social Capital:
- ✓ Institutions and relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being.
- ✓ Includes:
  - Common values and behaviour.
  - Key relationships, the trust and loyalty that an organization has developed and strives to build and protect with customers, suppliers, and business partners.
  - An organization's social license to operate.

vi) Intellectual Capital:

Key element in an organization's future earning potential, with a tight link and contingency between investment in R&D, innovation, human resources, and external relationships, which can determine the organization's competitive advantage.

Asia Pacific region continues to dominate in presenting sustainability data in annual reports. Approximately 60% of Companies reporting in 2022. Integrated reporting is strong in the Middle East.

Question 9 **(PYP May 25 5M)**

GAS limited, is in the business of renewable energy, including fuel cell, electrolyzer, battery energy storage system wishes to contribute to clean energy ecosystem and National Green Hydrogen mission. GAS limited is among top 1000 listed entities and have to mandatorily provide BRSR reporting (Business Responsibility and Sustainability Reporting) on ESG parameters in accordance with the principles of "National Guidelines on Responsible Business Conduct" as mandated by SEBI. One of the principles states that "This can work only with close participation and collaboration amongst the entities, authorities, the civil associations contributing to one another for a better livelihood, and assistance to the marginalized communities." Elucidate the essence of core elements associated with the aforesaid principle.

Answer:

Principle 8 – Promote Inclusive Growth and Equitable Development can work only with close participation and collaboration amongst the entities, authorities, the civil associations contributing to one another for a better livelihood, and assistance to the marginalized communities.

The core elements of the eighth principle are:

(i) The entities should have systems in place to identify and address the impacts of their activities on the social, cultural, and economic aspects of the people. This includes business-created issues like land acquisition and use, and construction activities for new facilities.

(ii) The entities should review, measure, and track the adverse impacts of their activities on society and the environment and make action plans to mitigate them adequately.

(iii) The entities should make efforts to bring up creative products, technologies, and business concerns that help the marginalized communities to have well-being and a better quality of life.

(iv) Entities, when designing their CSR activities, should review the local and regional development priorities to help the marginalized groups and communities.

(v) The entities should take care to ensure that business-induced displacement or relocation of communities does not happen, and in unavoidable cases, should make sure to have mutually agreed, participative, and informed negotiations to provide fair compensation to the affected people.

(vi) All forms of intellectual property and traditional knowledge should get the deserved respect from the organisation, and efforts should be made to ensure that benefits derived from their knowledge are shared equitably.

Illustrations from ICAI SM

Illustration 1.

A Chartered Accountant in practice has been suspended from practice for a period of 6 months and he had surrendered his Certificate of Practice for the said period. During the said period of suspension, though the member did not undertake any audit assignments, he undertook representation assignments for income tax whereby he would appear before the tax authorities in his capacity as a Chartered Accountant.

Solution:

Undertaking Tax Representation Work: A chartered accountant not holding certificate of practice cannot take up any other work because it would be violation of the relevant provisions of the Chartered Accountants Act, 1949.

In case a member is suspended and is not holding Certificate of Practice, he cannot in any other capacity take up any practice separable from his capacity to practice as a member of the Institute.

This is because once a person becomes a member of the Institute; he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations.

If he appears before the income tax authorities, he is only doing so in his capacity as a chartered accountant and a member of the Institute. Having bound himself by the said Act and its Regulations made there under, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity.

Conclusion: Thus, in the instant case, a chartered accountant would not be allowed to represent before the income tax authorities for the period he remains suspended. Accordingly, in the present case he is guilty of professional misconduct.

Illustration 2.

Mr. A, a practicing Chartered Accountant agreed to select and recruit personnel, conduct training programmes for and on behalf of a client where he is not providing any assurance service. Is this a professional misconduct?

Solution:

Providing Management Consultancy and Other Services: Under Section 2(2)(iv) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed "to be in practice" when individually or in partnership with Chartered Accountants in practice, he, in consideration of remuneration received or to be received renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice. Pursuant to Section 2(2)(iv) above, the Council has passed a resolution permitting a Chartered Accountant in practice to render entire range of "Management Consultancy and other Services".

The definition of the expression "Management Consultancy and other Services" includes Personnel recruitment and selection. Personnel Recruitment and selection includes development of human resources including designing and conduct of training programmes, work study, job description, job evaluation and evaluations of workloads.

Conclusion: Therefore, Mr. A is not guilty of professional misconduct.

Illustration 3.

Mr. X & Mr. Y, partners of a Chartered Accountant Firm, one in-charge of Head Office and another in-charge of Branch at a distance of 80 km. from the municipal limits, puts up a name-board of the firm in both premises and also in their respective residences.

Solution:

Putting Name Board of the Firm at Residence: The Council of the Institute has decided that with regard to the use of the name-board, there will be no bar to the putting up of a name-board in the place of residence of a member with the designation of chartered accountant, provided, it is a name-plate or board of an individual member and not of the firm.

In the given case, partners of XY & Co. put up a name board of the firm in both offices and also in their respective residences.

Conclusion: Thus, the chartered accountants are guilty of misconduct. Distance given in the question is not relevant for deciding.

Illustration 4.

Mr. K, Chartered Accountant practicing as a sole proprietor has an office in the suburbs of Chennai. Due to increase in the income tax assessment work, he opens another office near the income tax office, which is within the city and at a distance of 30 km. from his office in the suburb. For running the new office, he has employed a retired Income Tax Commissioner who is not a Chartered Accountant.

Solution:

Maintenance of Branch Office in the Same City: As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 km from the municipal limits of a city, in which the first office is located.

In the given case, Mr. K, Chartered Accountant in practice as a sole proprietor at Chennai has an office in suburbs of Chennai, and due to increase in the work he opened another branch within the city near the income tax office. He also employed a retired income tax commissioner to run the new office, and the second office is situated within a distance of 30 kilometers from his office in the suburb.

Conclusion: In view of the above provisions, there will be no misconduct if Mr. K will be in-charge of both the offices. However, he is bound to declare which of the two offices is the main office.

Illustration 5.

C, Chartered Accountant, in practice allowed his brother-in-law Mr. P, who is not a Chartered Accountant, to practice in the name of CA C. He also allowed CA T, who is an employee in his firm to practice in the name. Whether CA C is correct in allowing his brother-in-law Mr. P and CA T employee of his firm to practice in his name.

Solution:

Allowing to Practice in a Chartered Accountant's name: As per Clause (1) of Part I to the First Schedule to Chartered Accountants' Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

In the given situation CA C, Chartered Accountant who is in practice allowed a non-Chartered Accountant, his brother-in-law Mr. P to practice in the name of CA C is not correct in view of Clause 1 of Part I to the First Schedule. However, he can allow CA T who is an employee in his firm to practice in his name.

Conclusion: Thus, CA C will be held guilty of professional misconduct for allowing Mr. P who is not a Chartered Accountant to practice in his name as a chartered accountant as per Clause (1) of Part I to the First Schedule

Illustration 6.

Mr. Qureshi, Chartered Accountant, in practice died in a road accident. His widow proposes to sell the practice of her husband to Mr. Pardeshi, Chartered Accountant, for Rs.5 lakhs. The price also includes right to use the firm name - Qureshi and Associates. Can widow of Qureshi sell the practice and can Mr. Pardeshi continue to practice in that name as a proprietor?

Solution:

Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

It lays down that the sale is permitted subject to certain conditions discussed in the above flowchart. It further resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.

Conclusion: Thus, in a given case, the widow of Mr. Qureshi, who has proposed to sell the practice for Rs.5 lakhs is in effect proposing the sale of goodwill. Thus, the act of Mrs. Qureshi is permissible and Mr. Pardeshi can continue to practice in that name as a proprietor.

Illustration 7.

Mr. S, a Chartered Accountant published a book and gave his personal details as the author. These details also mentioned his professional experience.

Solution:

Soliciting Professional Work: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means. Therefore, members should not adopt any indirect methods to advertise their professional practice with a view to gain publicity and thereby solicit clients or professional work. Such a restraint must be practiced so that members may maintain their independence of judgement and may be able to command the respect of their prospective clients. While elaborating forms of soliciting work, the Council has specified that a member is not permitted to indicate in a book or an article, published by him, his association with any firm of chartered accountants. In this case, Mr. S, a Chartered Accountant published the book and mentioned his professional experience in detail in the same.

Conclusion: Mr. S being a chartered accountant in practice has committed the professional misconduct by mentioning his professional experience.

Illustration 8.

M/s XYZ, a firm of Chartered Accountants created a website "www.xyzindia.com". The website besides containing details of the firm and bio-data of the partners also contains the passport size photographs of all the partners of the firm.

Solution:

Hosting Details on Website: As per detailed guidelines of the ICAI laid down in Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant of the firm can create its own website using any format subject to guidelines. However, the website should be so designed that it does not solicit clients or professional work and should not amount to direct or indirect advertisement. The guidelines of the ICAI to allow a firm to put up the details of the firm, bio-data of partners and display of a passport size photograph.

Conclusion: In the case of M/s XYZ, all the guidelines seem to have been complied and there appears to be no violation of the Chartered Accountants Act, 1949 and its Regulations.

Illustration 9.

M/s LMN, a firm of Chartered Accountants responded to a tender from a State Government for computerization of land revenue records. For this purpose, the firm also paid Rs.50,000 as earnest deposit as part of the terms of the tender.

Solution:

Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. As per the guidelines if a matter relates to any services other than audit, members can respond to any tender. Further, in respect of a non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits. However, on having received complaint/ instance of exorbitant EMD/Deposit, the Ethical Standards Board may look into the matter on case to case basis.

Conclusion: In the instance case, since computerization of land revenue records does not fall within exclusive areas for chartered accountants, M/s LMN can respond to tender as well as deposit Rs.50,000 as earnest deposit and shall not have committed any professional misconduct.

Illustration 10.

Mr. Honest, a Chartered Accountant in practice, wrote two letters to M/s XY Chartered Accountants a firm of CAs; requesting them to allot him some professional work. As he did not have a significant practice or clients he also wrote a letter to M/s ABC, a firm of Chartered Accountants for securing professional work. Mr. Clever, another CA, informed ICAI regarding Mr. Honest's approach to secure the professional work. Is Mr. Honest wrong in soliciting professional work?

Solution:

Securing Professional Work: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Provided that nothing herein contained shall be construed as preventing or prohibiting any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice.

Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Conclusion: In the given case, Mr. Honest wrote letters only to other Chartered Accountants, M/s XY and M/s ABC requesting them to allot some professional work to him, which is not prohibited under Clause (6) as explained above. Thus, Mr. Honest has not committed any professional misconduct by soliciting professional work.

Illustration 11.

A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, as a Tax Consultant.

Solution:

Tax Consultant: Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public.

Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Conclusion: Thus, it is improper to use designation "Tax Consultant" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council.

Illustration 12.

B, a Chartered Accountant in practice is a partner in 3 firms. While printing his personal letter heads, B gave the names of all the firms in which he is a partner.

Solution:

Advertisement of Professional Attainments: Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public. Even a member is not permitted to specify the date of setting up of practice or establishment of firm on letterheads. However, there is no prohibition for printing names of all the three firms on the personal letterheads in which a member holding Certificate of Practice is a partner.

Conclusion: Thus, B is not guilty of any misconduct under the Chartered Accountants Act, 1949.

Illustration 13.

The offer document of a listed company in which Mr. D, a practising Chartered Accountant is a director mentions the name of Mr. D as a director along with his various professional attainments and spheres of specialisation.

Solution:

Advertisement of Professional Attainments: The Council of the ICAI has in a communication to members stated that if a public company, in which a chartered accountant in practice is a director, issues a prospectus or gives any announcement that gives descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field, it shall constitute a misconduct under Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The Council has further stated that in such cases the member concerned has to take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the members.

Conclusion: Thus, in the instant case, Mr. D would be held to be guilty of professional mis-conduct and liable for disciplinary action.

Illustration 14.

A Chartered Accountant in practice, empanelled as an Insolvency Professional (IP) has mentioned the same on his visiting cards, letter heads and other communications also. A person residing in his neighbourhood, has filed a complaint for professional misconduct against the said member for such mention of IP.

Solution:

Using Designation of Insolvency Professional: As per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than 'Chartered Accountant" on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.

Here, a Chartered Accountant empaneled as IP (Insolvency Professional) can mention "Insolvency Professional" on his visiting cards, letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause 7 of Part 1 of First Schedule to the Chartered Accountants Act, 1949.

Conclusion: Thus, complaint of neighbour is not enforceable/ valid.

Illustration 15.

Mr. X, a Chartered Accountant accepted his appointment as tax auditor of a firm under Section 44AB, of the Income-tax Act,1961 and commenced the tax audit within two days of his appointment since the client was in a hurry to file Return of Income before the due date. After commencing the audit, Mr. X realised his mistake of accepting this tax audit without sending any communication to the previous tax auditor. In order to rectify his mistake, before signing the tax audit report, he sent a registered post to the previous auditor and obtained the postal acknowledgement. Will Mr. X be held guilty under the Chartered Accountants Act?

Solution:

Communication with the Previous Auditor: As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, Mr. X will be held guilty since he has accepted the tax audit, without first communicating with the previous auditor in writing. The object of the incoming auditor communicating in writing with the retiring auditor is to ascertain whether there are any circumstances which warrant him not to accept the appointment, for example, whether the previous auditor has been changed on account of having qualified the report or he had expressed a wish not to continue on account of something inherently wrong with the administration of the business. The retiring auditor may even give out information regarding the condition of the accounts of the client or the reason that impelled him to qualify his report. Under all circumstances, it would be essential for the incoming auditor to carefully consider the facts before deciding whether or not he should accept the audit. As a matter of professional courtesy and professional obligation it is necessary for the new auditor appointed to communicate with such earlier auditor.

Conclusion: Therefore, Mr. X will be held guilty of professional misconduct.

Illustration 16.

W, a Chartered Accountant had sent letters under certificate of posting to the previous auditor informing him his appointment as an auditor before the commencement of audit by him.

Solution:

Communication with the Previous Auditor: Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 requires communication by the incoming auditor with the previous auditor before accepting a position by him. The Council of the Institute has taken the view that a mere posting of a letter "under certificate of posting" is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person communicated with. A Chartered Accountant who relies solely upon a letter posted "under certificate of posting" therefore does so at his own risk. Since the letters were sent by "W" to the previous auditor informing him of his appointment as an auditor before the commencement of audit by him under Certificate of Posting is not sufficient to prove communication with the retiring auditor. In the opinion of the Council, communication by a letter sent "Registered Acknowledgement Due" or by hand against a written acknowledgement would in the normal course provide positive evidence.

Conclusion: Hence "W" was guilty of professional misconduct under Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949

Illustration 17.

CA Raja was appointed as the Auditor of Castle Ltd. for the year 2023-24. Since he declined to accept the appointment, the Board of Directors appointed CA Rani as the auditor in the place of CA Raja, which was also accepted by CA Rani.

