

# SUPER SUMMARY BOOK FOR CA FINAL



## ADVANCED AUDITING & PROFESSIONAL ETHICS

APPLICABLE FOR MAY 17 & NOV 17 EXAMS

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### SPECIAL FEATURES

- Completely Revised and Updated as per the latest syllabus
- Includes Revised SA 610, SAE 3420
- CARO 2016
- Amendments at a glance
- Exam oriented and reader friendly.

  
**VARIOUS VALUES**  
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## PREFACE

We are pleased to present a COMPILER OF ADVANCED AUDITING AND PROFESSIONAL ETHICS for CA Final students of new course. The salient features of this book are as follows:

- Tabular and Graphical presentation to facilitate easy understanding and learning.
- Inclusion of flow charts on various topics, including standard on Auditing.
- Presentation of maximum topics in point wise manner.
- Contents of the book are strictly as per syllabus prescribed by ICAI.
- Incorporating the relevant provisions of the Companies Act, 2013 as applicable for May, 2017, CA Final Exams.
- The book is concise, yet covers the whole of syllabus, making it easy for students to revise quickly before exam.
- It is super summary

We are thankful to students and colleagues for their valuable suggestions and our family to make it possible through their love and blessings.

We are thankful and hopeful that students will find this book beneficial from exam point of view.

*“LEARNING IS A NEVER ENDING PROCESS”*

# DEDICATED TO

***“The readers.....The aspiring  
Chartered Accountants.....!”***

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## PART I – CODE OF ETHICS

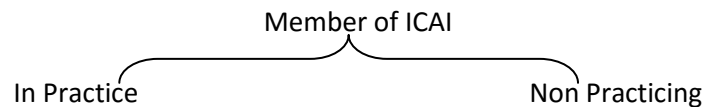
The Chartered Accountancy Act, 1949 is application on members of ICAI and does not depends upon the place where act or misconduct is committed.

### Chartered Accountant

As per **Section 2** of the Act, chartered accountant is a person who is a member of the institute (ICAI)

#### \* Member of ICAI

As per **section 4** of the Act, any person who has passed the prescribed examination and completed the prescribed training shall be entitled to have **his name in the register of members**.



### Member in Practice:

As per **section 2(2)** of the Act, a member of the institute shall be deemed to be in practice, “ when he, in consideration od remuneration received, or to be received.

- i) engages himself in the **practice of accountancy** or,
- ii) offers to perform or performs services involving the **auditing or verification** of financial transactions, book of accounts or records or the preparation, verification or **certification of financial accounting** or
- iii) renders **professional service or assistance** in or about matters of principle or detail relating to accounting procedures or the recording, presentation or certification of financial facts or
- iv) renders such **other service, as in the opinion of council**, are or may be rendered by CA in practice

#### Note: Practicing CA cannot perform following activity:

- P** – Portfolio management services
- U** – Underwriter in public issue
- R** - Recovery / collection agent (but act as an advisor)
- B** – Broker to public issue (but act as an advisor)
- I** - Insurance agent
- NRI** - Management of NRI fund

#### Non Practicing Chartered Accountant (NPCA)

NPCA is one who is engaged in **employment** in any entity / organization.

#### Fellow and Associate Members of ICAI

As per **section 5** of the Act, states that -

Any personal shall, on his name, being entered in the register, be deemed to have become an **Associate Member** of the Institute.

Member who has been an Associate for a continuous period of not less than 5 years is a **Fellow Member** of the Institute.

### Certificate of practice

As per **section 6** of the Act, a member of ICAI shall not be entitled to practice whether in india or elsewhere unless he has obtained a **Certificate of Practice (COP)** from the council.

#### Case study

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A CA in practice has been suspended from practice for a period of 6 months and he had surrendered his COP 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 CA is this action valid?

**Ans.:** Once a person becomes a member of ICAI he is bound by the provisions of the CA Act and its regulation. If he is suspended 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 ICAI.

## Member to be known as Chartered Accountants

As per **section 7** of the Act,

A Member in Practice **cannot** use **any designation other than** that of a “Chartered Accountant “. He cannot use any other description, whether in addition thereto or in substitution thereof.

A member who is **not in practice**, and does not use the designation of a Chartered Accountant may use any other description.

### Case Study

A Member cannot designate himself as a **Cost Accountant**, but he can use the letter ACMA after his name, when he is a Member of that Institute.

### Case Study

A Firm, all the Partners of which are Members of the Institute and in practice, can be known by its Firm Name as ‘Chartered Accountants’.

### Recent Amendments

Committee on ethical standards, allowed the use of ‘Dr.’ with the designation ‘CA’ It is left to the discretion of member Whether to use ‘CA first, or ‘Dr’. first, or use ‘Dr’. only before the name of the member

### Case Study

Whether following sentence is correct

“Every person eligible to become member of the Institute is entitled to designate himself as Chartered Accountant”

**Ans.:** No, only member of ICAI can designate himself as CA (Sec. 7)

### Case Study

Every member whether practicing or non practicing is entitled to designate himself as Chartered Accountant. Give opinion.

**Ans.:** Yes, Refer Sec. 7

## Disabilities to become a Member

As per section 8 of the Act, a person is debarred from having his name entered in or borne on the Register of Members if he –

1. Has not attained the age of 21 years
2. Is of unsound mind
3. Is an un-discharged Insolvent
4. Being a discharged insolvent – has not obtained from the Court.
5. Has been convicted by a competent court whether within India or outside India (offence including moral turpitude and punishable with imprisonment) not of a offence of technical nature.
6. Has been removed from membership of the institute

### Recap

**Sec 2** : Chartered Accountant

**Sec 4** : Member of ICAI

**Sec 5** : Fellow and Associate Members of ICAI

**Sec 6** : Certificate of Practice

**Sec 7** : Members to be known as CA

**Sec 8** : Disabilities to become a Member

**Sec 20** : Removal from the register of members

**Sec 27** : Maintenance of branch offices

## Misconducts

As per **Section 22** of the Act, **Professional and other misconduct** shall be deemed to include any act of omission provided in any of the Schedules of the Act. It is the conduct, i.e. act or omission or details etc. of a Chartered Accountant, which is punishable under the CA Act and Regulations framed thereunder.

