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SUGGESTED ANSWERS

FKJS

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

Answer 1 (a) : As per SRE 2400, “Engagement to Review Historical Financial Statements”, prior to accepting a review engagement, the practitioner shall:

- (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 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



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If the practitioner is not satisfied as to any of the matters set out above as preconditions for accepting a review engagement, the practitioner shall discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the practitioner as to those matters, the practitioner shall not accept the proposed engagement unless required by law or regulation to do so. However, an engagement conducted under such circumstances does not comply with this SRE. Accordingly, the practitioner shall not include any reference within the practitioner's report to the review having been conducted in accordance with this SRE.

If it is discovered after the engagement has been accepted that the practitioner is not satisfied as to any of the above preconditions, the practitioner shall discuss the matter with management or those charged with governance, and shall determine:

- (a) Whether the matter can be resolved;
- (b) Whether it is appropriate to continue with the engagement; and
- (c) Whether and, if so, how to communicate the matter in the practitioner's report.

Answer 1(b): Engagements to Report on the Compilation of Pro Forma Financial Information:

As per SAE 3420," Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus", before agreeing to accept an engagement to report on whether pro forma financial information included in a prospectus has been compiled, in all material respects, on the basis of the applicable criteria, the practitioner shall-

- (a) Determine that the practitioner has the capabilities and competence to perform the engagement;
- (b) On the basis of a preliminary knowledge of the engagement circumstances and discussion with the responsible party, determine that the applicable criteria are suitable and that it is unlikely that the pro forma financial information will be misleading for the purpose for which it is intended;
- (c) Evaluate the wording of the opinion prescribed by the relevant law or regulation, if any, to determine that the practitioner will likely be able to express the opinion so prescribed based on performing the procedures specified in this SAE;
- (d) Where the sources from which the unadjusted financial information and any acquiree or divestee financial information have been extracted have been audited or reviewed and a modified audit opinion or review conclusion has been expressed, or the report contains an Emphasis of Matter paragraph, consider whether or not the relevant law or regulation permits the use of, or reference in the practitioner's report to, the modified audit opinion or review conclusion or the report containing the Emphasis of Matter paragraph with respect to such sources;
- (e) If the entity's historical financial information has never been audited or reviewed, consider whether the practitioner can obtain a sufficient understanding of the entity and its accounting and financial reporting practices to perform the engagement;

- (f) If the event or transaction includes an acquisition and the acquiree's historical financial information has never been audited or reviewed, consider whether the practitioner can obtain a sufficient understanding of the acquiree and its accounting and financial reporting practices to perform the engagement; and
- (g) Obtain the agreement of the responsible party that it acknowledges and understands its responsibility for:
- Adequately disclosing and describing the applicable criteria to the intended users if these are not publicly available;
 - Compiling the pro forma financial information on the basis of the applicable criteria; and
 - Providing the practitioner with:
 - 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;
 - Additional information that the practitioner may request from the responsible party for the purpose of the engagement;
 - 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
 - When needed for purposes of the engagement, access to appropriate individuals within the acquiree(s) in a business combination.

Answer 1 (c) :

The purpose of this SRS 4410 Compilation engagement is to establish standards on the professional responsibilities of the Practitioner, when an engagement to compile financial statements or other financial information is undertaken and the form and content of the report issued in connection with such a compilation so that the association of the name of the Practitioner with the financial statements is not misconstrued by a user of those statements or information as having been audited by him. 2) The objective of a compilation engagement is for an Practitioner to use accounting expertise, as opposed to auditing expertise, to collect, classify and summaries financial information.

The Practitioner should obtain a general knowledge of the business and operations of the entity and should be familiar with the accounting principles and practices of the industry in which the entity operates and with the form and content of the financial statements / other financial information that is appropriate in the circumstances.