Solution:

Appointment of Auditor by Board: Board can appoint the auditor in the case of casual vacancy under section 139(8) of the Companies Act, 2013. The non-acceptance of appointment by CA Raja does not constitute a casual vacancy to be filled by the Board. In this case, it will be deemed that no auditor was appointed in the AGM.

Further, as per Section 139(10) of the Companies Act, 2013 when at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. The appointment of the auditor by the Board is defective in law.

Clause (9) of Part I of First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant is deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956 (now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013), in respect of such appointment have been fully complied with.

Conclusion: Hence, CA Rani is guilty of professional misconduct since she accepted the appointment without verification of statutory requirements.3

Illustration 18.

Mr. X is a Chartered Accountant accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor before accepting the audit. He also failed to ascertain the compliance of requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.

Solution:

Communication by incoming auditor with previous auditor: Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 requires communication by the incoming auditor with the previous auditor before accepting a position by him.

Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (now Section 139 and 140 of the Companies Act, 2013), in respect of such appointment have been duly complied with.

Under this clause it is obligatory on the incoming auditor to communicate with previous auditor and ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.

In this case Mr. X accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor. Further, he accepted the appointment without first ascertaining whether the requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.

Conclusion: Therefore, Mr. X is liable for misconduct under clause 8 and Clause 9 since he accepted the appointment without communicating with previous auditor as well as for not verifying the compliance of statutory requirements.

Illustration 19.

Mr. P a practicing chartered accountant acting as liquidator of AB & Co. charged his professional fees on percentage of the realization of assets.

Solution:

Restriction on fees based on a Percentage: According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, CA Regulation allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of a receiver or a liquidator, and the fees may be based on a percentage of the realization or disbursement of the assets.

In the given case, Mr. P, a practicing Chartered Accountant, has acted as liquidator of AB & Co. and charged his professional fees on percentage of the realisation of assets.

Conclusion: Therefore, Mr. P shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the realisation of assets being a liquidator.

Illustration 20.

A chartered accountant holding certificate of practice and having four articled clerks registered under him accepts appointment as a full-time lecturer in a college. Also, he becomes a partner with his brother in a business. Examine his conduct in the light of the Chartered Accountants Act, 1949 and the regulations thereunder.

Solution:

Specific Permission to be Obtained: Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. This clause, in effect, has empowered the Council of the Institute to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper. Accordingly, the Council had formulated Regulations 190A and 191 to the Chartered Accountants Regulations, 1988 to provide a basis for considering applications of chartered accountants seeking permission to engage in other business or occupation. A member can accept full- time lecturer-ship in a college only after obtaining the specific and prior approval of the Council as also becoming a partner in a business with his brother would require specific permission.

Conclusion: Thus, the chartered accountant is liable for professional misconduct since he failed to obtain specific and prior approval of the Council in each case.

Illustration 21.

Mr. A, a practicing Chartered Accountant, took over as the executive chairman of Software Company on 01-04-2024. On 10-04-2024 he applied to the Council for permission.

Solution:

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, Mr. A took over as the executive chairman on 01-04-2024 and applied for permission on 10-04-2024. On the basis of these facts, he was engaged in other occupation between the period 01-04-2024 and 10-04-2024, without the permission of the Council.

Conclusion: Therefore, Mr. A is guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Illustration 22.

CA Moksh, a leading income tax practitioner based in Mumbai with exceptional writing skills, also serves as the editor of a non-chartered accountancy related journal. He devotes approximately 50% of his time to managing the journal's editorial responsibilities of this journal. Is CA Moksh liable for professional misconduct?

Solution:

Engaging into a Business: As per Clause (11) of Part I of First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is 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.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, CA Moksh is engaged in the occupation of editorship of journals other than professional journals which is not covered under the general permission.

Conclusion: Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under Clause (11) of Part I of First Schedule of the Chartered Accountants Act, 1949.

Illustration 23.

S, a practicing Chartered Accountant gives power of attorney to an employee Chartered Accountant to sign reports and financial statements on his behalf.

Solution:

Power of Signing Reports and Financial Statements: Under Clause (12) 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 allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

This clause read in conjunction with Section 26 of the Chartered Accountants Act, 1949 stipulates that no person other than the member of the institute shall sign any document on behalf of a Chartered Accountant in practice or a firm of Chartered Accountants in his or its professional capacity.

The term 'Financial Statement' for this purpose would cover an examination of the accounts or financial statements given under a statutory enactment or otherwise.

Further, Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

Conclusion: Accordingly, S is guilty of professional misconduct under Clause (12) of Part I of First Schedule and also under Clause (1) of Part II of Second Schedule for contravening Section 26.

Illustration 24.

CA Smart, a practicing Chartered Accountant was on Europe tour between 15-09-24 and 25-09-24. On 18-09-24 a message was received from one of his clients requesting a stock certificate to be produced to the bank on or before 20-09-24. Due to urgency, CA Smart directed his assistant, who is also a Chartered Accountant, to sign and issue the stock certificate after due verification, on his behalf.

Solution:

Allowing a Member Not Being a Partner to Sign Certificate: As per Clause (12) 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 allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case, CA Smart allowed his assistant who is not a partner but a member of the Institute of Chartered Accountants of India to sign stock certificate on his behalf and thereby commits misconduct.

Conclusion: Thus, CA Smart is guilty of professional misconduct under Clause (12) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Illustration 25. Exceptional

Mr. 'C', a Chartered Accountant holds a certificate of practice while in employment also, recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from employer paid a particular sum as referral fee to Mr. 'C'.

Solution:

Referral Fee from Lawyer: According to Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949, a member of the Institute(other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

In the present case, Mr. C, who beside holding a certificate of practice, is also an employee and by referring a lawyer to the company in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.

Conclusion: Therefore, Mr. C is guilty of professional misconduct by virtue of Clause (2) of Part II of First schedule.

Illustration 26. Exceptional

Mr. 'G', while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business.

Solution:

Disclosure of Information: As per Clause (2) of Part III of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant, in practice or not, does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

In the given case, Mr. "G", a Chartered Accountant while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business. Details of engagement in business need to be disclosed while applying for the certificate of practice as it was the information called for in the application, by the Institute.

Conclusion: Thus, Mr. G will be held guilty of professional misconduct under Clause (2) of Part III of First Schedule of the Chartered Accountants Act, 1949.

Illustration 27.

Mr. X, a Chartered Accountant, employed as a Paid Assistant with a Chartered Accountant firm, leaves the services of the firm on 31st December, 2024. Despite many reminders from ICAI he fails to reply regarding the date of leaving the services of the firm.

Solution:

Failed to Supply Information Called For: As per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Conclusion: Thus, in the given case, Mr. X has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant. Therefore, he is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

Illustration 28.

YKS & Co., a proprietary firm of Chartered Accountants, was appointed as a concurrent auditor of a bank. YKS, the proprietor, used his influence to get a loan and thereafter failed to repay the loan.

Solution:

Disrepute to the Profession: This is a case which is covered under the expression in other misconduct of the Chartered Accountants Act, 1949. As per Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work. Here the Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards calls for disciplinary action.

In the present case, YKS & Co, being a concurrent auditor, used his position to obtain the funds and failed to repay the same to the bank. This brings disrepute to the profession of a Chartered Accountant. This act of YKS & Co is not pardonable.

Conclusion: Therefore, YKS & Co will be held guilty of other misconduct under Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949.

Illustration 29.

Mr. P, a Chartered Accountant was invited by the Chamber of Commerce to present a paper in a symposium on the issues facing Indian Leather Industry. During the course of his presentation, he shared some of the vital information of his client's business under the impression that it will help the Nation to compete with other countries at international level.

Solution:

Disclosure of Client's Information: Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 deals with the professional misconduct relating to the disclosure of information by a chartered accountant in practice relating to the business of his clients to any person other than his client without the consent of his client or otherwise than as required by any law for the time being in force would amount to breach of conduct. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. The Chartered Accountant may however, disclose the information in case it is required as a part of performance of his professional duties. In the given case, Mr. Ph has disclosed vital information of his client's business without the consent of the client under the impression that it will help the nation to compete with other countries at International level.

Conclusion: Thus, it is a professional misconduct covered by Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Illustration 30.

Mr. J, a Chartered Accountant during the course of audit of M/s XYZ Ltd. came to know that the company has taken a loan of Rs.10 lakhs from Employees Provident Fund. The said loan was not reflected in the books of account. However, the auditor ignored this information in his report.

Solution:

Failure to Disclose Material Facts: As per Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading. In this case, Mr. J has come across information that a loan of Rs.10 lakhs has been taken by the company from Employees Provident Fund. This is contravention of Rules and the said loan has not been reflected in the books of accounts. Further, this material fact has also to be disclosed in the financial statements. The very fact that Mr. J has failed to disclose this fact in his report, he is attracted by the provisions of professional misconduct under Clause (5).

Conclusion: Mr. J will be liable of professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Illustration 31. Exceptional

A practicing Chartered Accountant was appointed to represent a company before the tax authorities. He submitted certain information and explanations to the authorities on behalf of his clients, which were found to be false and misleading.

Solution:

Submitting Information as Authorised Representative: As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, if a member in practice fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional capacity, he will be held guilty under Clause (5). As per Clause (6) of Part I of Second Schedule if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity, he will be held guilty under Clause (6).

In given case, the Chartered Accountant had submitted the statements before the taxation authorities. These statements are based on the data provided by the management of the company. Although the statements prepared were based on incorrect facts and misleading, the Chartered Accountant had only submitted them acting on the instructions of his client as his authorized representative.

Conclusion: Hence, the Chartered Accountant would not be held liable for professional misconduct.

Illustration 32.

CA C who conducted statutory audit of a Haryana daily 'New Era' certified the circulation figures based on Management Information System Report (M.I.S Report) without examining the books of Account.

Solution:

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

In the instant case, CA C did not exercise due diligence and is grossly negligent in the conduct of his professional duties since he certified the circulation figures without examining the books of accounts. To ascertain the number of paid copies verification of remittances from the agents, credit allowed to the agents for unsold copies returned, examination of books of account is essential. Further certification of circulation figures based on statistical information without cross verification with financial records amounts to gross negligence and failure to exercise due diligence.

Conclusion: Hence, CA C is guilty of professional misconduct as per Clause (7) of Part I of Second Schedule of the Chartered Accountants Act, 1949.

Illustration 33.

Mr. D, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.

Solution:

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

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

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

Since Mr. D has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements.

Conclusion: Therefore, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Illustration 34.

Mr. A, a Chartered Accountant, was the auditor of 'A Limited'. During the financial year 2023-24, the investment appeared in the Balance Sheet of the company of Rs.12 lakh and was the same amount as in the last year. Later on, it was found that the company's investments were only Rs.25,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan.

Solution:

Grossly Negligent in Conduct of Duties: As per Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice, under Clause (2); does not exercise due diligence, or is grossly negligent in the conduct of his professional duties, under Clause (7); or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, under Clause (8).

The primary duty of physical verification and valuation of investments is of the management.

However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation.

In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty.

Conclusion: Accordingly, Mr. A, will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Illustration 35.

A charitable institution entrusted Rs.10 lakhs with its auditors M/s R & Co., a Chartered Accountant firm, to invest in a specified securities. The auditors deposited it in their Savings bank account and no investment was made in the next three months.

Solution:

Failure to Keep Money in Separate Bank Account: If a Chartered Accountant in practice fails to keep moneys of his clients in a separate bank account or fails to use such moneys for purposes for which they are intended then his action would amount to professional misconduct under Clause (10) of Part I of Second Schedule to the Chartered Accountants Act, 1949. In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilise such funds only in accordance with the instructions of the client or for the purposes intended by the client.

Conclusion: In the given case by depositing the client's money by M/s R & Co., a firm of Chartered Accountants, in their own savings bank account, the auditors have committed professional misconduct. Hence in the given case, M/s R & Co. will be held guilty of professional misconduct.

Illustration 36.

L, a chartered accountant did not maintain books of account for his professional earnings on the ground that his income is less than the limits prescribed u/s 44AA of the Income Tax Act, 1961.

Solution:

Maintenance of Books of Account: As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct. Accordingly, it does not matter whether section 44AA of the Income Tax Act, 1961 applies or not.

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

Illustration 37.

A member of the institute shall not accept in a year more than the specified number of tax audits under section 44AB of the Income Tax Act.

Mr. G is a partner in M/s. XYZ & Co., a firm of Chartered Accountants with 6 partners.

During the assessment year 2023-24, Mr. G alone had signed 290 tax audit reports consisting of both corporate and non-corporate assesses.

Solution:

Ceiling limit for signing the Tax Audit Reports: As per Council General Guidelines 2008, a member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961. It is also provided further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate.

In the case of firm of Chartered Accountants in practice "the specified number of tax audit assignments" means 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

Further, as per clarification issued by the Institute on Tax Audit Assignments, tax audit reports may be signed by the partners in any manner whosoever in accordance with specified audit limits. Thus, one partner can individually sign all the tax audit reports subject to specified tax audit assignment limits on behalf of all the partners in the firm of Chartered Accountants in practice or all the partners of the firm can collectively sign the tax audit reports.

In the instant case, there are 6 partners in M/s XYZ & Co., a Chartered Accountants firm, accordingly, specified ceiling limit for the firm will be (60 tax audit assignments per partner X 6 partners) = 360.

Therefore, all the 6 partners of the firm can collectively sign 360 tax audit reports. This maximum limit of 360 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 360 tax audit reports in case remaining 5 partners are not signing any tax audit report.

Assuming Mr. G has signed 290 tax audit reports consisting of both corporate and non-corporate assesse on behalf of firm and remaining partners are signing audit reports within the specified number of tax audit assignments u/s 44AB i.e. upto 70.

Conclusion: Hence, Mr. G shall not be deemed to guilty of professional misconduct provided total number of tax audit reports on behalf of firm do not exceeds 360.

Illustration 38.

Mr. C accepted the statutory audit of M/s PSU Ltd., whose net worth is negative for the year 2022-23. The audit was to be conducted for the year 2023-24. The audited accounts for the year 2023-24 showed liability for payment of tax audit fees of Rs.15,000 in favour of Mr. E, the previous auditor.

Solution:

Accepting Appointment as an Auditor: As per Chapter 7 of Council General Guidelines 2008, a member of the Institute of Chartered Accountants of India in practice shall be deemed to be guilty of professional misconduct if he accepts appointment as auditor of an entity in case the undisputed audit fee of another chartered accountant for carrying out the statutory audit under the Companies Act, 2013 or various other statutes has not been paid.

As per the proviso, such prohibition shall not apply in case of a sick unit where a sick unit is defined to mean "where the net worth is negative".