## Schedules to the CA Act

### First Schedule

Part	Particulars	Nature	Clause
I	Professional Misconduct of members in practice	Professional	12
II	Professional Misconduct of members in service	Professional	2
III	Professional Misconduct of members generally	Professional	3
IV	Other Misconduct of members generally	Other	2

### Second Schedule

Part	Particulars	Nature	Clause
I	Professional Misconduct of members in practice	Professional	10
II	Professional Misconduct of member generally (NPCA)	Professional	4
III	Other Misconduct of members generally	Other	1

## THE FIRST SCHEDULE

**Part I** : Professional misconduct of members in practice

A chartered accountant in practice shall be deemed to be guilty of professional misconduct

### Clause 1:

If any person allows a **non-member to practice** as chartered **in his name** he will be guilty of professional misconduct but he can do so if the other person is also Chartered Accountant in practice and is in employment or partnership with him.

### Clause 2:

“**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 (if allowed by Partnership deed) 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 time to time in or outside India.

### Note:

- (a) On death of sole proprietor, the firm name will be kept in abeyance by ICAI for one year, so that the legal representative of deceased can sale the goodwill of the firm to other eligible CA and another eligible CA can use the firm name.
- (b) In case of any dispute to legal heir, of deceased proprietor then,

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- (i) Intimate the ICAI immediately
- (ii) ICAI will keep the name of firm in abeyance till one year from settlement of dispute.

**Case Study**

Mr. MN GARG a Chartered Accountant in practice pays 20% of his professional fees to the widow of his deceased partner only on humanitarian grounds

**Hint:** Shall be provided in deed not on humanitarian grounds. (Clause 2 of Part 1 of The First Schedule to the Chartered Accountant Act)

**Case Study**

The widow of deceased partner receives share of profit every year for the next fifteen years pursuant to a clause in Partnership deed to this effect.

**Hint:** No Misconduct (Clause 2 Part 1 of the First Schedule to the Chartered Accountant Act)

**Case Study**

Mr A purchased a proprietary firm of Mr B after his death and agrees to pay 20% of total professional fees to Mrs B in addition to purchase consideration paid ` 325000 as goodwill

**Hint:** Misconduct (Clause 2 of Part 1 of the First Schedule to the Chartered Accountant Act)

**Clause 3:**

**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 : Provided that nothing herein contained shall be construed as prohibiting a member from entering into profits sharing or other similar arrangements, including receiving any **share commission or brokerage in the fees**, with a member of such professional body or other person having qualifications, as is referred to in Clause 2

**Note**

A member in practice cannot accept commission or share in the fees from a person other than member of the institute, member of any other professional body or a person having such qualification as may be prescribed by the council or government.

**Clause 4:**

Enters into **partnership**, in or outside India, **with any person other than Chartered Accountant in practice** or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (V) of sub-section (I) of section 4 or whose qualifications are recognized by the Central Govt. or the Council for the purpose of permitting such partnerships.

Recently council has introduced a regulation 53B under which it had defined that for the purposes of entering into partnership under item (4) of Part I of the First Schedule to the Act, a person shall be a member of the following professional bodies, namely:-

Professional bodies or institutions outside India whose qualifications relating to accountancy are recognized by the Council under sub-section (2) of section 29 of the Act.

**Case Study**

Mr. A a Chartered Accountant holding certificate of practice could not succeed in getting any professional work from last 4 years, finally entered into partnership with his brother who is MBA to undertake management consultancy services.

**Hint:** No Misconduct

**Case Study**



Mr. B a fresh Chartered Accountant entered into partnership with Revaldo & Co. a Chartered Accountancy firm from Brazil on the terms to share profits and losses both in India and without India.

**Hint:** Misconduct (Clause 4 of Part 1 of The First Schedule to the Chartered Accountants Act)

### Case Study

Mr. X a Chartered Accountant in practice entered into partnership with Mr. Y a member of ICAI and ICWAI holding COP of ICWAI

**Hint:** No Misconduct, as allowed by regulation 53 B.

### Clause 5:

Secures either through the services of a person who is not an employee of such CA or who is not his Partner or professional bodies, or by means which are not open a Chartered Accountant, any professional business.

### Case Study

CA Manish Naramdeo who is finance manager of Electrolux India Ltd. has offered A Trivedi practicing CA to a reconciliation work of dealers accounts on the basis that Mr. Trivedi will pay 10% of his fees with Mr. Naramdeo for next five years.

**Hint:** Misconduct (Clause 5 of Part I of the First Schedule to the Chartered Accountant Act)

### Case Study

Mr. MD a PCA managed to get a table and chair in the industrial finance branch of IDBI Ltd. and manger is forwarding all projects to him on the profit sharing mutually decided by them.

**Hint:** Misconduct (Clause 5 & 4 of Part 1 of the First Schedule to the Chartered Accountants Act)

### Case Study

Mr. AP a PCA has been allotted a cabin in the industrial finance branch of Bank of Baroda and manager is forwarding all projects on weekly basis for credit appraisal the fees has been decided by the Head Office as ` 3,000/- per application.

**Hint:** There is no misconduct it is outsourcing (Clause 5 of Part 1 of the First Schedule to the Chartered Accountant Act)

### Clause 6:

**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.

1. Any CA from applying or requesting for or inviting or securing professional work from another Chartered Accountant in practice, or
2. A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.

### Case Study

As Airtel Ltd changed all telephone No. a Group 25 of Chartered Accountants in practice has published their own telephone Directory for new telephone No. and sent it to all the clients, friends, relatives, and any person happens to be connected with them directly or indirectly.

**Hint:** Misconduct as indirect solicitation. (Clause 6 of Part 1 of the First Schedule to the Chartered Accountants Act)

### Case Study

A classified in Economics Times appeared as follows “Wanted a suitable life partner for a PCA whom should also be a PCA as to create a life time partnership” Ms. A & Co., Chartered Accountant.

**Hint:** Misconduct advertisement shall be given in members personal name not in the name of the firm hence indirect solicitation (Clause 6 of Part 1 of The First Schedule to the Chartered Accountants Act)

**Case Study**

A CA in practice writes to the registrar of co operative societies, stating that though his name is on the panel, no allotment of audit has been made to him and requests him to take actions immediately.