Practitioner

1. Make any inquiries of management to assess the reliability and completeness of the information provided;
2. Assess internal controls;
3. Verify any matters; or
4. Verify any explanations.
5. The Practitioner may also request the management to provide additional information.

This may be asked in the form of management representation letter. If the management refuses to provide additional information, the Practitioner should withdraw from the engagement, informing the entity of the reasons for such withdrawal. 6. If one or more accounting standards are not complied with, the same should be brought to the notice of the management and if the same is not rectified by the management, the Practitioner should include the same in notes to the accounts and the compilation report to the management.

Answer 1 (d) :

As per SA 810, "Engagement to Report on Summary Financial Statements", the auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

- (i) Evaluate whether the summary financial statements adequately disclose their summarised nature and identify the audited financial statements.
- (ii) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:
 - (1) From whom or where the audited financial statements are available; or
 - (2) The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.
- (iii) Evaluate whether the summary financial statements adequately disclose the applied criteria.
- (iv) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be re-calculated from the related information in the audited financial statements.
- (v) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.
- (vi) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.



- (vii) Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements.

Answer 2 (a) :

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

I. Risk Assessment Process

- Identify significant accounts and disclosures.
- Qualitative and Quantitative considerations.
- Relevant Financial Statement Assertions (FSA).
- Identify likely sources of misstatement.
- Consider risk arising from use of IT systems.

II. Understand and Evaluate

- Document understanding of business processes using Flowcharts / Narratives.
- Prepare Risk and Control Matrices (RCM).
- Understand design of controls by performing walkthrough of end-to-end process.
- Process wide considerations for Entity Level Controls, Segregation of Duties.
- IT General Controls, Application Controls.

III. Test for Operating Effectiveness

- Assess Nature, Timing and Extent (NTE) of controls testing.
- Assess reliability of source data; completeness of population.
- Testing of key reports and spreadsheets.
- Sample testing.
- Consider competence and independence of staff /team performing controls testing.

IV. Reporting

- Evaluate Control Deficiencies.
- Significant deficiencies, Material weaknesses.
- Remediation of control weaknesses.
- Internal Controls Memo (ICM) or Management Letter.
- Auditor's report.



Answer 2 (b) :

SA 560 on “Subsequent Events” establishes standards on the auditor’s responsibility regarding subsequent events.

SA 560 on “Subsequent Events” states that the term “subsequent events” refers to events occurring between the date of the financial statements and the date of the auditor’s report, and facts that become known to the auditor after the date of the auditor’s report.

Subsequent Events: This case requires attention to SA 560 “Subsequent Events”, AS 4 “Contingencies and Events occurring after the Balance Sheet Date” and AS 29 “Provisions, Contingent liabilities and Contingent Assets”. As per AS 4 “Contingencies and Events occurring after the Balance Sheet Date”, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. Similarly as per AS 29 “Provisions, Contingent liabilities and Contingent Assets”, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the will occur.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor’s report, or as near as practicable thereto. xi) 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:

- (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- (b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- (c) 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.
- (d) Reading the entity’s latest subsequent interim financial statements, if any.

In the instant case, the amount of Rs. 1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. The facts have become known to the auditor before the date of issue of the Audit Report and Financial Statements. The auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the financial statements i.e. 31-3-2015 to the date of Auditors Report ie. 15-05-2015.

It will be observed that as a result of long pending negotiations a sum of Rs. 1.50 crores representing arrears of salaries of the year 2015-16 and 2016-17 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29. As per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. So the auditor should request the management to adjust the sum of Rs. 1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the audit report.

Answer 2 (c) :

1. As per SA 240, "The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements", the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.
2. In addition an auditor conducting an audit in accordance with SAs 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. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
3. As per SA 580, "Written Representations", if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist
4. If the Management fails to give Written Representation under SA 580 then the auditor shall:
 - (i) Discuss the matter with management
 - (ii) Re-evaluate the Integrity of the management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general and
 - (iii) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor should disclaim an opinion on the financial statements if management does not provide written representations. In addition, as per sub-section (12) of section 143 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 Audit committee or board within 2 days of his knowledge of fraud seeking for their reply with 45 days from the date of report, & if the amount involved is 1 crore or above then report to Central Government within 15 days if board had replied on the fraud or within 60 days of his knowledge of fraud and following the prescribed procedure. a. The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved has to be indicated. b. 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.