Conclusion: In the instant case, though the undisputed fees are unpaid, Mr. C would still not be guilty of professional misconduct since the M/s PSU Ltd. is a sick unit having negative net worth for the year 2022-23.

Illustration 39.

A is the auditor of Z Ltd., which has a turnover of Rs.200 crore. The audit fee for the year is fixed at Rs.50 lakhs. During the year, the company offers A an assignment of management consultancy within the meaning of Section 2(2)(iv) of the CA Act, 1949 for a remuneration of Rs.1 crore. A seeks your advice on accepting the assignment.

Solution:

Appointment as a Statutory Auditor of a PSUs'/Govt Company(ies)/Listed Company(ies) and Other Public Company(ies): As per the Council General Guidelines 2008, under Chapter IX on appointment as statutory auditor a member of the Institute in practice shall not accepts the appointment as a statutory auditor of a PSUs'/Govt company(ies)/Listed company(ies) and other public company(ies) having a turnover of Rs.50 crores or more in a year and where he accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking. For this purpose, the other work/services include Management Consultancy and all other professional services permitted by Council excluding audit under any other statute, Certification work required to be done by the statutory auditor and any representation before an authority.

Conclusion: In view of the above provision, it would be a misconduct on A's part if he accepts the management consultancy assignment for a fee of Rs.1 crore.

Illustration 40.

D, who conducts the tax audit u/s 44AB of the Income Tax Act, 1961 of M/s ABC, a partnership firm, has received the audit fees of Rs.2,50,000 on progressive basis in respect of the tax audit for the year ended 31.3.2024. The audit report was, however, signed on 25.5.2024.

Solution:

Entire Audit Fees Received in Advance: As per Chapter X of Council General Guidelines, 2008 a member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding Rs.1,00,000/-

However, the Research Committee of the ICAI has expressed the opinion that where in accordance with the terms of engagement of auditor by a client, the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company at any stage.

Conclusion: In the instant case, Mr. D is appointed to conduct a tax audit u/s 44AB of the Income Tax Act, 1961. He has received the audit fees of Rs.2,50,000 in respect of the tax audit for the year ended 31.3.2024 which is on a progressive basis. Therefore, Mr. D will not be held guilty for misconduct.

Case Scenarios from ICAI SM

Case Scenario 1.

Synopsis: The case scenario underscores ethical and quality requirements to be complied with by statutory auditor of a listed company. Failure to perform audit of financial statements in accordance with Standards on Auditing can result in breakdown of trust of investors and public at large. The case involves issue of non-adherence to requirements of SA 501, SA 550 and SA 505 by statutory auditor of a listed company.

Only major lapses have been considered for developing this case scenario for the sake of brevity.

The case scenario is presented in the following manner: -

I. Relevant provisions of the Companies Act, 2013 and requirements of relevant Standards on Auditing

II. Relevant Clauses of Part I of Second Schedule to Chartered Accountants Act, 1949

III. Facts of the case

IV. Major lapses pointed out by NFRA, engagement partner's submissions and NFRA's contentions / findings

V. Conclusion including its basis

I. Relevant provisions of the Companies Act, 2013 and requirements of relevant Standards on Auditing

[1] Section 132(4) of the Companies Act, 2013

NFRA has power to investigate into matters of professional or other misconduct committed by any member or firm of chartered accountants registered under Chartered Accountants Act, 1949

for certain classes of bodies corporate. By virtue of this section, it has also got power to impose penalty on erring members and debarring members of firm from undertaking audit work.

[2] Relevant requirements of Standards on Auditing

- ✓ SA 501 requires that when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting unless impracticable.

  It further requires that if attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.
- ✓ SA 550 requires auditor to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the applicable financial reporting framework.
- ✓ SA 505 requires that in case management refuses to allow the auditor to send a confirmation request, reasons adduced by management need to be inquired and audit evidence has to be sought for as to validity and reasonableness of reasons. Further, implications of such refusal on risks of material misstatement including risk of fraud and on nature, timing and extent of other audit procedures are to be evaluated.

  It further requires auditor to perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

II. Relevant clauses of Part I of Second Schedule to Chartered Accountants Act, 1949

- ✓ Under clause 7 of Part I of Second Schedule to Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

- ✓ Under clause 8 of Part I of Second Schedule to Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion
- ✓ Under clause 9 of Part I of Second Schedule to Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

III. Facts of the case

NFRA initiated action u/s 132(4) of the Companies Act, 2013 for investigating into professional misconduct of engagement partner of an audit firm pursuant to information received from ROC, Mumbai regarding investigation conducted by Regional Director into affairs of WNLL, listed on SME segment of BSE. The key financial data for company for financial year 2016-17 was as under: -

Particulars	Amount (in Rs.crores)
Revenue from Operations	51.77
PBT	1.44
Inventory	20.60
Trade receivables	14.93
Trade payables	13.78

The engagement partner had issued an unmodified opinion for financial year 2016-17. The engagement partner was requested on 18.02.2022 to submit audit file and SQC1 policy of firm which was submitted by him vide email dated 18.03.2022. Subsequently, a show-cause notice was issued to engagement partner charging him with professional misconduct for failure to perform his duties as engagement partner.

IV. Major lapses pointed out by NFRA, engagement partner's submissions and NFRA's contentions / findings

[1] Failure to obtain audit evidence regarding existence and condition of inventory

The EP was charged with failure to obtain sufficient appropriate audit evidence regarding existence and condition of inventory by not attending physical inventory counting in accordance with SA 501.

	EP's submissions	NFRA's contentions/findings
1.	The appointment as statutory auditor was made on 18.4.2017. Therefore, it was not possible to attend physical verification of inventories as on 31.3.2017.	SA 501 requires if attendance at physical inventory count is impracticable, alternative audit procedures shall be performed to obtain sufficient appropriate audit evidence regarding existence and condition of inventories. If it is not possible to so, the auditor shall modify opinion in accordance with SA 705. There was no documentation in audit file of audit procedures having been performed in this respect. Reliance was also placed on decision of PCAOB, US regulator in a similar case.
2.	Inventory holding level was in accordance with past trends. Stock records were cross verified in respect of selected items and	There was no documentation in audit file of audit procedures having been performed in this respect.

	reconciled with entries of receipts and issue in books of accounts.	

[2] Failure to identify related party and related party transactions

The EP was charged with failure to identify related parties and transactions with them. The company made almost 100% of sales to a related party which was not identified as such in annual report of the company for FY 2016-17.

	EP's submissions	NFRA's contentions/findings
1.	It was tried to be ascertained from management regarding existence of related parties and previous audit reports were also relied upon in this regard.	The related party to whom 100% of sales was made was previously identified as related party in financial statements for FY 2013-14. Since almost 100% of sales were to this party, EP should have applied professional skepticism to probe further into antecedents of the party. There is no evidence in audit file regarding this. Reliance was also placed on similar decision of PCAOB where it was held that auditor must evaluate whether related party transactions have been properly accounted for and disclosed in financial statements.

[3] Failure to obtain external confirmations for Trade receivables and Trade payables

The EP was charged with gross negligence for not obtaining direct confirmations of balances from debtors and creditors and with failure to perform any alternative audit procedure in absence of confirmations from debtors and creditors in accordance with SA 505.

	EP's submissions	NFRA's contentions/findings
1.	The company management had denied contact details of parties due to fear of losing the business information. Further, all debtors and creditors were outstanding for less than 6 months.	It shows that management had imposed a limitation on scope of audit. Limitations imposed by management may have other implications for audit such as evaluation of fraud risks and continuance of engagement as per SA 705. No assessment of fraud risk having been evaluated is available in audit file and there is no evidence of additional procedures being performed by EP in absence of external confirmations. Reliance was also placed on PCAOB order in Satyam case in which failure during audit to obtain external confirmation of bank balances was highlighted.

V. Conclusion including its basis

The engagement partner did not comply with provisions of the Chartered Accountants Act, 1949 and showed gross negligence and lack of due diligence in performing statutory audit. He didn't ensure audit quality and was grossly negligent of professional duties by not adhering to requirements laid down in relevant Standards on Auditing as discussed above. It led to issuance of audit report that was not backed by valid audit evidence and was lacking in audit quality.

The engagement partner was held guilty of professional misconduct under clauses 7, 8 and 9 of Part I of Second Schedule to Chartered Accountants Act, 1949. He was also penalized and debarred for a period of two years from undertaking any audit of financial statements or internal audit of the functions and activities of any company or body corporate.

Test Your Knowledge

Question 1

P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2024, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Is P guilty of professional misconduct?

Answer:

Advising on Portfolio Management Services: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients.

In view of this, P would be guilty of misconduct under the Chartered Accountants Act, 1949.

Question 2

Mr. G, a Chartered Accountant in practice as a sole proprietor has an office in Mumbai near Church Gate. Due to increase in professional work, he opens another office in a suburb of Mumbai which is approximately 80 kilometers away from the municipal limits of the city. For running the new office, he employs three retired Income-tax Officers. Is Mr. G guilty of professional misconduct?

Answer:

In terms of section 27 of the Chartered Accountants Act, 1949, if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. There is however an exemption for the above if the second office is located in the same premises, in which the first office is located; or the second office is located in the same city, in which the first office is located; or the second office is located within a distance of 50 kms from the municipal limits of a city, in which the first office is located. Since the second office is situated beyond 50 kms of municipal limits of Mumbai city, he would be liable for committing a professional misconduct.

Question 3

Write a short note on Other Misconduct.

Answer: Refer GOAT Notes - Straight Concept Question and hence ignore here

Question 4

Mr. K, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. Discuss this in the light of Professional Ethics issued by ICAI.

Answer:

Sharing of Audit Fees with Non-Member: As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant in practice pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

In the instant case, Mr. K, a practising Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. In this case, it is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into.

The Chartered Accountant had shared his profits and, therefore, Mr. K will be held guilty of professional misconduct under the Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Question 5

Mr. X who passed his CA examination of ICAI on 18th July, 2024 and started his practice from August 15, 2024. On 16th August 2024, one female candidate approached him for articleship. In addition to monthly stipend, Mr. X also offered her 1 % profits of his CA firm. She agreed to take both 1 % profits of the CA firm and stipend as per the rate prescribed by the ICAI. The Institute of Chartered Accountants of India sent a letter to Mr. X objecting the payment of 1 % profits. Mr. X replies to the ICAI stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the financial position of the articled clerk is very weak. Is Mr. X liable to professional misconduct?

Answer:

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

In view of the above, the objections of the Institute of Chartered Accountants of India, as given in the case, are correct and reply of Mr. X, stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the position of the articled clerk is weak is not tenable.

Hence, Mr. X is guilty of professional misconduct in terms of Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949.

Question 6

M/s XYZ, a firm in practice, develops a website "xyz.com". The colour chosen for the website was a very bright green and the web-site was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator. Is this website in compliance with guidelines issued by ICAI in this regard?

Answer:

Posting of Particulars on Website: The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s XYZ are:

✓ No restriction on the colours used in the website;
✓ The websites are run on a "pull" technology and not a "push" technology;
✓ Names of clients and fees charged not to be given.

However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that "This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].

In view of the above, M/s XYZ would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

Question 7

A partner of a firm of chartered accountants during a T.V. interview handed over a bio-data of his firm to the chairperson. Such bio-data detailed the standing of the international firm with which the firm was associated. It also detailed the achievements of the concerned partner and his recognition as an expert in the field of taxation in the country. The chairperson read out the said bio-data during the interview. Discuss whether this action by the Chartered Accountant would amount to misconduct or not.

Answer:

Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means since it shall constitute professional misconduct. The bio-data was handed over to the chairperson during the T.V. interview by the Chartered Accountant which included details about the firm and the achievements of the partner as an expert in the field of taxation. The chairperson simply read out the same in detail about association with the international firm as also the achievements of the partner and his recognition as an expert in the field of taxation. Such an act would definitely lead to the promotion of the firms' name and publicity thereof as well as of the partner and as such the handing over of bio-data cannot be approved. The partner would be held guilty of professional miscount under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Question 8

(a) An advertisement was published in a Newspaper containing the photograph of Mr. X, a member of the institute wherein he was congratulated on the occasion of the opening ceremony of his office.

(b) Mr. X, a Chartered Accountant and the proprietor of X & Co., wrote several letters to the Assistant Registrar of Co-operative Societies stating that though his firm was on the panel of auditors, no audit work was allotted to the firm and further requested him to look into the matter.

Answer:

(a) Publishing an Advertisement Containing Photograph: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or

indirectly by a circular, advertisement, personal communication or interview or by any other means.
In the given case, Mr. X published an advertisement in a Newspaper containing his photograph on the occasion of the opening ceremony of his office. On this context, it may be noted that the advertisement which had been put in by the member is quite prominent. If soliciting of work is allowed, the independence and forthrightness of a Chartered Accountant in the discharge of duties cannot be maintained.
The above therefore amounts to soliciting professional work by advertisement directly or indirectly. Mr. X would be therefore held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(b) Soliciting Professional Work: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.
In the given case, Mr. X, a Chartered Accountant and proprietor of M/s X and Co., wrote several letters to the Assistant Registrar of Co-operative Societies, requesting for allotment of audit work. In similar cases, it was held that the Chartered Accountant would be guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The writing of continuous letter to ascertain the reasons for not getting the work is quite alright but in case such either amount to request for allowing the work then Mr. X will be liable for professional misconduct.
Consequently, Mr. X would therefore be held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

Question 9

A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant. Is this a misconduct?

Answer:

Cost Accountant: As stated in the Illustration given in clause 7 with reference to tax consultant, this would also constitute misconduct under section 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. A chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". However as per the Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant".

Question 10

Mr. Nigal, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While delivering the speech, he told to the audience that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment.

Answer:

Using Designation Other Than a CA and Providing Details of Services Offered: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write must not be promotional of his or his firm but must be an objective professional view of the topic under consideration.

Thus, it is improper to use designation "Management Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Management Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6).

Question 11

Mr. A is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. Y a Chartered Accountant his employee for taking care of routine matters of his office. During his absence Mr. Y has conducted the under mentioned jobs in the name of M/s A & Co.

i. He issued the audit queries to client which were raised during the course of audit.
ii. He issued production certificate to a client under the GST Act.
iii. He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.

Please comment on eligibility of Mr. Y for conducting such jobs in name of M/s A & Co. and liability of Mr. A under the Chartered Accountants Act, 1949.

Answer:

Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA A proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

i. In the given case, Mr. Y, a chartered accountant being an employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here Y is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
ii. Further, issuance of production certificate to a client under GST Act by Mr. Y being an employee of M/s A & Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA A is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.
iii. In this instance, Mr. Y, CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

Question 12

XYZ Co. Ltd. has applied to a bank for loan facilities. The bank on studying the financial statements of the company notices that you are the auditor and requests you to call at the bank for a discussion. In the course of discussions, the bank asks for your opinion regarding the company and also asks for detailed information regarding a few items in the financial statements. The information is available in your working paper file. What should be your response and why?