**Hint:** Enquiry Misconduct, Indirect Solicitation (Clause 6 of Part 1 of The First Schedule to the Chartered Accountants Act)

**Case Study**

Mr. A Chartered Accountant in practice created his website in the following name [www.taxbachao.com](http://www.taxbachao.com)

**Hint:** Misconduct, as per guidelines issued by council in this behalf, name should resemble to the firm name

**Case Study**

A prospectus of P Ltd includes introduction of its Directors in the introduction of Mr B a CA in practice and one of the Directors of the company was appeared as follows

“Mr. B aged 58 years is a senior partner in B & S Chartered Accountants have vast experience and expertise in income tax matters”

**Hint:** Misconduct (Clause 6 of Part 1 of the First Schedule to the Chartered Accountants Act) indirect solicitation

**Clause 7:**

“**Advertises his professional attainments or services**, or uses any designation or expressions other than the 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 Institute of Chartered Accountants or of any other institution that has been recognized by the Central Government or may be recognized by the Council provided that a member in practice may advertise through a write up, setting out the service provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council.

**Case Study**

T, a PCA uses the designation, ‘Municipal Councillor’ apart from the expression ‘FCA’ on his visiting card. Comment RTP

**Hint:** Member must not use the designation such as ‘Member of Parliament’, ‘Municipal Councilor’ or any other functionary in addition to that of Chartered Accountant. Hence, guilty under Clause 7 of Part 1 of First Schedule.

**Case Study**

The visiting card of a CA in practice mentions that he specializes in tax planning

**Hint:** Misconduct, advertising professional attainment (Clause 7 of Part 1 of The First Schedule to the Chartered Accountants Act)

**Case Study**

The Offer Document of a Listed Company in which Mr. D, a PCA is a Director, mentions the name of Mr. D as a Director along with his various professional attainments and spheres of specialization. Is there any misconduct on the part of the Ca in this case?

**Hint:** If a Public Company, in which a CA in practice is a Director, issues a Prospectus or gives any CA’s expertise, specialization and knowledge in any particular field, it will attract professional misconduct under Clauses 6 & 7, Part 1, First Schedule.

**Clause 8:**

Accept a position as Auditor previously held by another CA or restricted state auditor **without first communicating with him in writing.**

**Note:-**

Council directions under clause 8 of Part 1 of First Schedule to the CA Act prescribe that it would be a healthy practice if a tax auditor appointed for conducting special audit under the Income Tax Act, communicates with the member who has conducted the statutory audit.

### Case Study

A CA in practice who is appointed as the tax auditor of a company accepts the audit without communicating with the predecessor.

**Hint:** Misconduct (Clause 8 of Part 1 of the First Schedule to the Chartered Accountants Act)

### Case Study

A CA in practice appointed as Special Auditor has not communicated to the statutory auditor before accepting the appointment.

**Hint:** No need to communicate

### Case Study

Mr. A before accepting an audit appointment communicated to Mr. B the predecessor about his appointment as a new auditor. Mr. B objected on the same and replied to Mr. A that he must not accept the appointment as he would have been issued a qualification on financial statement I he would have been allowed to conduct the audit Mr. A however accepted the appointment.

**Hint:** No Misconduct if A has sound reasons to accept the appointment.

### Clause 9:

Accepts an appointment as auditor of a company without ascertaining from it whether requirement of section 139 & 144 of Companies Act, 2013 (Sec. 224 & 225 of old Companies Act, 1956)

### Clause 10:

Charges / offers to charge accepts / offers to accepts with respect to any professional employment, **fee based on a percentage of profits** or which are **contingent upon findings** or results of such employment, except in cases which are permitted.

### Note

Clause is **Not applicable** if fee is fixed by court / public authority

### Note

Exception (may by % of profits) to this value are given by regulation 192

1. Receiver or liquidator (% of realization / distribution)
2. Auditor or Co-Op. Society (% of paid up / working capital, gross/net income / profit)
3. Voucher under the tax laws (% of valued property)

### Case Study

The auditor of a company charges audit fee on the basis of quantum of work as indicated by the audited figure of sales for the year

**Hint:** Misconduct (Clause 10 of Part 1 of the First Schedule to the Chartered Accountants Act)

### Case Study

The auditor of a co operative society charges the audit fee as a specified percentage of the working capital of the society.

**Hint:** It is permitted to charge fee in % of finding in this case by Council.

### Case Study

A CA in practice undertakes to conduct an appeal before the IT appellate tribunal on the understanding with his client that he would be paid ` 2000 in the event of his succeeding in the appeal and ` 500 in the event of appeal not succeeding.

**Hint:** Misconduct (Clause 10 of Part 1 of The First Schedule to the Chartered Accountants Act)

**Clause 11:**

Engages in any business or **occupation other than the profession of Chartered Accountant unless permitted** by the Council so to engage. Provided that nothing contained herein shall disentitle a CA from being a director of a company (Not being managing director or a whole time director) unless he or any of his partners is interested in such company as an auditor”.

**OCCUPATION / BUSINESS REQUIRING GENERAL PERMISSION**

1. Employment under CA / CA firm
2. Private tutorship
3. Authorship of Books / Articles
4. Holding Life Insurance Agency License (Renewal Commission)
5. Attending class and appearing in any exams
6. Holding public elective office (MP, MLA)
7. Honorary office of Charitable educational Institute
8. Notary public, Justice of peace, Special Executive Magistrate and like
9. Part time tutorship under coaching organization of Institute
10. Valuation of paper, paper setter, head-examiner or moderator for any exam
11. Editorship of professional journal
12. Acting as Surveyor / Loss Assessor under Insurance Act
13. Recovery Consultant
14. Insurance brokerage

**OCCUPATION / BUSINESS REQUIRING SPECIFIC PERMISSION**

1. Full time / Part time employment in Business concerns provided he / his relative not having sub. Intt.
2. Full time / Part time employment in non-business concern
3. Managing Director / Whole-time Director Concern
4. Intt. In family Business concern
5. Intt. In agriculture / allied activities with help of hired labour.
6. Intt. In any educational Institute
7. Part time / Full time lectureship for courses other than CA exams
8. Part time / Full time tutorship under any educational Institute other than coaching org. of Institute
9. Editorship of journal other than professional one
10. Any other Business /Occupation considering it to be necessary to take permission.

**Case Study**

A CA in practice who was an agent of LIC before he become a member of the ICAI is receiving the commission from the said corporation.

**Hint:** No Misconduct as permitted to receive commission for policies issued earlier.

**Case Study**

Mr. A CA in practice authored a book on “Jyotish and Vastu Shashtra”

**Hint:** No Misconduct

**Case Study**

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Mr. B accepted editorship of a monthly magazine “Desh Darshan” without first obtaining the permission from the Council.

Hint: Misconduct (Clause 11 of Part 1 of the First Schedule to the Chartered Accountants Act) special permission required

### Clause 12

**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

### Case Study

A CA in practice to allows his audit assistant who is not a CA to sign the bills for audit fee on behalf of the firm.