Auditor Shall Determine Applicable professional & legal responsibilities which requires reporting to Person or persons appointed the auditor.

If auditor withdraws from the engagement Whether withdrawal is legally permitted

The reasons for withdrawal to be discussed with management & TCWG , Regulatory authorities in some cases. The auditor should consider whether it is appropriate to withdraw from engagement and whether it is legally permitted. In the instant case, in the course of audit of K Ltd., its auditor Mr. N observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report, which was not provided by the management despite of many reminders. Mr. N also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent. Hence, the fact is required to be reported as per Paragraph 3(x) of the CARO, 2016 and the auditor should also disclaim an opinion on the financial statements.

Answer 2 (d) :

(i) Reporting to Shareholders vs. Reporting to those Charged with Governance:

REPORT	
Reporting to Shareholders	Reporting to those Charged with Governance
<ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.
<ul style="list-style-type: none"> • Statutory Audit Report is on true and fair view and as per prescribed Format 	<ul style="list-style-type: none"> • It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
<ul style="list-style-type: none"> • Statutory Audit Reports are in public domain. 	<ul style="list-style-type: none"> • Reporting to those Charged with Governance is an internal document i.e. private report.



(ii) *Audit Qualification vs. Emphasis of Matter*

REPORT	
Audit Qualification	Emphasis of Matter
<ul style="list-style-type: none">• Standard on Auditing 705 “Modifications to the Opinion in the Independent Auditor’s Report”, deals with the provisions relating to Audit Qualification.	<ul style="list-style-type: none">• 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.c.
<ul style="list-style-type: none">• Audit Qualifications are also known as “subject to report” or “except that report”.	<ul style="list-style-type: none">• 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.
<ul style="list-style-type: none">• Audit Qualifications are given when auditor is having reservations on some of the items out of the financial statements as a whole i.e. Auditor’s Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements relating to if the impact of material misstatements is not pervasive on the financial statements but is present at some levels of the financial statements, qualified report is issued.	<ul style="list-style-type: none">• Emphasis of Matter is a paragraph which is issued when there is a uncertainty relating to future outcome of exceptional litigation, regulatory action, etc.; or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.

Answer 3 (a) (i):

Non-cash Transactions with Relative of Director:

- (a) As per Clause (xv) if paragraph 3 of CARO, 2016, the auditor is required to report “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 Companies Act, 2013 have been complied with”.
- (b) Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.
- (c) In the instant case, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director, which is Wan arrangement by which RPS Ltd. is in process to acquire assets for consideration other than cash. In the above situation, the provisions of section 192 of Companies Act, 2013 have been complied with.



- (d) However, the reporting requirements under this clause are given in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.
- (e) In the given situation, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is affirmative answer to the first part of the Clause (xv) of Paragraph 3 of CARO, 2016, thus, reporting is required for the same. Draft report is given below.
- (b) According to the information and explanations given to us, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of one of the directors during the year, for the acquisition of assets, which in our opinion is covered under the provisions of Section 192 of the Companies Act, 2013.

Answer 3 (a) (ii):

Reporting under CARO, 2016 for Registration under RBI Act, 1934: As per Clause(xvi) of paragraph 3 of the CARO, 2016, the auditor is required to report whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934. If so, whether the registration has been obtained.

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.

Answer 3 (b)

1. The Board shall lay down a code of conduct for all Board members and senior management of the company who shall affirm the same on annual basis. The code of conduct shall be posted on the website of the company.
2. The annual report of the company shall contain a declaration to such affirmation signed by CEO.
3. The code shall incorporate the duties of Independent directors as in Co.'s act, 2013.
4. An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.