Answer:

As per Clause (1) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force. SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

In the instant case, the bank has asked the auditor for detailed information regarding a few items in the financial statements available in his working papers. Having regard to the position stated earlier, the auditor cannot disclose the information in his possession without specific permission of the client. As far as working papers are concerned, working papers are the property of the auditor. The auditor may at his discretion, make portions of or extracts from his working papers available to his client".

Thus, there is no requirement compelling the auditor to divulge information obtained in the course of audit and included in the working papers to any outside agency except as and when required by any law.

Question 13

Mr. A, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. X gave him an idea to start online services and give stock certifications to traders with Cash Credit Limits in Banks. Mr. A started a website with colorful catchy designs and shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services". Discuss if the actions of Mr. A are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.

Answer:

As per Clause (6) of Part I of the First Schedule of 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.

Mr. A is wrong in seeking clients through family and friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients names is also prohibited as per the guidelines.

In the given situation, Mr. A shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on the website issued by the ICAI. Thus, CA A would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

Question 14

Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. Is Mr. D right in accepting the auditor position?

Answer:

As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. In view of the above provisions Mr. D cannot accept the Directorship of the company until the completion of two years after his resignation.

Thus, CA D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.

Question 15 Exceptional

Mr. F, a Chartered Accountant, gave advisory services to PQR Pvt.Ltd. Further, he gave them GST consultancy, compilation engagement for historical financial information and helped in ERP set up. Later, the company turned out to be a part of a group of companies involved in money laundering. Mr. F was asked to provide details of the companies. Mr. F refused on the grounds that he gave only consultancy services to the company and wasn't supposed to keep any information about the company. Is Mr. F right as per the guidelines issued by the ICAI?

Answer:

The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice.

In the given situation, CA F, gave GST consultancy, compilation engagement for historical financial information and helped in ERP set up along with advisory services to PQR Pvt. Ltd. Mr. F was asked to provide details of the companies as the company, turned out to be a part of a group of companies, involved in money laundering. Contention of Mr. F that he gave only consultancy services and compilation engagement for historical financial information to the company and wasn't supposed to keep any information about the company is not valid as Mr. F should have kept following information in compliance with KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestation functions.

In the given case of PQR Pvt. Ltd, a Corporate Entity, Mr. F should have kept following information:

A. General Information
   - ✓ Name and Address of the Entity
   - ✓ Business Description
   - ✓ Name of the Parent Company in case of Subsidiary
   - ✓ Copy of last Audited Financial Statement

B. Engagement Information
   - ✓ Type of Engagement

C. Regulatory Information
   - ✓ Company PAN No
   - ✓ Company Identification No
   - ✓ Directors' Names & Addresses
   - ✓ Directors' Identification No

Question 16

Mr. S, the auditor of ABC Pvt. Ltd. has delegated following works to his articles and staff:

i. Issue of audit queries during the course of audit.
ii. Issue of memorandum of cash verification and other physical verification.
iii. Letter forwarding draft observations/financial statements.
iv. Issuing acknowledgements for records produced.
v. Signing financial statements of the company.

Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

Answer:

As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

i. Issue of audit queries during the course of audit.
ii. Asking for information or issue of questionnaire.
iii. Letter forwarding draft observations/financial statements.
iv. Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
v. Acknowledging and carrying on routine correspondence with clients.
vi. Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
vii. Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.
viii. Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
ix. Any other matter incidental to the office administration and routine work involved in practice of accountancy.

In the instant case, Mr. S, the auditor of ABC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company.

Therefore, Mr. S is correct in allowing first four tasks i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles.

However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, Mr. S is wrong in delegating signing of financial statements to his staff.

Conclusion: In view of this, S would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

Question 17

Mr. S is a practising chartered accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper-setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part.

You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members).

Answer:

Given situation can be visualised in following parts:

A. Mr. S used to involve himself in equity research and used to advise his friends, relatives and other known people: As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation.

   In the given case, though Mr. S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr. S shall not make him guilty of professional misconduct.

B. Mr. S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities: As per Clause 11 of Part I of First Schedule of the Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is 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.

   Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include:

   - ✓ Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination.
   - ✓ Owning agricultural land and carrying out agricultural activities.

   Therefore, in the given case, the activities of Mr. S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct.

C. Mr. S was discharged insolvent: Disabilities for the Purpose of Membership: Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period.

   In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council.

   In the given case, it is clearly stated that Mr. S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. S has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.

Question 18

CA Pankaj accepted professional work of acting as valuer under direct taxes. He charges fees on a percentage of the property valued. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

Restriction on fees based on a Percentage: According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, Regulation 192 exempts Chartered Accountants in practice to charge fees based on a percentage of profits or contingent upon findings or results for professional work for certain professional services.

Regulation 192 specifically states that in the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of the property valued.

Conclusion: Consequently, CA Pankaj shall not be deemed to be guilty of professional misconduct, as he is within the permissible scope of charging fees based on a percentage of the property valued.

Question 19

Mr. Johny, a chartered accountant, was invited to a seminar on bank audits to give a presentation on the process of conducting such audits. During his presentation, he provided examples from his clients' experiences and shared the significant information about clients with the intention of aid in understanding of audience on the topic. Does above situation have implications in relation to the professional ethics?

Answer:

Disclosure of Client's Information: Confidentiality is one of fundamental principles governing professional ethics. Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, addresses professional misconduct related to the disclosure of information by a chartered accountant in practice concerning the business of their clients. Such disclosure to any person other than the client, without the client's consent or unless mandated by prevailing law, is considered a breach of conduct. The Code of Ethics emphasizes that this duty continues even after the completion of the assignment, except when disclosure is necessary for the performance of professional duties.

In the provided case, CA Johny disclosed significant information about his client's business without obtaining the client's consent, believing that it would enhance the audience's understanding of the topic.

Conclusion: Therefore, this action of CA Johny constitutes professional misconduct under Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Question 20

CA Vaayu is the auditor of Viva Limited having a turnover of more than Rs.200 Crores. The audit fee for the year is fixed at Rs.80 Lakhs. During the year, the company offers CA Vaayu an assignment of representation before Income Tax Appellate Tribunal for certain matter for remuneration of Rs.1.75 crores. CA Vaayu accepted the assignment. Discuss action of CA Vaayu with reference to the provisions of the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto.

Answer:

As per the Council General Guidelines 2008, under Chapter IX on appointment as statutory auditor a member of the Institute in practice shall not accepts the appointment as a statutory auditor of a PSUs'/Govt company(ies)/Listed company(ies) and other public company(ies) having a turnover of Rs.50 crores or more in a year and where he accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking. For this purpose, the other work/services include Management Consultancy and all other professional services permitted by Council excluding audit under any other statute, Certification work required to be done by the statutory auditor and any representation before an authority.

In the given case, the company offers CA Vaayu, the statutory auditor, an assignment of representation before Income Tax Appellate Tribunal for remuneration of Rs.1.75 Crores.

Conclusion: In view of the above provision, it would not be misconduct on Vaayu's part if he accepts the assignment of representation before Income Tax Appellate Tribunal for remuneration of Rs.1.75 crore.

Question 21

Sanjeev & Associates, a firm of Chartered Accountants responded to a tender from a PF Office, Chembur for filing quarterly e-TDS returns. The terms of tender are as follows:

i. Earnest Money Deposit of Rs.7,500/-
ii. It is open for all categories
iii. Maximum fees of Rs.7,500/- per quarter

Discuss whether Sanjeev and Associates can respond to the said tender with reference to provisions of the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto

Answer:

As per Clause 6 of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall 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.

Provided that nothing herein contained shall be construed as preventing or prohibiting -

i. Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or
ii. A member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence.

However, as per the Guidelines issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organisation or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such a restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the given case, Sanjeev & Associates responded to a tender from a PF Office, Chembur, filing quarterly e-TDS returns.

Conclusion: Sanjeev & Associates can respond to the said tender as the tender is open to all the categories i.e. it is open to other professionals along with the Chartered Accountants.

Question 22

CA Shubh, a Chartered Accountant in practice specializing in the field of Information Systems Audit. He is considered to be one of the experts in this field because of his command over the subject. ZX Limited, a company engaged in rendering management consultancy offered him to appoint as its managing director. CA Shubh accepted the position of managing director without obtaining prior permission from the Institute. One of his friends, CA Varun informed him that now he cannot retain full time certificate of practice, thus cannot do attestation function and train articled assistants. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

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 the Chartered Accountant unless permitted by the Council so to engage.

As per the Guidelines for Corporate Form of Practice, the Council has allowed the members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate within the meaning of the Companies Act, 2013 provided that the body corporate is engaged exclusively in rendering Management Consultancy and Other Services permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard. The name of the Management Consultancy Company is required to be approved by the Institute and such a Company has to be registered with the Institute.

The members can retain a full-time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such management consultancy company. There will be no restriction on the quantum of the equity holding of the members, either individually and/ or along with the relatives, in such a company. Such members shall be regarded as being in full- time practice and therefore can continue to do attest function either in individual capacity or in Proprietorship/Partnership firm in which capacity they practice and wherein they are also entitled to train articled/audit assistants.

In the given case, CA Shubh, a Chartered Accountant specializing in Information Systems Audit and considered an expert in the field, was offered the position of Managing Director by ZX Limited, a management consultancy firm. He accepted the role without obtaining prior permission from the Institute of Chartered Accountants of India

From the above provisions, it can be concluded that the action of CA Shubh is valid.

Question 23

Pitch Private Limited requested CA Angad, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Ravi, one of the Director of Pitch Private Limited, along with the copy of resignation letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Ravi was simply copied and pasted by another Director of Pitch Private Limited. CA Angad, without verifying the genuineness of the resignation letter, digitally signed the form and the said form was uploaded on the website of Registrar of Companies. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

As per Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he does not exercise due diligence or is grossly negligent in the conduct of this professional duties.

In the given case, Pitch Private Limited requested CA Angad, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Ravi, one of the Director of Pitch Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Ravi was simply copied and pasted by another Director of Pitch Private Limited.

CA Angad, without verifying the genuineness of the Resignation Letter, digitally signed the Form and the said form was uploaded on the website of Registrar of Companies.

Due to forged resignation letter, the resignation of Mr. Ravi from directorship of the Pitch Private Limited had been occurred. It was noted that CA Angad had not taken any step to verify forged signature on resignation letter which anyone would have taken in normal circumstances.
Hence, CA Angad would be held liable for professional misconduct as per Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Question 24

Shri Limited, a listed Company, having its registered office at Mumbai is engaged in manufacturing of various types of yarns to be supplied to the textile mills. The Company has installed pollution control equipment for processing the pollutants so that before discharge of effluents outside the factory, the level of pollution is kept at a level below the prescribed standard. The company managed to get the pollution clearance certificate by unfair means, while still there continues to be breach of pollution control laws in matters of discharge of polluting effluents. The amount of Rs.18.75 Lacs had been incurred for arranging clearance certificate and the amount incurred unlawfully had been booked as pollution recycling expenditure. The matter had not reached those in governance, and the Director-Finance, who is a Chartered Accountant, came to know of these matters on review of major expenditure incurred during the period. Comment on the action/responses expected of Director - Finance (CA Gopal) referring to any applicable requirements of Responses for NOCLAR under Code of Ethics.

Answer:

In the given situation, Shri Limited, a listed company, has installed pollution control equipment for processing the pollutants to keep the level of pollution below the prescribed standard. The company managed to get pollution certificate by unfair means whereas breach of pollution control laws still continues. For arranging clearance certificate amount of ₹ 18.75 lacs had been incurred unlawfully. CA Gopal, Director Finance, came to know about these matters on review of the same during the period.
NOCLAR, under Code of Ethics, is applicable on professional accountants in service, and in practice. Among those in practice, it applies to Auditors, as well as professional services other than Audit.
It is applicable to Senior Professional Accountants in service, being employees of listed entities. Senior professional accountants in service ("senior professional accountants") includes directors.
NOCLAR takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.
As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted.
CA Gopal, Director-Finance is expected of taking the following action/responses:

- ✓ Obtaining an understanding of the Matter.
- ✓ Addressing the matter.
- ✓ Seeking advice.
- ✓ Determining whether further action is needed.
- ✓ Determining whether to disclose the matter to an Appropriate Authority.
- ✓ Imminent breach.
- ✓ Documentation.

Question 25

CA Kapila, in practice, is desirous of filling Multi-purpose Empanelment Form (MEF) for inclusion of her name in panel for allotment of statutory audit of bank branches web hosted by Professional Development Committee (PDC) of ICAI for financial year 2023-24. The form requires applicants to upload XML files of their personal income tax returns along with computation of income. During relevant year for which information is being sought by PDC, CA Kapila has transacted in futures and options derivatives (equity) and has reflected income from such transactions in her return of income as "Business Income". Analyse the above situation with reference to the provisions of the Chartered Accountants Act, 1949.

Would it make any difference if CA Kapila had earned income from transacting in currency derivatives and commodity derivatives?

Answer:

Clause 11 of Part I of First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of Chartered Accountants unless permitted by the Council so to engage.

Provided that nothing contained herein shall disentitle a Chartered accountant from being a director of a Company, (not being a managing director or a whole-time director), unless he or any of his partners is interested in such company as an auditor.

Ethical Standards Board of ICAI has announced that it is permissible for a member in practice to engage in derivative transactions in his personal capacity but not in professional capacity i.e. for clients. Such engagements in derivatives are not violative of provisions of Clause 11 of Part I of First Schedule to the Chartered Accountants Act, 1949. Further, members are allowed to transact in equity and currency derivatives. There is no requirement to take permission of Council in this matter.

Therefore, there is no difference if CA Kapila had earned income from currency derivatives. However, in accordance with the announcement of Ethical Standards Board of ICAI, it is not permissible for members in practice to transact in commodity derivative transactions. In such a case, CA Kapila would be held guilty of professional misconduct for engaging in business other than profession of Chartered Accountancy.

Question 26

In terms of subsection 114 of Revised Code of Ethics, a professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as result of professional and employment relationships. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in knowledge that the information will not be disclosed to a third party. In this context, enumerate the circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate. In deciding whether to disclose confidential information what are the points that should be kept in the mind of professional accountants?

Answer:

Principle of Confidentiality: In terms of subsection 114 of Revised Code of Ethics, a professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

1. Disclosure is required by law,
2. Disclosure is permitted by law and is authorized by the client or the employing organisation;
3. There is a professional duty or right to disclose, when not prohibited by law:
   i. To comply with the requirements of Peer Review or Quality Review of the Institute;
   ii. To respond to an inquiry or investigation by a professional or regulatory body;
   iii. To protect the professional interests of a professional accountant in legal proceedings; or
   iv. To comply with technical and professional standards, including ethics requirements.