Hint: No Misconduct, billing is not an attest function.

### Case Study

A CA in practice met with an accident and hence authorized his employee who is a qualified CA to sign the audit report of the company as it was getting delayed.

Hint: Misconduct (Clause 12 of Part 1 of The First Schedule to the Chartered Accountants Act)

## Part II: Professional Misconduct of Members in Service

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person-

### Clause 1:

**Pays or allows** or agrees to pay directly or indirectly to any person any share in the **emoluments** of the employment undertaken by him.

### Clause 2:

**Accepts** or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant, or broker engaged by such company, firm or person by way of **commission or gratification**.

## Part III: Professional Misconduct of Members Generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he –

### Clause 1:

**Not being a fellow** of the Institute, **acts as a fellow** of the Institute.

### Clause 2:

**Does not supply the information** called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committee, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

### Case Study

In spite of repeated reminders a CA fails to reply to the letters of the Director Discipline asking him to confirm the date of registration by a paid assistant.

**Hint:** Misconduct (Clause 2 of Part 3 of the First Schedule to the Chartered Accountants Act)

### Clause 3:

While inviting professional work from another chartered accountant or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (6) and (7) of Part 1 of this Schedule, **gives information knowing it to be false.**

### Case Study

A CA in practice is presently an associate member of the Institute but has applied for admissions to fellowships describes himself as FCA in an empanelment of auditors, since only FCAs are entitled to make the applications.

**Hint:** Misconduct (Clause 1 of Part 3 The First Schedule to the Chartered Accountants Act) also misconduct (Clause 3 of Part 3 The Second Schedule to the Chartered Accountants Act)

## Removal from the register of members

As per section 20 of the Act, in following cases the Council may remove name of any member from the register of institute:

1. Death of member
2. Member's request
3. Non-payment of membership fees
4. Found to be unfit to have name on register –  
Member has become subject, to any of the disabilities (see Sec. 8), or for any other reason has ceased to be member

It is mandatory to the Council to remove from the Register the name of any member in respect of whom an order has been passed under this Act for removing him from membership of the Institute.

## Maintenance of branch offices

As per section 27 of the Act.

1. If CA n practice or CA firm has more than one office in India – **Each one of such offices should be in the separate charge of a member of the Institute.** The member in separate charge means “who either attends the said office or resides in the city of such office, at least 182 days in a year”. The incharge should be associated with him or with the firm either as a **partner** or as a paid **assistant (in whole time employment)**, and
2. Definition of Office – A place where a name-board is fixed or where such place is mentioned in the letter-head or any other documents as a place of business.
3. Name-board with designation CA at residence – No bar to 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 a name-board of an individual member and **not of the Firm.**

## Exemptions from Section 27

SECOND OFFICE	TEMPORARY OFFICE
1. Which is situated at a) In the <b>same premises</b> , in which the first office is located, or b) in the <b>same city</b> , or c) <b>within 50 km.</b> from the municipal limits of a city, in which the first office is located 2. A member having two offices of the type	Members / firms practicing in bill areas-subject to the following conditions: 1. In a city in the plains for a maximum <b>of 3 months</b> in a year 2. <b>All correspondence</b> can continue to be made at the regular office. 3. The <b>name-board</b> of the firm in the temporary office should <b>not be displaced</b> at times other than the permitted period.

referred to above shall have to declare, this of the two offices in his main office, which would constitute his professional address.

4. The temporary office should **not** be mentioned as a **place of business** office documents.

5. Before commencement and at close of every winter, the member / firm shall inform the Institute by registered post.

### **Case Study**

Guna, a CA in practice as a Sole Proprietor, has an office in Mumbai near Churchgate. Due to increase in professional work, he opens another office in a suburb of Mumbai, which is approximately 80 kilometers away from his existing office. For running the new office, he employs 3 retired income-tax officers. Is he guilty of professional misconduct?

**Ans.:**

1. In the given case, the Second Office is located **beyond 50 kms from the Municipal Limits** of Mumbai City. The exemption in respect of Second Office is not available.
2. The CA in practice has contravened the provision of **Sec. 27**. Since the suburb "Branch" is not under the separate charge of a Member.

## **Part IV: Other Misconduct of Members Generally**

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he –

### **Clause 1:**

Is held guilty by any civil or criminal court for an offence which is punishable with **imprisonment for a term not exceeding six months**.

### **Clause 2:**

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.

### **Case Study**

Mr. X PCA retain the books of his client and fails to return them to the client without reasonable cause.

**Hint:** Other misconduct as per clause (2) of Part IV of The First Schedule to THE ACT.

### **Case Study**

Mr. X PCA retain the books of accounts on the grounds that client is not paying the fees for work done by him on the books.

**Hint:** Can retain books according to **general law of lien**, Hence no misconduct.

### **Case Study**

During a raid of income tax some important files of income concealment were found at auditor's residence?

**Hint:** Other misconduct as per clause (2) of part IV of The First Schedule to THE ACT.

### **Case Study**

The Mayor of Mumbai Mahanagar Palika Nigam has complained to the Council that Mr. X the PCA is not giving property tax of his office premises despite of several reminders.

**Hint:** Other misconduct as per clause (2) of the part IV of The First Schedule to THE ACT.

### **Case Study**

Manager of Dena Bank complained about the Mr. JM a PCA that he has signed the balance sheet of their branch on the following grounds

- All pending finance proposal of his client M/s SG shall be cleared before the dispatch of the audit report.
- All financial proposal of South Mumbai shall be directed by the manger to him for CMA data and projection.

**Hint:** Other misconduct as per clause (2) of Part IV of The First Schedule TO THE ACT.

## THE SECOND SCHEDULE

### Part I : Professional Misconduct of Members in Practice

#### Clause 1:

“**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”.

i.e.

- i. A CA in practice discloses information acquired in the Course of his professional engagement,
- ii. Such disclosure is to any person other than his client so engaging him.
- iii. Such disclosure is otherwise than as required by any law for the time being in force,
- iv. Such disclosure is without the client’s consent

If all the above conditions (i) to (iv) are satisfied, disclosure of information by a CA in practice tantamount to professional misconduct.

#### Case Study

A CA who has requested to prepare the income tax return by a client finds that a substantial part of the current income has been suppressed. He advises, the client to make full disclosure in the return. The client does not oblige. The CA nevertheless continues with the assignment.