5. All Board members and senior management personnel shall affirm compliance with the code on an annual basis.
6. The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013
7. The code of conduct shall be posted on the Website of the company Explanation: "Senior management" shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

Role of Auditor: The auditor should ascertain:

- I. Whether the Board of Directors of the company has laid down a Code of Conduct for all Board members and senior personnel of the company and obtain a copy of the same.
- II. He should also verify whether all Board members and senior management personnel have affirmed compliance with the code on an annual basis and whether the code has been posted on company's website.

Answer 3 (c)

Applicable Clause: Clause 6 of Part I of First Schedule of CA Act 1949 as amended by CA Amendment Act 2006 as per Website guidelines issued in 212th, 235th, 242nd Meeting and 345th Meeting of council of ICAI.

- (a) Firm name is used as website name. Hence, there is no violation.
- (b) There is no restriction on the colours used. Hence, there is no violation.
- (c) Website should work on "pull" model only. Hence this guideline has been violated.
- (d) Names of Partners can 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). But names of Major clients cannot be given. Hence this guideline has been violated. Conclusion: In view of the above, M/s XYZ would have no restriction on the colors used in the website but failed to satisfy the other two guidelines. Since the Firm has not complied with the guidelines, it would be liable for professional misconduct as it would amount to soliciting work by advertisement.

Answer 3 (d)

SA 800 Special Consideration – Audit of special purpose financial statements While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:



- (i) To obtain an understanding of the entity's selection and application of accounting policies. Financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.
- (ii) Compliance of all SAs relevant to audit, the auditor may judge it necessary to depart from a relevant requirement in a SA by performing alternative audit procedures to achieve the aim of that requirement.
- (iii) Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor.
- (iv) In case of Special purpose financial statements prepared in accordance with the requirements of contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.
- (v) Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements.

In the case of special purpose financial statements, those charged with governance may not have such a responsibility.

Answer 4 (a)

As per Section 134 of the Companies Act 2013, the term Internal Financial Controls means the policies and procedures adopted by the company for ensuring:

- i. Orderly and efficient conduct of its business, including adherence to Company's policies,
- ii. Safeguarding of its assets,
- iii. Prevention and detection of frauds and errors,
- iv. Accuracy and completeness of the accounting records, and
- v. Timely preparation of reliable financial information. Internal Financial Controls Over Financial Reporting (ICFR) shall mean: A Process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles".

The Central Government amends the Notification G.S.R. 464(E), dated 5th June 2015 Vide Notification G.S.R. 583(E) Dated 13th June, 2017. Amendments are given below:

- (i) Section 143(3)(i), shall not apply to a private company:-
- (ii) which is a one person company or a small company; or

which has turnover less than rupees fifty crore as per latest audited financial *statement* or which has aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than rupees twenty five crore.”

A Company's internal financial control over financial reporting includes those policies and procedures:

- (a) Pertain to the maintenance of the records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company.
- (b) It provides reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles, and those receipts and expenditures of the company are being made only in accordance with authorizations of management and director of the company.
- (c) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition use or disposition of the company's assets that could have a material effects of the Financial statement.

Provision of Companies Act for Internal financial reporting

- (a) As per section 134 Company Act 2013, In the case of a listed company, the Directors' Responsibility statement highlights that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively.
- (b) As per section 143 Company act 2013, The auditor's report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls
- (c) As per section 177 Company act 2013, Audit committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
- (d) As per Schedule IV Company Act 2013, The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.
- (e) As per Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 – The director's report should contain details in respect of adequacy of internal financial controls with reference to the financial reporting. The guidance note is applicable to all the companies as per section 143(3)(i) of the Companies Act, 2013. The auditors will have to report on ICFR in respect of both stand alone and consolidated financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. The auditor needs to obtain reasonable assurance to state whether an adequate internal financial controls system was maintained and whether such internal financial controls system operated effectively in the company in all material respects with respect to financial reporting only.