In deciding whether to disclose confidential information, professional accountants should consider the following points:

1. Whether the interests of any party, including third parties whose interests might be affected, could be harmed if the client or employing organization consents to the disclosure of information by the professional accountant;
2. Whether all the relevant information is known and substantiated, to the extent it is practicable; and
3. The proposed type of communication, and to whom it is addressed;
4. Whether the parties to whom the communication is addressed are appropriate recipients.

Question 27

CA Raj, a practicing chartered accountant, is offered to take up an appointment as a "Secretary" in his professional capacity by the Central Government for a Metro Project for a term of 2 years not on a salary-cum-full-time basis. After giving deep thought to the offer, CA Raj accepted the appointment. Comment in terms of the Chartered Accountant Act, 1949 and Schedules thereto.

Answer:

As per Section 2(2)(iv) of the Chartered Accountant Act, 1949 as amended from time to time, a member of the Institute shall be deemed 'to be in practice' when individually or in partnership with Chartered Accountants in practice, or in partnership with members of such other recognized professional as may be prescribed, he, in consideration of remuneration received or to be received, renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice.

As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is 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.

However, the Council of the Institute is empowered to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper. Accordingly, the Council formulated Regulations 191 to the Chartered Accountants Regulations, 1988 specifying the activities with which a member in practice can associate himself with or without the permission of the Council. As per Regulation 191 a Chartered Accountant in practice may take up an appointment that may be made by the Central Government or a State Government or a court of law or any other legal authority or may act as a secretary in his professional capacity, provided his employment is not on a salary-cum-full-time basis".

In the instant case, CA Raj, a practicing chartered accountant has been appointed as a "Secretary" in his professional capacity by the Central Government for a metro project for a term of 2 years not on a salary-cum-full-time basis.

Conclusion: In view of above, in the given scenario, CA Raj will not be held liable for misconduct for acceptance of appointment as Secretary in terms of compliance of Regulations 191 read with Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.

Question 28

TP Limited is a listed company engaged in the business of manufacturing of kids garments under the brand name of MM. M/s R & Associates, firm of chartered accountants, are appointed as a Statutory Auditor of the Company for the year 2023-24. CA R is looking after the audit of the Company. During the audit, CA R observed that there are number of notices received from GST Department and Income-tax Department for various issues. Further during plant visit, CA R observed that few child labourers are engaged in some of the activity. In response to the observation made, CA R followed the procedure as envisaged in SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements". According to CA R, the provisions of SA 250 and the provisions of NOCLAR (Non-Compliance with Laws and Regulations) under Revised Code of Ethics are one and the same. Do you agree? If not, give your comments.

Answer:

In the given situation, CA R is looking after the audit of TP Limited, a listed company. During the audit, CA R observed that there are a number of notices received from GST Department and Income-tax Department for various issues. Further during plant visit, CA R observed that few child labourers are engaged in some of the activity. In response to the observation made, CA R followed the procedure as envisaged in SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements". assuming the provisions of SA 250 and the provisions of NOCLAR (Non-Compliance with Laws and Regulations) under Revised Code of Ethics are one and the same. However, following points indicates that the provisions of SA 250 and NOCLAR (Non-Compliance with Laws and Regulations) under the Revised Code of Ethics are not one and same:

i. SA 250 is applicable only on Audit, and not on other Assurance engagements. However, NOCLAR is applicable on professional accountants in service, and in practice.
ii. SA 250 talks of auditor's responsibilities for laws having direct effect on the determination of material amounts and disclosures in the financial statements (such as tax and labour laws); and other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business. NOCLAR, while being alike to SA 250 till this point, is further ahead of it in that it takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.
iii. SA 250 does not define stakeholders. NOCLAR is related to affect of non-compliance on investors, creditors, employees as also the general public.
iv. As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted. This provision is not existent in SA 250.

Question 29

CA Kumar, a practicing-chartered accountant, is well known in the field of pleading of Income-tax cases at Income-tax Tribunal and does not provide any assurance services. Considering the long standing in the field, CA Kumar is approached by XYZ Limited to file an appeal in the Tribunal against the Income-tax Demand of Rs.10 crore which was added by the CIT(A) and to plead on behalf of XYZ Limited in the matter. CA Kumar offers to accept the case with the following fee structure:

The fees for filing an appeal and to plead at the Income-tax Tribunal will be 10% of Tax Demand Reduced.

Comment on the act of CA Kumar in terms of the Chartered Accountant Act, 1949 and Schedules thereon.

Answer:

Restriction on Fees based on a Percentage: According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, Regulation 192 allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of a non-assurance services to non-audit clients, and the fees may be based on a percentage of Tax Demand Reduced.

In the given case, CA Kumar, a practicing Chartered Accountant, provides non-assurance services. He is approached by XYZ Limited, a non-audit client, to file an appeal in Tribunal against Income-tax Demand of Rs.10 crore which was added by the CIT(A) and to plead on behalf of XYZ Limited in the matter. CA Kumar offers to accept the case and agrees to charge fees 10% of Tax Demand reduced.

Conclusion: Therefore, Mr. Kumar will not be held guilty of professional misconduct since he is not providing any assurance services to non-audit clients pursuant to Regulation 192 read with Clause 10 of Part I of First Schedule.

Question 30 Exceptional

GeM (e-market place) is a public procurement portal which provides opportunities to start-ups, entrepreneurs etc. to showcase their innovative products and services to government buyers and engage in public procurement. The Government e Marketplace Special Purpose Vehicle (GeM SPV), a 100% government owned and section 8 (Non-Profit) company under the Ministry of Commerce, Government of India has been incorporated under the Companies Act, 2013 to develop, manage and maintain GeM platform. Whether a firm of Chartered Accountants can register on GeM portal for rendering professional services to government departments?

Answer:

As per provisions of Council Guidelines for Advertisement, 2008, it is not permissible for members to list themselves with online application based service provider Aggregators, wherein other categories like businessmen, technicians, maintenance workers, event organizers etc. are also listed.

Further, as per explanation to Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, the government departments, government Companies/ corporations, courts, cooperative societies and banks and other similar institutions prepare panels of Chartered Accountants for allotment of audit and other professional work. Where the existence of such a panel is within the knowledge of a member, he is free to write to the concerned organization with a request to place his name on the panel. However, it would not be proper for the Chartered Accountant to make roving enquiries by applying to any such organization for having his name included in any such panel. It is permissible to quote fees on enquiries being received or respond to tenders from the organizations requiring professional services, which maintain such panel.

Getting registered on GeM portal by members does not appear to amount either to empanelment or listing on Aggregator. In Aggregator, it is the third party which is operating, and not the client itself. GeM is operated by the client itself.

It is a pre-requirement of rendering professional services to the Government departments, as stipulated by them, and be considered as ancillary requirement to providing services to the Government departments. Firms of Chartered Accountants are permitted to register on GeM Portal for rendering professional services as there is no violation of the ethical norms of the Institute in registering on the GeM portal and such registration on the Portal is a pre-requirement for providing services to the Government departments/ organisations.

However, firms should ensure compliance with the tender guidelines issued by the Institute while participating in tender or bid floated through GeM Portal. The ICAI has made an announcement in relation to the above.

Question 31

CA Gyan is a Chartered Accountant in practice and also an engineer by qualification. He wants to pursue a registered valuer course and work as a registered valuer for plant and machinery under the Companies Act, 2013. Comment on above with reference to provisions of the Chartered Accountants Act, 1949.

Answer:

As per section 2(2)(iv) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed "to be in practice" when individually or in partnership with the Chartered Accountants in practice or in partnership with members of such other recognised professions as may be prescribed, he, in consideration of remuneration received or to be received, renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice.

Pursuant to section 2(2) (iv) above, the Council has passed a resolution permitting a Chartered Accountant in practice to render entire range of "Management Consultancy and other Services" which, inter alia, includes rendering services of valuation of shares and business and advice regarding amalgamation, merger and acquisition, acting as Registered Valuer under the Companies Act, 2013 read with the Companies (Registered Valuers and Valuation) Rules, 2017. In this regard, such rules qualify Chartered Accountants for valuation of the securities or the financial Assets only and not for the Plant and Machinery. Therefore, valuation of plant and machinery does not form part of Management Consultancy and other services permitted by the council.

Further, in accordance with the resolution passed under Regulation 190A of the Chartered Accountant Regulations, 1988, members in practice are generally permitted for attending classes and appearing for any examination. There is no need to take prior permission of ICAI in this regard. Therefore, it is generally permitted for a member in practice to attend classes and appear for any examination, and accordingly, doing the Registered valuer course would be deemed as permissible.

Hence, keeping in view above and in terms of the provisions of the Chartered Accountants Act, 1949 and Code of Ethics, it is not permissible for a Chartered Accountant in practice to work as an Engineer/ valuer in plant & machinery simultaneously.

Question 32

CA Evan has been in practice for two years and runs his proprietorship firm in the name of "Evan & Co.". He maintains notes in his mobile where he records the fees received from various clients. Using these records, he prepares and files his income tax return. Comment with respect to the provisions of the Chartered Accountant Act, 1949.

Answer:

Maintenance of Books of Account by a CA in Practice: Chapter V of the Council General Guidelines, 2008 specifies that a member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his professional practice, proper books of accounts including the following-

i. a Cash Book

ii. a Ledger

Thus, a Chartered Accountant in practice is required to maintain proper books of accounts.

In the instant case, CA Evan does not maintain proper books of accounts and writes the fees received from various clients in notes on his mobile. Notes maintained by him in mobile cannot be treated as books of accounts.

Hence, CA Evan, being a practicing Chartered Accountant will be held guilty of misconduct for violation of Council General Guidelines, 2008.

Question 33

The manager of Miskin (P) Ltd. approached CA Rahul in need of a certificate in respect of a consumption statement of raw material. Without having a certificate of practice (CoP), CA Rahul issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute.

Answer:

Issuing Certificate without having Certificate of Practice: As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the Regulations made thereunder or any Guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act,1949 and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, CA Rahul has issued a certificate in respect of a consumption statement of raw material to the manager of Miskin (P) Ltd as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, CA Rahul will be held guilty of professional misconduct in terms of Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

Question 34

A special notice has been issued for a resolution at 4th annual general meeting of TRIM Ltd., providing expressly that CA Lucky shall not be re-appointed as an auditor of the company. Consequently, CA Lucky submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA Lucky included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

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.

The proposition of the auditor to highlight contributions made by him in strengthening the control procedures in the representation should not be included in such representations because the representation letter should not be prepared in a manner to seek publicity.

Thus, highlighting contributions made by him in strengthening the control procedures, while submitting representation u/s 140(4)(iii) of the Companies Act, 2013 would amount to canvassing or soliciting for his continuance as auditor.

Therefore, CA Lucky will be held guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Question 35

CA Anita joined as an audit executive in a CA firm on April 1, 2024. Despite receiving multiple reminders from ICAI, she has failed to respond with her appointment date and submit her membership certificate. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

Failed to Supply Information Called For: In accordance with Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, is considered to be engaged in professional misconduct if he fails to provide the information requested or does not comply with the requirements set forth by the Institute, Council, or any of its Committees, including the Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board, or the Appellate Authority.

Conclusion: Therefore, in the given scenario, CA Anita has neglected to respond to the Institute's letters seeking confirmation of her appointment date and has not submitted her membership certificate. Consequently, she is deemed to be guilty of professional misconduct as given in Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

Questions From RTP'S, MTP'S, QP'S

Question 1 **(MTP 1 Nov '24 5M)**

Mr. Aditya, a Chartered Accountant was the auditor of 'DRAW Limited'. During the financial year 2023-24, the investment appeared in the Balance Sheet of the company of Rs.23 lakh and was the same amount as in the last year. Later on, it was found that the company's investments were only Rs.76,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and Schedules thereto.

Answer: Already covered in Illustration Qn

Question 2 **(MTP 1 Nov '24 5M)**

CA Shubh, a Chartered Accountant in practice specializing in the field of Information Systems Audit. He is considered to be one of the experts in this field because of his command over the subject. ZX Limited, a company engaged in rendering management consultancy offered him to appoint as its managing director. CA Shubh accepted the position of managing director without obtaining prior permission from the Institute. One of his friends, CA Varun informed him that now he cannot retain full time certificate of practice, thus cannot do attestation function and train articled assistants. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and Schedules thereto.

Answer: Already covered in TYK Qn

Question 3 **(MTP 1 Nov '24 4M)**

Pitch Private Limited requested CA Angad, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Ravi, one of the Director of Pitch Private Limited, along with the copy of resignation letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Ravi was simply copied and pasted by another Director of Pitch Private Limited. CA Angad, without verifying the genuineness of the resignation letter, digitally signed the form and the said form was uploaded on the website of Registrar of Companies. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and Schedules thereto.

Answer: Already covered in TYK Qn

Question 4 **(MTP 1 Nov '24 4M)**

Shri Limited, a listed Company, having its registered office at Mumbai is engaged in manufacturing of various types of yarns to be supplied to the textile mills. The Company has installed pollution control equipment for processing the pollutants so that before discharge of effluents outside the factory, the level of pollution is kept at a level below the prescribed standard. The company managed to get the pollution clearance certificate by unfair means, while still there continues to be breach of pollution control laws in matters of discharge of polluting effluents. The amount of Rs.18.75 Lacs had been incurred for arranging clearance certificate and the amount incurred unlawfully had been booked as pollution recycling expenditure. The matter had not reached those in governance, and the Director-Finance, who is a Chartered Accountant, came to know of these matters on review of major expenditure incurred during the period. Comment the action/responses expected of Director - Finance (CA Gopal) referring to any applicable requirements of Responses for NOCLAR under Code of Ethics.

Answer: Already covered in TYK Qn

Question 5 Exceptional **(MTP 1 Nov '24 5M)**

CA. Kapila, in practice, is desirous of filling Multi-purpose Empanelment Form (MEF) for inclusion of her name in panel for allotment of statutory audit of bank branches web hosted by Professional Development Committee (PDC) of ICAI for financial year 2023-24. The form requires applicants to upload XML files of their personal income tax returns along with computation of income. During relevant year for which information is being sought for by PDC, CA. Kapila has transacted in futures and options derivatives (equity) and has reflected income from such transactions in her return of income as "Business Income". Analyse the above situation with reference to the provisions of the Chartered Accountants Act, 1949. Would it make any difference if CA. Kapila had earned income from transacting in currency derivatives and commodity derivatives?

Answer: Already covered in TYK Qn

Question 6 Exceptional **(MTP 2 Nov '24 4M)**

DIGI & Associates. conducted Stock Audit of PQR Ltd. as per instructions issued by ASG Bank. However instead of visiting the site where the stock was lying, the firm relied on the Management Information Systems report along with inspections reports and photographs of Stock taken by the employees of PQR Ltd. The photographs were also carrying the date and time printed on them.

Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereon.