**Hint:** Misconduct. It is not duty of the member to shield the client under tax frauds (Clause 1 of Part I of the Second Schedule to the Chartered Accountants Act)

#### Clause 2:

If **he certifies** / submits in his / his firms name a report of an examination of financial statements **unless examination is made** by him / his partner, his employee or another member in practice.

#### Clause 3:

“Permits his name or the name of his firm to be used in connection with an **estimate of earning contingent upon future transaction** in manners which may lead to belief that he vouches for the accuracy of the forecast”.

The Council has issued a guidance note entitled “Guidance Note on Accountants Report on Profit forecasts and/or financial Forecasts” According to that:-

Member can participate in the preparation of profit or financial and can review them, provided he indicates clearly in his report:-

- The **sources of information**
- The **basis of forecasts** and
- Also the **major assumptions** made in arriving at the forecasts

Auditor should not issue any opinion leads to belief that the forecasts are likely to achieve.

#### Case Study

While reporting on a profit forecast to be submitted to a bank in connection with a loan application of the client the CA mentions that in his view forecast are most likely to materialize.

**Hint:** Misconduct (Clause 3 of Part I of the Second Schedule to the Chartered Accountants Act)

#### Clause 4:

**Express his opinion on final statement** of any business or enterprise in which he, his firm, or a partner in his firm has a **substantial interest**.

#### Note



1. “Substantial Interest” – Same meaning as is assigned thereto, under Appendix (a) of the Chartered Accountants Regulations, 1988
2. Clause (4) is applicable to all attest functions – including e.g., Tax Audit, Concurrent Audit of Banks, Concurrent Audit of Borrowers of Financial institutions, Audit of non-corporate borrowers of banks and financial institutions, audit of stock exchange, brokers, etc.

**Case Study**

A PCA who is working as a part-time lecturer in a college accepts its audit.

**Hint:** Misconduct (Clause 4 of Part I of the Second Schedule to the Chartered Accountants Act)

**Case Study**

A PCA accepts a audit of a trust in which his partner is a trustee.

**Hint:** Misconduct (Clause 4 of Part I of the Second Schedule to the Chartered Accountants Act)

**Case Study**

A firm of CA’s was appointed by a Company to evaluate the costs of the various products manufactured by it for their information system. One of the Partners of the Firm was a Non-Executive Director of the Company. Do you approve the above? Why? N 01, N 04, N 10

**Hint:** Clause 4 of Part I of Second Schedule:

1. Where a CA is a Director of a Company, the Firm in which the said Member is a Partner, should not express any opinion on its financial statements.
2. There is no “expression of opinion” on Financial Statements in the given case. Since the firm has been appointed to evaluate the costs of the various products manufactured by it for their information system, it cannot be held liable for professional misconduct.

**Case Study**

Shah, a CA, certified the Financial Statements of a Company in which his wife is a Director holding substantial interest. Is he guilty of any misconduct?

**Hint:** The CA is guilty of professional misconduct under Clause (4) of Part I of Second Schedule and the cases cited above.

**Clause 5:**

**Fails to disclose a material fact known to him** which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement not misleading where he is concerned with that financial statement in a professional capacity.

**Clause 6:**

**“Fails to report a material misstatement known to him** to appear in a financial statement with which he is concerned in a professional capacity”.

**Note**

This clause in fact is complementary to above clause 5.

**Case Study**

A company did not provide for depreciation as required by the relevant law and although the auditor is aware that the company has substantially under provide depreciation he does not bring out this fact in his report.

**Hint:** Misconduct (Clause 5 & 6 of Part I of the Second Schedule to the Chartered Accountants Act)

**Clause 7:**

**CA Dr Mahesh Gour**  
9320473019

**CA Vidhi Chedda**  
8879377367

**Prof Khushboo Sanghavi**  
8082736683

“Does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.”

### Note

A certificate was issued by a CA to a proprietor of a firm in respect of the turnover of the betel nuts to enable the firm which was not dealing in the betel nuts to obtain import license without checking the books and documents himself, but relying on his article clerk for its correctness. Held, he was guilty of gross negligence under clause 7 of part I of Schedule II.

### Case Study

A CA certifies the circulation figures of a news paper by stating that he has checked interalia news print sheets and machine room returns when they have not at all been maintained by the publishers.

Hint: Misconduct (Clause 7 of Part I of The Second Schedule to the Chartered Accountants Act)

### Case Study

Rakesh, A CA, was employed by the Complainant for the purpose of Income Tax Appeal, before the Income Tax Appellate Tribunal (ITAT). The remuneration for this purpose to be paid had been fixed on certain percentage of the relief of tax.

The Complainant now submitted a complaint to the ICAI on the following grounds:

- a. That the Respondent failed to appear at the hearing of the appeal before the Tribunal inspite of agreement between them.
- b. That a large sum of money were wrongfully taken by him by false representation of the case RTP

Hint: Refer Clause 10 Part I of First Schedule and Clause 7 Part I of Second Schedule.

Charging Fees at a percentage of relief of tax claimed in appeal, constitutes misconduct under clause 10 Part I of First Schedule.

Failure to appeal at the hearing, false representation of the case, etc. constitutes gross negligence covered by Clause 7 Part I of Second Schedule.

### Case Study

Kunal, a CA was the Auditor of A Limited During a financial year, the Investments appeared in the Balance Sheet of the Company at ` 10 lakhs, and was the same amount as in the last year. Later on, it was found that the Company's investments were only ` 25,000, but the value of Investments was initiated for the purpose of obtaining higher amount of Bank Loan. Comment N 09

Hint: This constitutes Gross Negligence, and hence, the CA is guilty of Professional Misconduct under Clauses 5, 6 and 7 of Part I, Second Schedule.

### Clause 8:

“Fails to obtain sufficient information which is necessary for expression of an opinion or its exception are sufficiently material to negate the expression of an opinion.”

### Case Study

The auditors of a bank branch reports that he has not verified the cash in hand and that he has also signed the balance sheet in anticipation of the receipt of the confirmation letters from the banks in respect of balances with them.

Hint: Misconduct (Clause 8 of Part I of the Second Schedule to the Chartered Accountants Act)

### Clause 9:

Fails to invite attention to any material departure from generally accepted procedure of audit applicable to the circumstance.

All SAs and Guidance notes on Auditing should be complied with while a member is discharging its attest function.