Conclusion : Hence the contention of the Managing director is not correct.

Answer 4 (b)

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/its 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. Elegant does not maintain proper books of accounts and writes the fees received from various clients in notes in his mobile. Notes maintained by him in mobile cannot be treated as books of accounts.

Hence, CA. Elegant, being a practicing Chartered Accountant will be held guilty of misconduct for violation of Council General Guidelines, 2008

Answer 4 (c)

With a view to define the Environmental Audit, it may be stressed that it is a critical analysis of (i) policies (ii) principles (iii) systems (iv) procedures (v) practices and (vi) performances of the aspect which relates the environment. But a standard scope of Environmental Audit, as ought to be defined and adopted by standard companies, should be as follows:

“A management tool comprising a systematic, documented, periodic and objective evaluation of how well environmental organisation, management and equipment are performing with the aim of helping to safeguard the environment by v Facilitating management control of environmental Process. v Assessing compliance with company policies, which would include meeting regulatory requirements”.

Objective of the Environmental Audit: To evaluate the efficacy of the utilisation of resources of man, machines and materials, and to identify the areas of environmental risks and liabilities and weakness(es) of management system and problems in compliance of the directives of the regulatory agencies and control the generation of pollutants and/or waste.



Tools and techniques used in Environmental Auditing

Checklists – Checklists are very useful tools used to ensure that different tasks or topics are included during the audit. They are very useful in specialized cases where a complex range of issues and questions need to be asked to ensure that nothing is missed.

Questionnaires – Audit protocols or audit questionnaires provide the basis and structuring for most audits. They are based upon checklist questionnaires but are more complex and include more detail and sometimes logistical information and data relating to the audit and the site being audited.

Questioning – Questioning is one of the most crucial aspects of auditing yet from a training and awareness point of view, it is often given the least attention. The purpose is information gathering in nature and not an interrogation. The questioner must, therefore, be sensitive to the perspective of the auditee and avoid making the questions accusatory, judgmental or aggressive.

Observation – Observation is a vital component of an auditing exercise. Observation is a disciplined activity which must be carried out in a very deliberate and controlled manner. The idea of looking at something twice is important because it is part of the process that checks that the observation is accurately noted, analyzed and recorded.

Photographs – These are a very valuable aid in the audit process. However, in order to use them, a number of important practical points must be borne in mind. The most important one is formal approval before using this technique.

Research – It is useful to try and undertake some background research and investigation into the site or company to be audited. Familiarization with the operations, products, raw materials reports, press material and newspaper articles etc. all provides useful background information to supplement questioning sessions and

Answer 4 (d)

Actuarial Process:

- (i) Actuaries in Life Insurance business have gained tremendous importance. The role of Actuary in life insurance has shifted from supervising compliance to certify whether products and financial reports are in accordance with the general regulatory guidelines.
- (ii) The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk.
- (iii) The actuarial department is calculating and modelling hub of the Company. Within the department fundamentals of Insurance business is determined from pricing to policy valuations techniques.



- (iv) Role of Auditor: Auditors in the Audit report are required to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India in concurrence with the IRDA.
- (v) Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.

Actuarial department broadly concentrates following key areas of Insurance business:

- 1) Product Development/ Pricing and Experience analysis.
- 2) Model Development.
- 3) Business Planning.
- 4) Statutory Valuations and reserving.
- 5) Solvency management.
- 6) Management reporting on various business valuations and profitability models of the Life Insurance business.

Answer 4 (e)

Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who 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 because 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 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.

Answer 5 (a) (i)

The following points require special attention in the examination of Inter Branch transactions.