Answer:

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

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

In the instant case, DIGI & Associate did not exercise due diligence and is grossly negligent in the conduct of his professional duties since it did not visit the site where the stock was lying and instead the firm relied on the MIS report along with inspection reports and photographs of stock taken by the employees of PQR Ltd, which is incorrect.

To conduct stock audit, ascertainment of existence and physical condition of stocks, cross tallying the stock with Stock statement submitted by bank borrower, correct classification of stocks for valuation purpose etc. is essential. Further submitting stock audit report without physically verifying the stock amounts to gross negligence.

From the above, it can be concluded that DIGI & Associate is guilty of professional misconduct under Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Question 7 Exceptional **(MTP 2 Nov '24 4M)**

CA Ram, a practicing chartered accountant, is well known for his expertise in handling Goods and Services Tax (GST) cases at the GST Tribunal and he does not provide any assurance services. Given his long-standing reputation in the field, CA Ram is approached by DEF Limited to file an appeal in the Tribunal against a GST demand of ₹ 6 crore, which was imposed by the Commissioner (Appeals), and to represent DEF Limited in the matter. CA Ram offers to accept a fee of ₹ 3,50,000 for filing the appeal and pleading at the GST Tribunal.

Comment on the act of CA Ram in terms of the Chartered Accountant Act, 1949 and Schedules thereon.

Answer:

Under Section 2(2)(iv) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed "to be in practice" when individually or in partnership with Chartered Accountants in practice, he, in consideration of remuneration received or to be received renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice.

Pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949, read with Regulation 191 of Chartered Accountants Regulations, 1988 a member shall be deemed to be in practice if he, in his professional capacity and neither in his personal capacity nor in his capacity as an employee, acts as representative for taxation matters.

In the given situation, CA Ram, a practicing Chartered Accountant, provides non-assurance services. He is approached by DEF Limited, a non-audit client, to file an appeal in GST Tribunal against GST Demand of ₹ 6 crore, which was imposed by the Commissioner (Appeals) and to plead on behalf of DEF Limited in the matter. CA Ram offers to accept the case and agrees to charge fees of Rs.3,50,000.

Therefore, CA Ram is not guilty of professional misconduct.

Question 8 **(MTP 2 Nov '24 5M)**

Mr. Jay is a practicing Chartered Accountant working as proprietor of M/s Adhya & Co. He went abroad for 4 months. He delegated the authority to Mr. Vijay a Chartered Accountant his employee for taking care of routine matters of his office. During his absence, Mr. Vijay has conducted the under mentioned jobs in the name of M/s Adhya & Co.

i. Asking for information or issue of questionnaire.
ii. Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
iii. Acknowledging and carrying on routine correspondence with clients.

Comment on eligibility of Mr. Vijay for conducting such jobs in name of M/s Adhya & Co. and liability of Mr. Jay under the Chartered Accountants Act, 1949.

Answer:

Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA Jay proprietor of M/s Adhya & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Vijay, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause.

In the given case, Mr. Vijay, a Chartered Accountant being employee of M/s Adhya & Co. has asked for information or issued questionnaire. He has also proceeded for initiating and stamping of vouchers and of schedules prepared for the purpose of audit. Apart from the same, he acknowledged and carried out routine correspondence with clients. Here Vijay is right in doing the same, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First Schedule to the Act.

Question 9 **(MTP 1 May '24 5M)**

CA. Gyan is a Chartered Accountant in practice and also an engineer by qualification. He wants to pursue a registered valuer course and work as a registered valuer for plant and machinery under the Companies Act, 2013. Comment on above with reference to provisions of the Chartered Accountants Act, 1949.

Answer: Already covered in TYK Qn

Question 10 **(MTP 1 May '24 5M)**

Mr. Mayank, a Chartered Accountant was the auditor of 'Chew Limited' for the year 2021-22 and 2022-23. During the financial year, the investment appeared in the Balance Sheet of the company amounting ₹ 7.5 lac and was the same amount as in the last year 2021-22. Later it was found that the company's investments were only for ₹ 56,000, however, the value of investments was inflated for the purpose of obtaining higher amount of Bank loan. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer: Already covered in TYK Qn

Question 11 **(MTP 1 May '24 4M)**

GeM (e-market place) is a public procurement portal which provides opportunities to start-ups, entrepreneurs etc. to showcase their innovative products and services to government buyers and engage in public procurement. The Government e Marketplace Special Purpose Vehicle (GeM SPV), a 100% government owned and section 8 (Non-Profit) company under the Ministry of Commerce, Government of India has been incorporated under the Companies Act, 2013 to develop, manage and maintain GeM platform. Whether a firm of Chartered Accountants can register on GeM portal for rendering professional services to government departments?

Answer: Already covered in TYK Qn

Question 12 Exceptional **(MTP 1 May '24 5M)**

CA. Z, in practice, is desirous of filling Multi-purpose Empanelment form (MEF) for inclusion of his name in panel for allotment of statutory audit of bank branches web hosted by Professional Development Committee (PDC) of ICAI for financial year 2023-24. The form requires applicants to upload XML files of their personal income tax returns along with computation of income. During relevant year for which information is being sought for by PDC, CA. Z has transacted in futures and options derivatives (equity) and has reflected income from such transactions in his return of income as "Business Income". Analyse the above situation with reference to the provisions of the Chartered Accountants Act, 1949.

Would it make any difference if CA. Z had earned income from transacting in currency derivatives and commodity derivatives?

Answer: Already covered in TYK Qn

Question 13 **(MTP 2 May '24 5M)**

Mr. S is a practising Chartered Accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper-setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer: Already covered in TYK Qn

Question 14 **(MTP 2 May '24 5M)**

A special notice has been issued for a resolution at 4th annual general meeting of TRIM Ltd., providing expressly that CA. Lucky shall not be re-appointed as an auditor of the· company. Consequently, CA. Lucky submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Lucky included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer: Already covered in TYK Qn

Question 15 **(MTP 2 May '24 4M)**

CA. Evan has been in practice for two years and runs his proprietorship firm in the name of "Evan & Co." He maintains notes in his mobile where he records the fees received from various clients. Using these records, he prepares and files his income tax return. Comment with respect to the provisions of the Chartered Accountant Act, 1949.

Answer: Already covered in TYK Qn

Question 16 **(MTP 2 May '24 4M)**

The manager of Miskin (P) Ltd. approached CA. Rahul in need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA. Rahul issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute.

Answer: Already covered in TYK Qn

Question 17 **(PYP May '24 5M)**

In terms of subsection 114 of Revised Code of Ethics, a professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as result of professional and employment relationships. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in knowledge that the information will not be disclosed to a third party. In this context, enumerate the circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate. In deciding whether to disclose confidential information what are the points that should be kept in the mind of professional accountants?

Answer: Already covered in TYK Qn

Question 18 **(PYP May '24 4M)**

CA Raj, a practicing chartered accountant, is offered to take up an appointment as a "Secretary" in his professional capacity by the Central Government for a Metro Project for a term of 2 years not on a salary-cum-full-time basis. After giving deep thought to the offer, CA Raj accepted the appointment.

Comment in terms of the Chartered Accountant Act, 1949 and Schedules thereto.

Answer: Already covered in TYK Qn

Question 19 **(PYP May '24 4M)**

CA Kumar, a practicing-chartered accountant, is well known in the field of pleading of Income-tax cases at Income-tax Tribunal and does not provide any assurance services. Considering the long standing in the field, CA Kumar is approached by XYZ Limited to file an appeal in the Tribunal against the Income-tax Demand of Rs.10 crore which was added by the CIT(A) and to plead on behalf of XYZ Limited in the matter. CA Kumar offers to accept the case with the following fee structure:

The fees for filing an appeal and to plead at Income-tax Tribunal will be higher of the following (a) or (b):

(i) Rs.5,00,000/-

(ii) 10% of Tax Demand Reduced.

Comment on the act of CA Kumar in terms of the Chartered Accountant Act, 1949 and Schedules thereon.

Answer: Already covered in TYK Qn

Question 20 **(PYP Nov '24 5M)**

PN and Associates are appointed as the Statutory Auditors of The Iron Company Ltd. The Central Government holds 65% of the paid-up share capital in this company. The appointment letter of the company gave a very limited time to PN and Associates for accepting the audit. CA N, the engagement partner communicated with the previous auditor but due to lack of time he had to give acceptance for the audit assignment before receiving reply from the previous auditor. Hence CA N gave a conditional acceptance of the appointment and commenced the audit. Discuss with reference to the Chartered Accountants Act, 1949 and the schedules thereunder, whether CA N has complied with same.

Answer:

As per Clause (8) 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 accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

Although the mandatory requirement of communication with previous auditor being Chartered Accountant applies, in uniform manner, to audits of both government and Non-Government entities, yet in the case of audit of government Companies/ banks or their branches, if the appointment is made well in time to enable the obligation cast under this clause to be fulfilled, such obligation must be complied with before accepting the audit. However, in case the time schedule given for the assignment is such that there is no time to wait for the reply from the outgoing auditor, the incoming auditor may give a conditional acceptance of the appointment and commence the work which needs to be attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. In his acceptance letter, he should make clear to the client that his acceptance of appointment is subject to professional objections, if any, from the previous auditors and that he will decide about his final acceptance after taking into account the information received from the previous auditor.

In the given case, PN and Associates are appointed as the Statutory Auditors of The Iron Company Ltd. which is a government company as Central Government holds 65% of the paid-up share capital of the company and CA N has given a conditional acceptance of the appointment and commenced the audit. In view of above, it can be concluded that CA N has complied with the provisions of the Chartered Accountants Act, 1949 and the Schedules thereunder.

Question 21 **(PYP Nov '24 5M)**

CA Gosh, newly qualified Chartered Accountant, joins a reputed CA firm as a partner. He is full of confidence about his qualification and feels he possesses complete knowledge of his profession for the future assignments. The senior partner of the firm calls a meeting to brief the new partner and other newly appointed audit assistants in his firm regarding the ethics that need to be kept in mind while carrying out assurance and non-assurance services. One of the areas he touches upon is the professional competence and due care that a Chartered Accountant needs to possess all the time. Enumerate the matters envisaged in subsection 113 of Revised Code of Ethics that needs to be complied with by a professional accountant with respect to Professional Competence and Due Care.

Answer:

Professional Competence and Due Care – Subsection 113

1. A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:
   (a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
   (b) Act diligently in accordance with applicable technical and professional standards.
2. Serving clients and employing organizations with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.
3. Maintaining professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments.
4. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.
5. Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.
6. In complying with the principle of professional competence and due care, a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

Where appropriate, a professional accountant shall make clients, the employing organization, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities.

Question 22 **(PYP Nov '24 5M)**

CA F is the Chief Financial Officer of ABC General Insurance Limited. Being in insurance business, the company gets majority of its clients through their agency contracts. CA F has the practice of releasing the commission payments on the condition that he gets 20% of the commission amount from the agent. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

According to Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949, a member of the Institute (other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

The objective is that when a member is in employment, he must maintain high level of ethics and should not accept any other amount from anyone for which he is not entitled from employer under contractual agreement of service.

In the present case, CA F is the Chief Financial Officer of ABC General Insurance Limited. He releases the commission payments on the condition that he gets 20% of the commission amount from agent as majority of the clients are through their agency only.

Therefore, CA F is guilty of professional misconduct by virtue of Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949.

Question 23 **(Model TP 5M)**

CA. T, the statutory auditor of Race Limited, a PSU, for the year 2023-24. During the audit, CA. T did not detect any fraud having been committed during that year. However, the C & AG audit staffs, during their routine inspection, found that chief cashier of the company committed fraud in debtor's ledger and absconded with the amount. The investigation made in the fraud revealed that the auditor did not exercise proper skill and care and performed his work improperly.

Comment with reference to the provisions of the Chartered Accountants Act, 1949.

Answer:

Failure to Exercise Reasonable Care and Skill: Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

In the given case, CA. T did not detect any fraud. However, the C & AG audit staff, during their routine inspection, found that the chief cashier of the company committed fraud in debtor's ledger and absconded with the amount.

Apparently, it appears that the auditor did not exercise proper skill and care and that he performed his work in an improper manner. In this matter, the test for auditor's liability lies in whether he has applied reasonable care, skill and caution called for in the circumstances of the case and whether he reasonably used all the information that he came across during the audit.

The auditor should have been highly concerned about the cashbook's state due to the unexpected disappearance of the head cashier. This unexplained absence is a major red flag and demands a thorough investigation by the auditor.

As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements", it can be concluded that the auditor did not plan and perform the audit with an attitude of professional skepticism. Thus, having regard to this that fraud has actually taken place during the year committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.

As it appears from the facts of the case, CA. T has been grossly negligent in performing his duties which constitutes professional misconduct. Thus, such instances require reference to Disciplinary Committee of the Council of the Institute.

Question 24 **(Model TP 5M)**

NIS Limited, a company registered under the Companies Act, 2013 has created a separate Trust "NIS Employees Gratuity Fund Trust". Both the Company and Trust are under the same management. Mr. Anuj is the auditor of both the entities. Mr. Anuj has observed that some part of the expenditure was not applied towards the objects of the trust. He informed the matter to the Board of Trustees through a separate report but did not qualify the audit report of the Trust. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer:

Disclosure of Material Facts: A Chartered Accountant in practice is deemed to be guilty of professional misconduct under Clause (5) of Part I of the Second Schedule if he "fails to disclose a material fact known to him which is not disclosed in a financial statement but disclosure of which is necessary to make the financial statement not misleading".

In the given case, Mr. Anuj was aware of some part of the expenses not applied towards the object i.e. contraventions and irregularities committed by the trust as these were referred to in the separate report given by him to the Board of Trustees of the company. However, he issued an audit report without any qualification is not in order.

Therefore, CA Anuj is deemed to be guilty of professional misconduct.

Question 25 **(Model TP 5M)**

CA. Rishi is a newly qualified Chartered Accountant in practice and in order to increase his professional practice and client base, entered into an agreement with Mr. Krish, a qualified and experienced registered valuer, to share 18% professional fees for all cases of valuation referred to him by CA. Rishi. Based on this, CA. Rishi received Rs. 1,15,000 during the year 2023-24 from Mr. Krish. Is CA. Rishi guilty of misconduct under the Chartered Accountants' Act, 1949?

Answer:

Sharing Professional Fees with Registered Valuer: As per Clause (3) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant will be guilty of professional misconduct if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute.

A member cannot share his fees with a non-member similarly he is also not permitted to receive and share the fees of others except for sharing with member of such professional body or other person having such qualification as may be prescribed (Regulation 53A of the Chartered Accountants Regulations, 1988) by the council.

Under the Regulation 53A of the Chartered Accountants Regulations, 1988, registered valuer is not included.