**Example**

A member had checked the cash books totals but not the bank column totals, verified all the entries, taken the casting only of few accounts, had resorted to test check despite of poor internal control and check, had not verified bank reconciliation statements for all the months. Held he was guilty of professional misconduct under clauses (7), (8) and (9).

**Clause 10:**

“**Fails to keep moneys** of his client other than fees or remuneration or money to be expended in a separate banking account or to use such money for purposes for which they are intended within a reasonable time.”

**Note**

Advance received by member against services to be rendered doesn't fall under this clause

It doesn't apply to expenses to be spent within reasonably short time. These need not be deposited into separate bank account.

**Case Study**

A PCA does not keep the monies given to him by a client for purchase of stamp paper and payment of court fees in a separate bank account. These moneys are with him for a year.

**Hint:** Misconduct (Clause 10 of Part I of The Second Schedule to the Chartered Accountants Act)

**Part II: Professional Misconduct of Members Generally**

Clauses (1) and (2) Part II of the Second Schedule deals with “Professional Misconduct in relation to the members of the Institute Generally”

**Clause 1:**

“If a **CA contravenes** any of the **provisions of this Act** or the regulations made there under or any guidelines issued by the Council. He shall be deemed to be guilty of professional misconduct. “

**INSTANCES IN WHICH CA HELD GUILTY UNDER THIS CLAUSE**

- i. Where a CA took into Articles a person who was employed in Government service and failed to inform the Council of the same and granted him a certificate of completion of service.
- ii. CA certified that an audit clerk was in service with him while he was also employed elsewhere with another employer between 11 A.M. and 5 P.M. and attended the office of the Chartered Accountant thereafter until 8 PM
- iii. CA falsely representing to a person that he had still a vacancy (when he already had 3 articled clerks) and induced him to enter into articles and subsequently cancelled the articles of the third articled clerk for irregular attendance without reference to the Institute. Held that he had contravened the provisions of Regulation 58 and was guilty of grave misconduct.
- iv. CA issued a certificate in respect of a consumption statement of a concern as a PCA on a date when he had not even applied for a Certificate of practice to the Institute – CA found guilty of professional misconduct for contravention of section 6 of the Act.
- v. CA took loan from a firm in which the articled clerk and his father were both interested – This is against the provisions of the Chartered Accountants Regulations, 1998 which prohibit taking of loan or deposit etc. from the articled clerk.
- vi. Not making payments of stipend to articled clerks every month.

**Case Study**

A PCA accepts a audit of a concern in which one of his relatives has a substantial interest.

**Hint:** Misconduct (Clause 1 of Part II of The Second Schedule to the Chartered Accountants Act) as per Council general guidelines, 2008.

**Case Study**

A PCA does not maintain any record of his professional receipts.

**Hint:** Misconduct (Clause 1 of Part II of The Second Schedule to the Chartered Accountants Act) as per council general guidelines, 2008.

**Case Study**

A PCA took a loan ` 20,000 from a firm in which his articulated clerk and his father were interested.

**Hint:** Misconduct (Clause 1 of Part II of The Second Schedule to the Chartered Accountants Act) violating regulation.

**Case Study**

A and B two CAs practice incorporate “Ticks and Ticks Pvt. Ltd. Chartered Accountants with the main object of carrying on the profession of accountancy and auditing.

**Hint:** Misconduct (Clause 1 of Part II of The Second Schedule to the Chartered Accountants Act) violating Section 25.

**Case Study:**

Mr. X accepted the appointment as a cost auditor of a company in which he is auditor appointed U/s 224.

**Hint:** Misconduct (Clause 1 of Part II of The Second Schedule to the Chartered Accountants Act) as per council general guidelines, 2008.

**Clause 2:**

Being an employee of any company, firm or person, **discloses confidential information** acquired in the course of his **employment** except and when required by any law for the being in force or except as permitted by the employee.

**Clause 3:**

**Includes in any information**, statement return or form to be to the Institute, Council or any of its Committee, Director (Discipline), Board of Discipline. Discipline Committee, Quality Review Board or the Appellate Authority any particulars **knowing them to be false**.

**Clause 4:**

**Defalcates** or embezzles **money** received in his professional capacity.

**Part III: Other Misconduct of Members Generally**

**Clause 1:**

A members of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is **held guilty** by any civil or criminal court for **an offence** which is punishable with imprisonment for a term **exceeding six months**.

**PART II – COMPANY AUDIT & AUDITORS****Section 139 Appointment of auditors**

139(1)	• APPOINTMENT OF AUDITORS AT AGM (FIRST AGM AND SUBSEQUENT AGMS)
139(2) &(4)	• Rotation of Auditor
139 (5)	• Appointment of subsequent auditor, in case of government.
139 (6) &(7)	• Appointment of First auditor
139 (8)	• Casual vacancy
139 (9) & (10)	• Re-appointment of retiring auditor.

**Section 139 : Appointment of Auditor**

[Sec. 139(6) and 139 (7)]		APPOINTMENT OF FIRST AUDITOR	
1. Manner of appointment of first auditor		<i>Case I [Sec. 139(7)]</i>	<i>Case II [Sec. 139(6)]</i>
		The company is a Government company or any other company owned or controlled, directly or CG, or by SG(s), or partly by CG and partly by SG(s)	The company is <u>any other</u> company:

	<p>(i) Appointment by CAG within 60 days of registration of the company.</p> <p>(ii) If CAG fails to appoint the first auditor within 60 days, the Board shall appoint the first auditor within next 30</p> <p>(iii) If the Board fails to appoint the First auditor within 30 days, the Board shall inform the members of the company who shall appoint the first auditor with 60 days at an extraordinary general meeting.</p>	<p>(i) Appointment by the Board within 30 days of registration of the company.</p> <p>(ii) If the Board fails to appoint the first auditor within 30 days, the Board shall inform the members of the company who shall appoint the first auditor with 90 days at an extraordinary general meeting.</p>
<p><b>2. Tenure of first auditor</b></p>	<p>The first auditor shall hold office till the conclusion of the first AGM [Sec. 139(6) and 139(7)].</p>	
<p><b>3. Definition of 'government company' [Sec. 2(45) of the Companies Act, 2013]</b></p>	<ul style="list-style-type: none"> <li>• Government company' means any company in which not less than 51% of the paid-up share capital is held by-             <ul style="list-style-type: none"> <li>(a) CG; or</li> <li>(b) SG(s) or</li> <li>(c) Partly by CG and partly by SG(s).</li> </ul> </li> <li>• 'Government Company' includes a company which is a subsidiary company of a Government company.</li> </ul> <p>➔ <b>Managing Director of PQR Ltd. Himself wants to appoint Shri Ganpati , a practicing Chartered Accountant as first auditor of the company . Comment on the proposed action of the Managing Director.</b></p> <p>HINT : Managing Director of PQR Ltd. should be advised not to appoint the first auditor of the company.</p> <p>➔ <b>The first auditor of M/s Healthy Wealthy Ltd. , a Government company , was appointed by the Board of Directors .</b></p> <p>HINT : The appointment of first auditors made by the Board of Directors of M/s Healthy Wealthy Ltd. is null and void.</p>	

**Example:** Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, A practicing Chartered Accountant, as first auditor of the company .Comment on the proposed action of the Managing Director.