- (i) While verifying the closing balance, special attention should be paid to the origin and validity of old outstanding unmatched entries, particularly debit entries. The auditor may also seek confirmation of transactions relating to outstanding in appropriate cases.
- (ii) Whether there are any reversal entries indicating the possibility of irregular payments or frauds.
- (iii) Whether the balances include any items in the nature of cash in transit included in this head which remain pending for more than a reasonable period. This is because such items are not expected to remain outstanding beyond a very small period during which they are in transit.
- (iv) Whether transactions other than those relating to inter branch transactions have been included in inter branch accounts. Any unusual items put through inter branch accounts as well as old or large entries outstanding in Inter branch accounts should be carefully looked into. The auditor should also seek explanations from the Management in this regard in appropriate cases.

Answer 5 (a) (ii)

If any advance, including bills purchased and discounted, becomes Non-Performing Assets as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).



Answer 5 (b)

Reporting of Payments Exceeding Rs. 35,000 in Cash: Disallowance under section 40A(3) of the Income Tax Act, 1961 is attracted if the assessee incurs any expenses in respect of which payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft, exceeds Rs. 10,000. However, in case of payment made for plying, hiring or leasing of goods carriage, limit is Rs. 35,000 instead of Rs. 10,000. Further, as per section 40A(3A) of the Income Tax Act, 1961, where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payments made to a person in a day, exceeds Rs. 10,000 (For AY 2018-19, Rs.10,000) (Rs. 35,000 in case of plying, hiring or leasing of goods carriages). However, exemption is provided under Rule 6DD having regard to nature and extent of banking facilities available and other relevant factors. Subsequently, under clause 21(d)(A) and 21(d)(B) of Form 3CD, the Tax Auditor has to scrutinize on the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) and 40A(3A) respectively read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, the same has to be reported under abovementioned clauses. Therefore, as per the provisions and explanations discussed above, the given cases are dealt as under-

- (i) Payments of 6 invoices of Rs. 5,000 each aggregating Rs. 30,000 made in cash on 4th July, 2017 need not be reported as the aggregate of payments do not exceed Rs. 35,000.
- (ii) Payments of 2 invoices of Rs. 18,000 each made in cash on 5th July, 2017 and 6th July, 2017 respectively aggregating Rs. 36,000 need not be reported as the payment do not exceed Rs. 35,000 in day.
- (iii) Payment of Rs. 40,000 made in cash against an invoice for expenses booked in 2016-17 is likely to be deemed to be the profits and gains of business or profession under section 40A(3A) of the Income Tax Act, 1961 in relation to outstanding expenses. Thus, the details of such amount needs to be furnished under clause 21(d)(B) of Form 3CD.



Answer 5 (c)

Various Stages involved in the Conduct of the Quality Review Assignments are:

1. Selection of Audit Firm and Technical Reviewer to conduct Quality Review and sending Offer Letter of Engagement to the Technical Reviewer.
2. Technical Reviewer to convey his acceptance of Letter of Engagement by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by the Technical Reviewer and his assistant/s, if any.
3. Intimation to the Audit Firm about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. Also marking a copy of the intimation to the Technical Reviewer.
4. Technical Reviewer to send the specified Quality Review Program General Questionnaire to the Audit firm for filling-up and call for additional information from the Audit Firm, if required.
5. Technical Reviewer to carry out the Quality Review by visiting the office of the Audit Firm by fixing the date as per mutual consent.
6. Technical Reviewer to send the preliminary report to Audit firm.
7. Audit firm to submit representation on the preliminary report to the Technical Reviewer.
8. Technical Reviewer to submit final report alongwith a copy of Annual report of the company/entity for the year, to the Board in the specified format, on their (individual) letterhead, duly signed and dated within 45 days from the date of acceptance of the assignment.
9. Technical Reviewer should also send a copy of their final report to the Statutory Auditor/Audit firm, requesting the firm to send their submissions thereon to the Board within 7 days of receipt of the final report with a copy to Technical Reviewer. Upon receipt of their final submission, Technical Reviewer shall submit within next 7 days a summary of their findings, reply of the audit firm thereon alongwith their final comments in the specified format.
10. Quality Review Group to consider the report of the Technical Reviewer and responses of the Audit firm and make recommendations to Quality Review Board.
11. Quality Review Board to consider the report of the Quality Review Group and decide the final course of action.