In the instant case Mr. Rishi, who is a newly qualified Chartered Accountant in practice entered into an agreement with Mr. Krish, a qualified and experienced registered valuer, to share 18% professional fees for all case of valuation referred to him by CA. Rishi. CA. Rishi also received ₹ 1,15,000 for the same from Mr. Krish. Thus, CA. Rishi will be held guilty for misconduct under clause (3) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

Question 26 **(Model TP 5M)**

The Director (Discipline) of the ICAI received information of alleged misconduct against Mr. Nandkishore, the proprietor of NK & Associates, where an event relating to Corporate Social Responsibility was sponsored by NK & Associates, whereby in the sponsorship banner, name of Mr. Nandkishore as 'CA Nandkishore, Proprietor, NK & Associates' was mentioned.

On the basis of above information and along with certain evidence against Mr. Nandkishore, he was found guilty and so he was reprimanded and a fine of ₹ 1 lakh was imposed by an order passed against him dated 21st May, 2023.

Against the said order, Mr. Nandkishore preferred an appeal with the Appellate Authority on 04th June, 2023 by submitting a statement of appeal along with the application form of appeal. During such appellate proceedings, it was discovered that the said statement of appeal contained some facts which were false to which Mr. Nandkishore admitted it to be false and apologized for it.

Mr. Nandkishore has violated which of the provisions of the Chartered Accountants Act, 1949? Comment.

Answer:

Mr. Nandkishore has violated following provisions of the Chartered Accountants Act, 1949:

(i) As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be 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.

In this connection, members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, mentioning a firm's name or CA Logo is not permitted.

An event relating to Corporate Social Responsibility was sponsored by NK & Associates, whereby in the sponsorship banner, name of Mr. Nandkishore as 'CA Nandkishore, Proprietor, NK & Associates' was mentioned. Thus, firm's name was mentioned which is not allowed and thus, Mr. Nandkishore has violated the restriction imposed under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(ii) As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the ICAI shall be deemed to be guilty of professional misconduct, if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority, any particulars knowing them to be false.

Mr. Nandkishore in the statement of appeal submitted with the Appellate Authority mentioned some facts knowing them to be false and thus, he has violated the restriction imposed under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

Question 27 **(MTP M25 S1 5M)**

Veda Ltd., a listed company having headquarter in Delhi, is engaged in the production and supply of unique chemicals to various industries. To comply with environmental regulations, the company installed pollution control equipment to
process and treat waste before its discharge. However, despite regulatory requirements, the company continued to violate pollution control laws regarding the disposal of industrial waste.

To obtain the necessary environmental clearance certificate, the company resorted to unethical means. An amount of Rs. 43.85 lakhs was unlawfully spent to secure the clearance, which was then misrepresented in the financial records as an environmental compliance expense. This matter had not been brought to the attention of those charged with governance. However, during a periodic financial review, the Director of Finance, CA Rohan, discovered the irregularities.

What actions should CA Rohan take in response to this situation, considering the applicable provisions of responses for NOCLAR (Non-Compliance with Laws and Regulations) under the Code of Ethics?

Answer: Already covered in TYK Qn

Question 28 **(MTP M25 S1 4M)**

CA Dhanush is the auditor of Jivi Limited having a turnover of more than
Rs. 300 Crores. The audit fee for the year is fixed at Rs. 2.25 crore. During the year, the company

offers CA Dhanush an assignment of representation before Income- tax Appellate Tribunal for certain matter for remuneration of Rs. 2.85 crores. CA Dhanush accepted the assignment. Discuss action of CA Dhanush with reference to the provisions of the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto.(4 Marks)

Answer: Already covered in TYK Qn

Question 29 **(MTP M25 S1 4M)**

Hitesh, a Chartered Accountant, applied for obtaining a Certificate of Practice. However, while filling out the application form, he intentionally did not fill the section requiring disclosure of any engagement in other occupations or businesses. Hitesh was actively involved in a business, making this non- disclosure a case of withholding crucial information that was explicitly sought by the Institute.

Analyse whether Hitesh's actions amount to professional misconduct as per the provision of the Chartered Accountants Act, 1949.

Answer: Already covered in Illustration Qns

Question 30 **(MTP M25 S1 5M)**

Mr. Chetan, a practicing Chartered Accountant, was involved in a family dispute over ancestral property. To gain an undue advantage, he allegedly forged the will of his late uncle, presenting it as a genuine document during legal proceedings. The forgery was later uncovered, and legal action was initiated against him.

Although the act was committed in his personal capacity and not in the course of his professional duties, a complaint was filed with the disciplinary committee of the Institute of Chartered Accountants of India (ICAI).

Analyse whether Mr. Chetan would be held liable for misconduct as per the provisions of the Chartered Accountants Act, 1949.

Answer:

Disrepute to the Profession: As per Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work. Here the Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards calls for disciplinary action.

In the present case, Mr. Chetan allegedly forged the will of his late uncle, presenting it as a genuine document during legal proceedings, to gain an undue advantage. This brings disrepute to the profession of a Chartered Accountant.

Therefore, CA Chetan will be held guilty of other misconduct under Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949.

Question 31 **(MTP M25 S2 4M)**

DND and Associates are the statutory auditor of XYZ Ltd. Audit of the company is pending for F.Y. 2022-23 and 2023-24 due to a dispute between auditor and company with respect to certain proposed remarks by the auditor in the audit report for F.Y. 2022-23. The company removed the auditor on 06.05.2024 in shareholders meeting complying with all legal formalities. DND and Associates after coming to know about the removal, intimated the Registrar of Companies (ROC) through letter highlighting the points of dispute including non-existence of fixed assets, bogus creditors etc. XYZ Ltd.

complained to ICAI against DND and Associates for their above letter to ROC. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

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

An accountant, in public practice, has access to a great deal of information of his client which is of a highly confidential character. It is important for the work of an accountant and for maintaining the dignity and status of the profession that he should treat such information as having been provided to him, only to facilitate the performance of his professional duties for which his services have been engaged. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment.

In the given situation, DND & Associates complained to the Registrar of Companies (ROC) through letter highlighting the points of dispute including non- existence of fixed assets, bogus creditors, etc. after coming to know about the removal. DND & Associates made voluntary disclosure of the information acquired during the professional engagement without the consent of the client and without there being any requirement in law to disclose the same.

Thus, DND & Associates will be held guilty of professional misconduct under Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Question 32 **(MTP M25 S2 4M)**

CA Yug, a practicing chartered accountant, is a promoter director of CDS Pvt. Ltd. and is also a sleeping partner in his family's garments manufacturing business. Is CA Yug liable for professional misconduct as per the Chartered Accountant Act, 1949?

Answer:

Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage.

There is no bar for a member to be a promoter / signatory to the Memorandum and Articles of Association of any company. There is also no bar for such a promoter / signatory to be a Director Simplicitor of that company irrespective of whether the object of the company includes areas which fall within the scope of the profession of Chartered Accountants. Therefore, members are not required to obtain specific permission from the Council in such cases.

Further, members of the Institute in practice may engage after obtaining the specific and prior approval of the Council in case of interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken.

In the given case, CA Yug is a promoter director of CDS Pvt. Ltd. and also, he is a sleeping partner in his family business of garments manufacturing firm. Applying the above to the given case, it can be concluded that, CA Yug:

- ✓ As Promoter Director- Not guilty of professional misconduct under the Chartered Accountants Act, 1949.

✓ As Sleeping Partner- Guilty of professional misconduct under the Chartered Accountants Act, 1949 as he did not obtain prior approval of the Council.

Question 33 **(MTP M25 S2 5M)**

The Cashier of a company committed a fraud and absconded with the proceeds thereof. The Chief Accountant of the company also did not know when the fraud had occurred. During the audit, auditor failed to discover the fraud. However, fraud was discovered by the Chief Accountant after the audit was completed. Investigation made at that time indicates that the auditor did not exercise proper skill and care and performed his work in a desultory and haphazard manner. With this background, the Directors of the company intend to file disciplinary proceedings against the auditor. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

Answer:

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

As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements", it can be concluded that the auditor did not plan and perform the audit with an attitude of professional skepticism. Thus, having regard to this and a fraud that has actually taken place during the year committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.

In the given case, the auditor failed to discover the fraud during the audit. It is clearly given that the investigation indicated that the auditor did not exercise reasonable skill and care and performed his work in a casual and unmethodical manner.

From the facts given in the case and by applying Clause (7) and SA 240, it can be concluded that the auditor is guilty of professional misconduct and the directors can file disciplinary proceedings against the auditor.

Question 34 **(MTP M25 S2 4M)**

Dheer & Co., a sole proprietary Chartered Accountancy firm in practice with an office in a busy belt of a city, had great difficulty in regularly attending to the consultancy needs of his clients who are mostly located in an industrial cluster in a nearby outskirt which is situated at a distance of 26 kms from the office of the firm. To mitigate the difficulty and to have ease of business, a facilitation centre was opened in the industrial cluster. The proprietor managed, both the office and the facilitation centre, by himself. No intimation was made to the Institute of Chartered Accountants of India. Examine whether there is any professional misconduct in this respect.

Answer: Already covered in MRP Qns

Question 35 **(MTP M25 S2 4M)**

CA Meet, a practicing Chartered Accountant was on foreign tour between 12-08-24 and 27-08-24. On 20-08-24, a message was received from one of his clients requesting a stock certificate to be produced to the bank on or before 22-08-24. Due to urgency, CA Meet directed his assistant, who is also a Chartered Accountant, to sign and issue the stock certificate after due verification, on his behalf.

Answer: Already covered in Illustration Qns

Question 36 **(PYP May 25 5M)**

M/s JAZZ & Co. is a partnership firm consisting of two partners CA J and CA Z.

CA J is exclusively associated with the firm and is not doing practice in individual capacity, whereas CA Z is doing practice in his individual capacity also.

For the financial year 2023-24, the firm has already undertaken audits and signed audit reports under section 44AB/44AD of the Income Tax Act, 1961 as under:

Under section 44AB for corporate clients	Under section 44AB for non-corporate clients		Under section 44AD/44AD
CA J	30	60	20
CA Z	5	10	12

For the financial year 2023-24, CA Z has undertaken audits in individual capacity and signed audit reports under section 44AB/44AD of the Income Tax Act, 1961 as under:

Under section 44AB for corporate clients	Under section 44AB for non-corporate clients		Under section 44AD/44ADA
CA Z	4	9	8

For the financial year 2023-24, the firm is approached further to take up the following assignments:

3 tax audit assignments under section 44AB for corporate clients.

4 tax audit assignments under section 44AD.

Advise whether the firm should accept the further tax audit assignments for the financial year 2023-24 as above in the light of professional code of conduct.

Answer:

As per Chapter VI, Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961, a member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961.

Further, in the case of a firm of Chartered Accountants in practice, the "specified number of tax audit assignments" means 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

It may be noted that the audits conducted under Section 44AD, 44ADA, and 44AE of the Income-tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments".

Furthermore, where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate. In computing the "specified number of tax audit assignments", the number of such assignments, which he or any partner of his firm has accepted, whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.

According to a clarification on Tax Audit Assignments by Committee on Ethical Standards Board of the Institute, if there are 10 partners in a firm of Chartered Accountants in practice, then all the partners of the firm can collectively sign 600 tax audit reports. This maximum limit of 600 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 600 tax audit reports in case the remaining 9 partners are not signing any tax audit reports.

In the instant case, M/s JAZZ & Co. is a partnership firm of Partner CA J and CA Z. CA Z is also doing practice in individual capacity. In the instant case, 60 tax audit assignments per partner in the firm,

whether in respect of corporate or non-corporate assesses, in a financial year, will be considered for "specified number of tax audit assignments", i.e., 120 tax audits = 2 Partners x 60 tax audits.
In the given situation, the number of tax audit reports signed under section 44AB are 118 (i.e., 90 reports signed by CA J [i.e., 30 reports for corporate clients and 60 reports for non-corporate clients] whereas, CA Z signed 28 reports [15 reports as a Partner of the Firm {i.e., 5 for corporate clients and 10 for non-corporate clients} and 13 Reports in individual capacity i.e. {i.e., 4 for corporate clients and 9 for non-corporate clients}] and number of tax audit reports signed under section 44AD are 40 (i.e., 20 reports signed by CA J and 20 reports signed by CA Z). It may be noted that the 40 audits conducted under Section 44AD of the Income-tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments".
The firm is also approached further to take up 3 tax audit assignments under section 44AB for corporate clients and 4 tax audit assignments under section 44AD.
In view of the above provisions, partner CA J and CA Z of M/s JAZZ & Co. have undertaken 118 audits, which is not more than 120 tax audits, i.e., "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961. Therefore, the firm can accept 2 more tax audit assignments for corporate clients under section 44AB and all 4 tax audit assignments under section 44AD as there is no limit on assignments under Section 44AD.

Question 37 **(PYP May 25 5M)**

CA A, the proprietor of A & Collegues, Chartered Accountants, is developing his practice and recently secured a major audit assignment for B State Cooperative Society. The engagement fee for this audit is Rs. 1 Cr.
In view of his vision of growth to expand the development of his business, CA A has entered into an agreement with an unregistered financial consultant, Mr. X, who is an MBA from a local university. Mr. X introduced CA A to his business clients and in return, CA A agrees to pay him a 2.5% commission (Rs. 2.5 lakhs) on the audit fee as a referral bonus.
Additionally, as per the State Cooperative Registrar's Circular, 5% of the audit fee (Rs. 5,00,000) has to be deposited into the State Treasury to cover administrative expenses. CA A complies with this requirement.
Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

As per Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.
The exception to this rule is specified in regulation 53A (3). The Regulation specifies that a Master in Business Administration from Universities established by law or technical institutions recognized by the All India Council for Technical Education. In the given situation, Mr. X is an MBA from a local university and CA. A agrees to pay commission on the audit fee as a referral bonus to Mr. X for introducing him to his business clients. Hence, CA A is guilty of misconduct.
Additionally, as per the State Cooperative Registrar's Circular, 5% of the audit fee (Rs. 5 Lakh) must

be deposited into the State Treasury to cover administrative expenses. Council decided that as such, there is no bar in the Code of Ethics to accept such an assignment wherein a percentage of the professional fee is deducted by the Government to meet the administrative and other expenditure. Hence, no violation is there.

Question 38 **(PYP May 25 4M)**

M/s GSTR & Associates, Chartered Accountants, is an audit firm consisting of three partners. The partnership firm was formed in the year 2019. M/s GSTR & Associates, specialised in internal audits and tax consultancy services, admitted CA Y as partner in the year 2024. CA Y had vast experience in audit of listed companies as he was the senior audit manager of a leading audit firm before he joins M/s GSTR & Associates. Ruby Limited, a listed entity, appointed M/s GSTR & Associates, Chartered Accountants as statutory auditors for the year ended 31st March 2025. CA Y, the engagement partner signed the balance sheet of Ruby Limited for the year ended 31st March 2025 on 21st May 2025. M/s GSTR & Associates, Chartered Accountants never subjected themselves to the Peer Review process of the Institute. Comment with reference to the Chartered Accountants Act, 1949.