**Ans:** Such appointment is a violation of section 139(6) of companies Act,2013, which authorizes the BOD to appoint the first auditor.

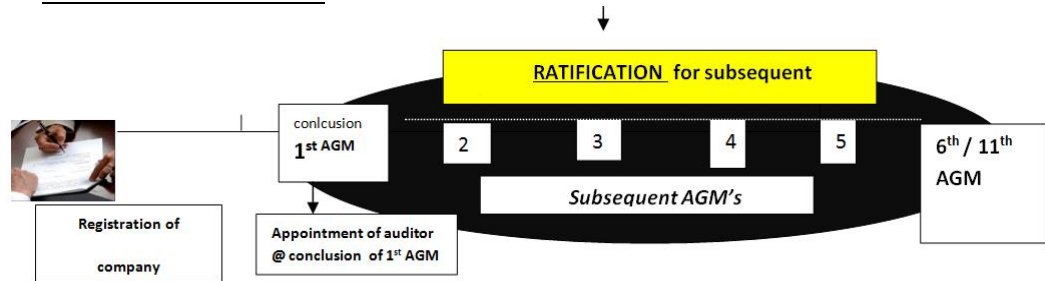
**Example:** The first auditor of M/S healthy Wealthy Ltd. a government Co. was appointed by the BOD.

**Ans.:** Such appointment is null and void. since first auditor shall be appointed by CAG of India.

<p><b>Section 139(1) APPOINTMENT OF AUDITORS AT AGM (Other than Government Company)</b></p>	
<p><b>1. Applicability</b></p>	<p>The provisions of Sec 139(1) are applicable to <b>all companies</b></p> <p>➔ (whether <b>public or private</b>, whether having a <b>share capital or not</b>, whether listed, and irrespective of is paid up share capital, borrowings, etc.)</p>

**2. Appointment and reappointment of auditors till sixth AGM**

(a) At the 1<sup>st</sup> AGM, every company shall appoint an individual or a firm as an auditor. **The auditor so appointed shall hold office from the conclusion of 1<sup>st</sup> AGM till the conclusion of 6<sup>th</sup> AGM.**



(b) After the 1<sup>st</sup> AGM, when any appointment of auditors is made at any AGM, **the auditor so appointed shall hold office till the conclusion of 6<sup>th</sup>/11<sup>th</sup> AGM**, with the AGM wherein such appointment has been made being counted as the first AGM [section 139(1) read with Rule3(7)]

(c) At every AGM (viz. 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup> and 5<sup>th</sup> AGM), the appointment of auditor shall be ratified by the members.

(d) If at any AGM, the appointment of auditor is not ratified by the members, the Board of directors shall appoint another individual or firm as its auditors (S) after following the procedure laid down under the Act [Explanation to Rule 3(7).]

→ Simply speaking, if the appointment is not ratified at any AGM, the auditor shall have to **vacate his** office, and such vacancy shall amount to **casual vacancy**,. The **Board** shall fill such casual vacancy in accordance with sub-section (8) of section 139.

**3. Manner and procedure of selection of auditors (Rule 3)**

The **manner and procedure of selection of auditors by the members** of the company at any AGM shall be such as may be prescribed

**Rule 3 of the Companies (Audit and Auditors) Rules, 2014** prescribed the following procedure;

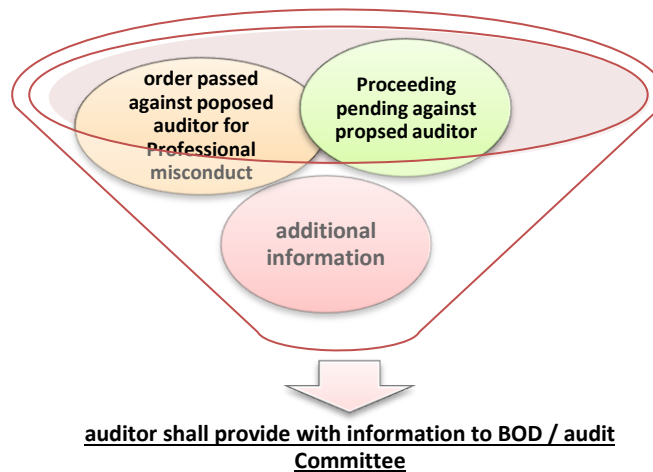
1. The qualifications and experience of the individual or the firm proposed to be appointed as auditor shall be considered by –

- (a) The board; or
- (b) The audit committee, in case the company is required to constitute an Audit Committee.