Answer 5 (d)

Key Functions of Energy Auditor: Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use efficiency. The function of an energy auditor could be compared with that of a financial auditor. The energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor:



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

- (i) Quantify energy costs and quantities.
- (ii) Correlate trends of production or activity to energy costs.
- (iii) Devise energy database formats to ensure they depict the correct picture – by product, department, consumer, etc.
- (iv) Advise and check the compliance of the organisation for policy and regulation aspects.
- (v) Highlight areas that need attention for detailed investigations.
- (vi) Conduct preliminary and detailed energy audits which should include the following:
 - (a) Data collection and analysis.
 - (b) Measurements, mass and energy balances.
 - (c) Reviewing energy procurement practices.
 - (d) Identification of energy efficiency projects and techno-economic evaluation.
 - (e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.
 - (f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.

Answer 5 (e)

To be effective, the internal auditor must be regarded as part of the management and not merely as an assistant thereto. He must have authority to investigate from the financial angles, every phase of the organisational activity under any circumstances. In recent years, there has been a growing tendency in Western countries to make the internal auditor responsible directly to the Board of Directors for the maintenance of adequate accounting procedures and for the preparation of financial statements and reports as regards the functioning of the business. His main responsibility, however, must be to maintain adequate system of internal control by a continuous examination of accounting procedures, receipts and disbursements and to provide adequate safe- guards against misappropriation of assets. In carrying out these functions, he must operate independently of the accounting staff and must not in any way divest himself of any of the responsibilities placed upon him. He should also not involve himself in the performance of executive functions in order that his objective outlook does not get obscured by the creation of vested interest.

It may be further pointed out that internal auditors who are qualified accountants, because of their training and experience, can be of great assistance to the management even in fields other than accounting. They can observe facts and situations and bring them to notice of authorities who would otherwise never know them; also, they critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected. In order that an internal auditor may be able to play such a role in the field of management, he must be closely associated with it and his knowledge must be kept up to date by his being kept informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies. Also, he must enjoy an independent status. audit shall be conducted and reported to the Board.



In addition, the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit. It may also be noted that the Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

Answer 6 (a)

1. Clarity of Terms of Reference :

- a) The approach to any investigation is determined on a consideration of the nature of the terms of reference.
- b) The inspector should ensure that the terms of reference are clear, unambiguous and in writing.
- c) It should also be seen that the terms of reference are not too general, because that may frustrate the whole objective of the investigation.
- d) The terms of reference and should keep the Central Government informed in writing about their effect on the investigation.

2. Scope of Investigation:

- a) The next point for consideration of the inspector would be the determination of the scope of the investigation based on the terms of reference.
- b) The inspector should go into the history of the company and its affiliates or associates.
- c) Inspector should evaluate the terms of reference in sketching the scope of investigation, this will enable him to locate the limitation, if any, in the terms of reference, not clearly mentioned.
- d) Inspector may need to stretch his inquiry into the books and records of allied and associated persons and concerns and may require to arm himself with the powers given under the Companies act 2013.

3. Period for investigation :

- a) He should also have regard to the period over which the investigation should stretch.
- b) The evaluation of terms of reference and the consequential determination of the scope of investigation are the twin props on which the entire investigation would rest.
- c) The inspector appointed Under Section 210 and 213 should devote careful attention to these.

4. Framing of Programme :

- a) Inspector should frame his programme for investigation in a systematic manner.
- b) He should keep adequate working notes and papers with references and cross references in a proper and methodical way to aid him in the preparation of the report.
- c) The actual process of investigation would be essentially an evidence gathering procedure.
- d) He should have regard to the procedures laid down in these sections regarding production of documents and evidence, examination on oath and seizure of documents.