Answer: Already covered in MRP Qns

Question 39 **(PYP May 25 4M)**

Ring Limited is a subsidiary of Pearl Limited. For the financial year 2024-25 M/s Vani & Co., Chartered Accountants were appointed as the statutory auditors of Ring Limited. The CEO of Pearl Limited was impressed with the professional competence of CA Devi, one of the partners of the firm and hence, he offered CA Devi to take up the position of Director (not MD/whole time director) of Pearl Limited. CA Devi is in a dilemma whether to accept the offer. She approaches you and seeks your advice on the same. Advise what CA Devi can do with the offer with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

Clause 11 of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of Chartered Accountants unless permitted by the Council so to engage.

Provided that nothing contained herein shall disentitle a Chartered Accountant from being a director of a Company, (not being a managing director or a whole-time director), unless he or any of his partners is interested in such a company as an auditor.

In view of above, a Chartered Accountant in practice cannot engage (unless permitted by the Council so to engage) in any business or occupation other that the profession of Chartered Accountant but he can be a director of a Company (not being a managing director or whole-time director) wherein he or any of his partners is not interested in such company as an auditor. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence. In view of the above, the Board, via a clarification, decided that the auditor of a Subsidiary Company can't be a Director of its Holding Company, as it will affect the independence of the auditor.

In the given situation, Ring Limited is the audit client of CA Devi's firm (M/s Vani & Co.) and Pearl Limited is the holding company of Ring Limited. The CEO of Pearl Limited is offering CA Devi a non-executive directorship in Pearl Ltd., while her firm is the auditor of Ring Ltd. (a subsidiary). CA Devi should not accept the offer as it will affect the independence of an auditor.

Exceptional Questions

Question 1 **(PYP Nov '24 5M)**

The Director (Discipline) of The Institute of Chartered Accountants of India had received the matters in respect of cases of alleged misconduct against CA H, the proprietor of M/s HA & Co, Chartered Accountants and was found guilty of professional misconduct under Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949 and Clause (11) of Part I of the First Schedule of the Chartered Accountants Act, and penalty was imposed by an order passed against him dated 15th June, 2024.

Against the said order, CA H preferred an appeal with the Appellate Authority on 5th August, 2024 by submitting the statement of appeal along with application form of appeal. During such appellate proceedings, it was discovered that the said statement of appeal contained some facts which were false to which CA H admitted it to be false and apologized for it.

Based on the above stated scenario of the matters placed before The Director (Discipline) of ICAI against CA H, you are required to answer the following:

(i) Comment on violation of provisions of the Chartered Accountants Act, 1949 and its schedules thereto by CA H.

(ii) Before which authority, the matters of CA H would have been placed and what maximum punishment could have been imposed on him by the said authority in accordance with the Chartered Accountants Act, 1949?

(iii) Has CA H filed an appeal with the Appellate authority against the order within the time limit prescribed under the said Act?

Answer:

(i) As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

In the instant case, CA H preferred an appeal with the Appellate Authority on 05th August,2024 by submitting the statement of appeal along with application form for the same. However, it was discovered that the said statement of appeal contained some facts which were false, and CA H admitted it to be false.

Therefore, CA H would be held guilty of professional misconduct under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

(ii) In case where CA H was found guilty of professional misconduct under Clause (4) of Part I of the Second Schedule and Clause 11 of Part I of the First Schedule of the Chartered Accountants Act, 1949: the matter would have been placed before Disciplinary Committee as it's allied to both the Schedule because as per the Chartered Accountant Act, 1949 if the matter is allied to the Second Schedule or Both it is referred to the Disciplinary Committee. The maximum punishment that the Disciplinary Committee could have imposed would be:

i) Reprimand the member

ii) Remove the name of the member from the Register permanently or for such period as it may think fit.

iii) Impose such a fine which may extend to rupees five lakhs.

(iii) Timeline for Filing an Appeal: Any member aggrieved by an order of the Board of Discipline or the Disciplinary Committee can prefer an appeal within 90 days. In the given case, CA. H has preferred an appeal with the appellate authority on 5th August,2024 against the order passed on 15th June 2024. From 15th June to 5th August, 90 days' timeline has not been lapsed. Thus, it can be said that CA H has filed an appeal within the time limit prescribed under the said Act.

Question 2 Exceptional **(RTP Nov '20)**

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

(a) CA. Srishti and CA. Mishti are two partners of the CA firm 'Srishti Mishti & Associates'. Being very pious, CA. Srishti organised a religious ceremony at her home for which she instructed her printing agent to add her designation "Chartered Accountant" with her name in the invitation cards. Later on, the invitations were distributed to all the relatives, close friends and clients of both the partners.

(b) Ms. Preeto, a CA, had an account with a bank. The normal balance in this account remained at a level below Rs. 5,000. The bank inadvertently credited this account with a cheque of Rs. 2,70,000 belonging to another account holder. When CA. Preeto came to know about this she withdrew the amount of Rs. 2,75,000 and closed the bank account. After 1 year the bank noticed the mistake and claimed Rs. 2,75,000 with interest. CA. Preeto contested this claim. Can the bank approach the Institute of Chartered Accountants of India for disciplinary action against CA. Preeto?

(c) CA. Moni is practicing since 2009 in the field of company audit. Due to her good practical knowledge, she was offered editorship of a 'Company Audit' Journal which she accepted. However, she did not take any permission from the Council regarding such editorship.

Answer:

(a) Printing of Designation "Chartered Accountant" on Invitations for Religious Ceremony:

As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be 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.

However, the Council of the ICAI is of the view that the designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards, invitations for marriages, religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned.

In the given case, CA. Srishti has instructed to write designation "Chartered Accountant" on invitation cards for a religious ceremony and distributed the same to all the relatives, close friends and clients of both the partners.

In this context, it may be noted that the Council has allowed using designation "Chartered Accountant" in invitations for religious ceremony, provided these are sent to clients, relatives and close friends of the members concerned only.

Therefore, CA. Srishti would be held guilty of professional misconduct under the said clause for sending such invitations to the relatives, close friends and clients of CA. Mishti as well.

[AUTHOR NOTE: PERSONALLY, I WILL NOT TREAT IT AS GUILTY AS THE GREETING CARDS ISSUED TO RELATIVES OF PARTNER OF THE FIRM ONLY. AS FIRM AND PARTNERS ARE ONE AND SAME]

(b) Disrepute to the Profession:

As per Clause 2 of Part IV of First Schedule of the Chartered Accountant Act, 1949, a Chartered Accountant will be deemed to be guilty of other misconduct if he in the opinion of the Council brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

In the instant case, CA. Preeto, a CA, had an account with a bank from which she withdrew the amount of Rs. 2,75,000 and closed the account. This amount of Rs. 2,75,000 was pertaining to Rs. 5,000 minimum balance and Rs. 2,70,000 belonging to other account holder and inadvertently credited to his account by the bank. The said act of CA. Preeto to withdraw the money which does not belongs to her will bring disrepute to the profession.

Hence under this clause the bank can file a suitable complaint under Clause 2 of Part IV of First Schedule of the Chartered Accountant Act, 1949 with the Institute of Chartered Accountants of India.

(c) Permission from the Council:

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.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In the instant case, CA. Moni accepted editorship of a journal for which she did not take any permission from the Council. In this context, it may be noted that the editorship of professional journals is covered under the general permission and specific permission is not required.

Therefore, CA. Moni shall not be held guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Question 3 **(PYP Jan '21)**

Nam & Co., conducted Stock Audit of DEF Ltd. as per instructions issued by HEG Bank. However instead of visiting the site where the stock was lying, the firm relied on the Management Information Systems report along with inspections reports and photographs of Stock taken by the employees of DEF Ltd. The photographs were also carrying the date and time printed on them. Comment with reference to the Chartered Accountants Act, 1949 and its schedules thereto.

Answer: Already covered in TYK Qn

Question 4 Exceptional **(QP Nov '19)**

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: A special notice has been issued for a resolution at 3rd annual general meeting of LED Ltd., providing expressly that CA. Anoop shall not be re-appointed as an auditor of the· company. Consequently, CA. Anoop submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Anoop included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company.

Answer: Already covered in TYK Qn

Question 5 **(RTP May '19)**

Mr. M, a Chartered Accountant in practice, has printed visiting cards which besides other details also carries a Quick Response (QR) code. The visiting curd as well the QR code contains his name, office and residential address, contact details, e-mail id and name of the firm's website.

Answer:

Printing of QR Code on Visiting Cards: As per Clause (7) 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 advertises his professional attainments or services.

Ethical Standards Board has also clarified that a member in practice is allowed to print Quick Response Code (QR Code) on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card.

In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice.

Thus, Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Question 6 Exceptional **(RTP Nov '22)**

Comment on the following with reference to the with reference to the Chartered Accountants Act, 1949 and Schedules thereto:

CA Dev started practice in Punjab in the year 2019. CA Dev issued 'Turnover Certificate' for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of availing cash credit facility and machinery term loan. Brother of CA Dev was proprietor of M/s. ASAUS Traders.

Answer:

As per Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Further, it is not permissible for a member to undertake the assignment of certification, wherein the client is relative of the member. The "relative" for this purpose would refer to the definition mentioned in Accounting Standard (AS) - 18.

In the given situation, CA Dev started practice in Punjab in the year 2019. CA Dev issued Turnover certificate for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of obtaining Loan. Brother of CA Dev is proprietor of M/s. ASAUS Traders. Brother is very well covered in the definition of relative mentioned in Accounting Standard (AS)-18.

Hence, CA Dev is guilty of professional misconduct

Question 7 Exceptional **(PYP May '18)**

M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city, had great difficulty in regularly attending to the consultancy needs of his clients who are mostly located in an industrial cluster in a nearby outskirt which is situated at a distance of 26 kms from the office of the firm. To mitigate the difficulty and to have ease of business, a facilitation centre was opened in the industrial cluster. The proprietor managed, both the office and the facilitation centre, by himself. No intimation was made to the Institute of Chartered Accountants of India. Examine whether there, is any professional misconduct in this respect.

Answer:

Maintenance of Branch Office in the Same City: As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 Kilometres from the municipal limits of a city, in which the first office is located. Further a member having two offices of the type referred to above, shall have to declare which of the two offices is his main office, which would constitute his professional address.

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

Question 8 Exceptional **(QP May 2018)**

Mr. Dice, a practising Chartered Accountant was ordered to surrender his Certificate of Practice and he was suspended for one year on certain professional misconduct against him. During the period of suspension, Mr. Dice, designating himself as GST Consultant, did the work of filing GST returns and made appearance as a consultant before various related authorities. He contended that there is nothing wrong in it as he, like any other GST consultant, could take such work and his engagement as such in no way violates the order of suspension inflicted on him. Is he right in his contention?

Answer:

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

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

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

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

Chartered Accountant before various related authorities for the period he remains suspended. Accordingly, in the present case he is guilty of professional misconduct

Question 9 Exceptional **(PYP May '19)**

CA Sant, a newly qualified professional with certificate of practice, approached CA Pant, the auditor of his father's company M/s Max Ltd., to allow him to have some practical and professional knowledge and experience in his firm before he can set up his own professional practice. CA Pant allowed him to sit in his office for 6 month and allotted a small chamber with other office infrastructure facility. In the course of his association with CA Pant' s office, he used to provide tax consultancy independently to the client of the firm and also filed few IT and GST return and represented himself before various tax authorities on behalf of the firm although no documents were signed by him. During his association in CA Pant's office, he did not get any salary or share of profit or commission but only re-imbursement of usual expenses like conveyance, telephone etc. was made to him. After the end of the agreed period, he was given a lump sum amount of Rs.3,00,000 by CA Pant for his association out of gratitude.

Examine the case in the light of code of professional misconduct.

Answer:

Clause (1) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner, or his employee and would work under his control and supervision.

In the instant case, CA Pant allowed CA Sant (who is a newly qualified CA professional with COP) to sit in his office for 6 months, and allowed him to provide tax consultancy independently to his firm's clients, filing of some IT and GST Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA Sant was only reimbursed with his usual expenses and was not paid any salary or share of profit for the same. However, after the end of agreed period he was given a lump-sums of rupees 3,00,000 for his association out of gratitude.

Thus, in the present case CA. Pant will be held guilty of professional misconduct as per Clause (1) of Part I of First Schedule to the Chartered Accountants Act, 1949 as he allowed CA Sant to practice in his name as Chartered accountant and CA Sant is neither in partnership nor in employment with CA. Pant.

Question 10 Exceptional **(QP May '22)**

CA K qualified as Chartered Accountant and started practice as proprietor in the name of M/s K & Associates in the year 2015-16. LST Limited, a listed entity, appointed M/s K & Associates as Statutory Auditor for the year ended 31st March, 2022. CA K signed the balance sheet of LST Limited for the year ended 31st March, 2022 on 14th May, 2022. M/s K & Associates never subjected themselves to the Peer Review process of the Institute since its inception of practice. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer:

Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available in general terms from the various pronouncements of the Institute is issued by way of Engagement and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers

Audit of Listed Companies: Pursuant to SEBI Notification, statutory audit of listed companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s. K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, CA K, the proprietor signed the balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. CA K would be held guilty of professional misconduct under Clause (9) of Part I of Second Schedule of the Chartered Accountants Act, 1949. Also, CA K did not comply with the SEBI Notification which was required to be complied with.

<u>ALTERNATIVE ANSWER:</u>

Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of misconduct if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. It requires every member of the institute to act within the framework of the Chartered Accountants Act, 1949 and the regulations and guidelines made by Council thereunder.

The Statement on Peer Review shall be deemed to be a guideline of the Council under Clause (1) of Part II of Second Schedule to the Act and it is obligatory for the Practice Unit to comply with the provisions contained in this Statement.

As per the Statement every Practice Unit including its branches who has conducted Statutory Audit of Enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI(LODR) regulations, 2015, will be subject to Peer Review in accordance with this statement.

Audit of Listed Companies: Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, Mr K, the proprietor signed the Balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. Hence, CA K would be held guilty of professional misconduct under clause (1) of Part II of Second Schedule of the Chartered Accountants Act, 1949.

WINNER!

Let's aim Exemption in Auditing! Yes, it's absolutely achievable, and I'm ready to put in the work for you. But remember, it takes two hands to clap. So, come on—join me! Together, we can conquer this and achieve success.

Wish you
Clarity, Confidence and Success

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ABOUT US

A Pioneer Institute in the digital classroom space, founded by CA Ram Harsha.

He has always catered to serve quality. As a result today, 'SHRESHTA' stands as the most preferred institution among students. We are privileged to provide the highest standard of coaching facility for CA and CMA students at most affordable prices, turning many of our students' dreams into reality.