- e) He should also keep his mind open for process of evidence collection and should assess whether the programme of investigation needs amendment or modification.

Using the work of Experts :

- a) He should also consider whether assistance of other experts like engineers, lawyers, etc.
- b) The interest of a comprehensive and full proof examination of the documents and information.

6. Legal requirements and investigation report :

- a) After he has completed the steps in the investigation programme and has marshaled all the information that he needed should prepare his report and can also make interim report.
- b) The findings should be completed and exhaustive.
- c) Before making his final report he should obtain and keep on record the evidences relied upon by him.
- d) Evidence should be as conclusive as possible depending on circumstances of the case.
- e) Inspector should make his report in accordance with the provisions of the Companies act 2013

What will be your approach in investigation under Section 210 and 213 into the affairs of the company registered under Companies Act, 2013 ?

Conclusion : The general approach for investigation under Sections 210 and 213 should, therefore, be formulated having regard to the terms of reference, scope, the period, the programme and procedure of the investigation and the attending legal requirements specified above.

Answer 6 (b)

SEBI's check list for auditors in respect of contract notes issued by a Stock Broker: The auditor should apply appropriate audit procedures to satisfy himself that -

1. Contract notes have been serially numbered.
2. No serial number has been left blank.
3. Format of the Contract Note is as prescribed by the Regulations of the Exchange.
4. Duplicate copies / counterfoils of contract notes are maintained.
5. Brokerage charged in contract notes is within the permissible limits and is indicated separately including service tax.
6. Contract notes have been signed by an authorised person.
7. Contract notes have been issued in respect of all transactions.
8. Transaction Identification, Trade Identification and Trade Execution time has been printed on the contract note issued.
9. SEBI Registration number, Settlement number, Settlement dates have been mentioned.
10. PAN number of the member and client has been mentioned on Contract Note where if required.
11. All clauses specified by the Exchange have been printed on the reverse of the contract notes.



Answer 6 (c)

C&AG's Role – The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees.

- (i) His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;
- (ii) He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;
- (iii) The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations. The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature ;
- (iv) In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

This ensures that the Audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

Answer 6 (d)

Special points that may be covered in the audit of NBFCs in case of Investment Companies are given below:

- (i) Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- (ii) NBFC Prudential Norms stipulates that NBFCs should not lend more than 15% of its owned funds to any single borrower and not more than 25% to any single group of borrower. The ceiling on investments in shares by a NBFC in a single entity and the aggregate of investments in a single group of entities has been fixed at 15% and 25% respectively. Moreover, a composite limit of credit to and investments in a single entity/group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC. Verify that the credit facilities extended and investments made by the concerned NBFC are in accordance with the prescribed ceiling.
- (iii) Verify whether the NBFC has not advanced any loans against the security of its own shares.
- (iv) Verify that dividend income wherever declared by a company, has been duly received by a NBFC and interest wherever due [except in case of NPAs] has been duly accounted for.
- (v) Test check bills/contract notes received from brokers with reference to the prices vis- à-vis the stock market quotations on the respective dates.



- (vi) Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.

Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.

- (i) Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- (ii) Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- (iii) An auditor will have to ascertain whether the requirements of AS 13 “Accounting for Investments” (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- (iv) In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- (v) In the case of securities lent/borrowed under the Securities Lending Scheme of SEBI, verify the agreement entered into with the approved intermediary (i.e. the person through whom the lender will deposit and the borrower will borrow the securities for lending/borrowing) with regards to the period of depositing/lending securities, fees for depositing/lending, collateral securities and provision for the return including pre- mature return of the securities deposited/lent.
- (vi) Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.)
- (vii) Verify charges received or paid in respect of securities lent/borrowed.
- (viii) Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.