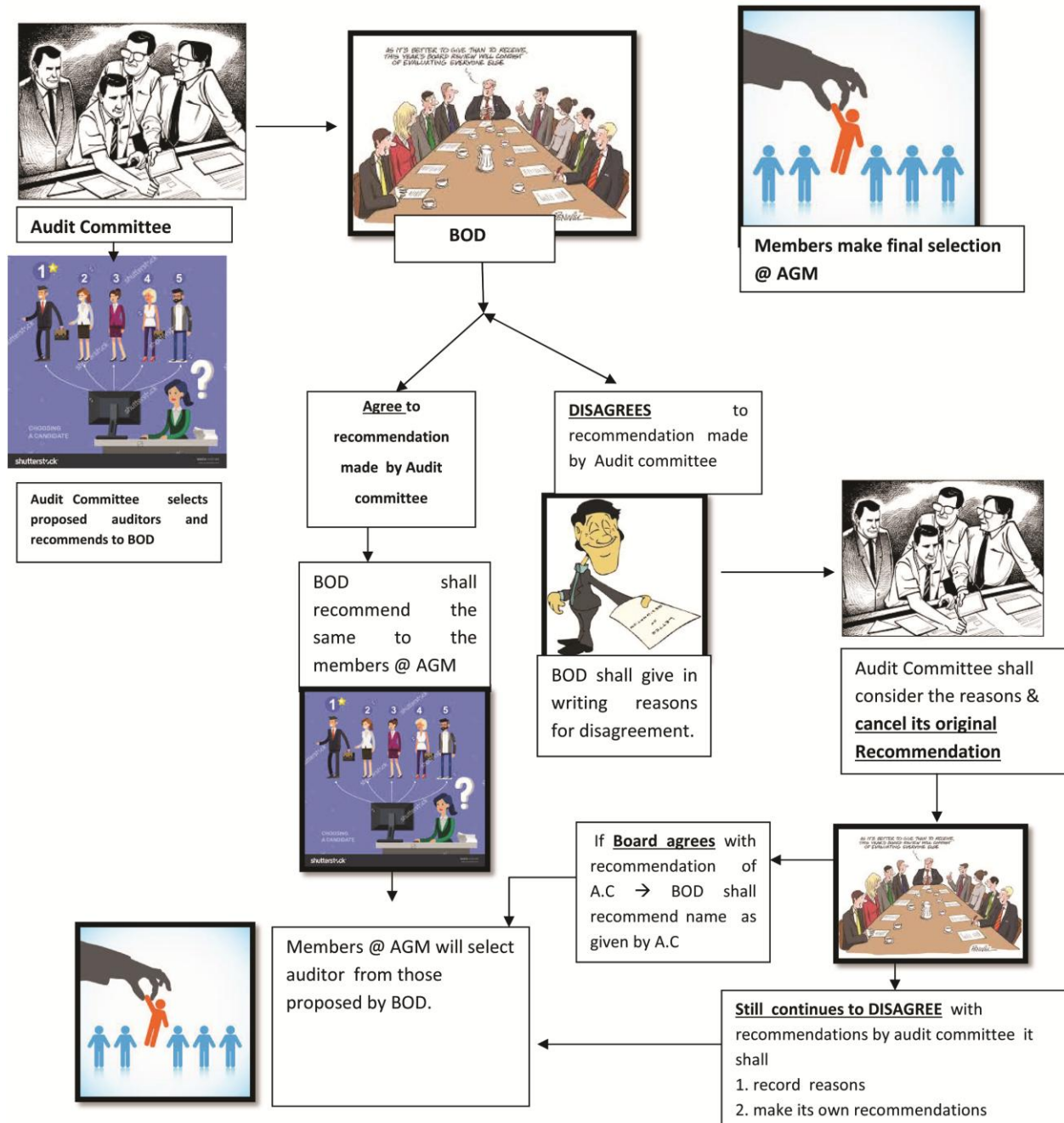
2. While considering the appointment the Board/Audit Committee shall have due regard to –  
 (a) Any order of professional misconduct passed against the proposed auditor; and  
 (b) Any proceedings of professional misconduct pending against the proposed auditor.

3. The Board/Audit Committee **may call** for such other information from the proposed auditor as it may deem fit.



4. In case the company is not required to constitute the Audit Committee, the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.
5. In case the company is required to constitute the Audit Committee, following procedure shall be adopted:
  - (a) The **Audit Committee** shall **recommend** the name of an individual or a firm as auditor to the Board for consideration.
  - (b) If the **Board agrees** with the recommendation of the Audit Committee, it shall further recommended such individual or such firm as auditor to the members in the AGM for appointment.
  - (c) If the **Board disagrees** with the recommendation of the Audit Committee, it shall refer back the recommendation to the Audit committee for reconsideration citing reasons for such disagreement.
  - (d) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, and the Board continues to disagree with the recommendations of the Audit Committee, the Board shall-
    - (i) record reasons **for its disagreement** with the committee.
    - (ii) send its **own recommendation** for consideration of the members in AGM;
    - (iii) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, and the **Board agrees**, with the recommendations of the Audit Committee, the Board shall recommend the name of the individual or the firm as recommended by the Audit Committee to the members in the AGM for appointment.





[Sec. 139(5)] APPOINTMENT OF SUBSEQUENT AUDITOR IN CASE OF A GOVERNMENT COMPANYY	
Applicability of Sec. 139(5)	1. Government companies 2. Any other company owned or controlled, directly or indirectly, by – (a) CG; or (b) SG(s) or (c) Partly by CG and partly by SG(s).
Appointment/ reappointment of auditor	<ul style="list-style-type: none"> <li>➤ In case of aforementioned companies</li> <li>➤ In respect of a financial year,</li> <li>➤ Appoint an auditor</li> <li>➤ Duly qualified to be appointed as an auditor of companies under this Act,</li> <li>➤ Within 180 days from the commencement of the financial year.</li> </ul>

Section 139(8) CASUAL VACANCY		
1. Manner of filling casual vacancy	Case I	Case II
	<p>The Casual vacancy arises in a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India</p> <p>(i) Such casual vacancy shall be filled <b><u>within 30 days, by CAG.</u></b></p> <p>(ii) If CAG does not fill the casual vacancy within 30 days, <b><u>the Board shall fill the causal vacancy within next 30 days.</u></b></p> <p>Within 30 days</p>	<p>The casual vacancy arises in any other company.</p> <p>(i) Such casual vacancy shall be filed <b><u>within 30 days, by the Board.</u></b></p> <p>(ii) in case the casual vacancy arose due to the <b>resignation</b> of auditor, it shall be filled within 30 days by the Board of directors, and the appointment made by the Board shall be <b>approved in a general meeting</b> convened within 3 months of the recommendation of the Board.</p> <p>Within 30 days</p>
2. Tenure of office	Any auditor appointed to fill a causal vacancy shall hold office till the conclusion of the next AGM	
Tenure	<b>The auditor shall hold office till the conclusion of the AGM.</b>	

**Example:** At the AGM of ICI Ltd. Mr. X was appointed as the statutory auditor . He however , resigned after 3 months since he wanted to give up practice and join industry. State, how the new auditor will be appointed by ICI Ltd. and the conditions to be complied for.

HINT : In this case the casual vacancy has been created on account of resignation . Therefore , Board of Directors will have to fill the vacancy within thirty days and such appointment shall be approved by the company at the general meeting within three months of the recommendations of the board . The new auditor so appointed shall hold office only till the conclusion of the next AGM

**Example:** Due to the resignation of the existing auditor (s) , the Board of directors of X Ltd. appointed Mr. Hari as the auditor . Is the appointment of Hari as auditor valid ?

HINT : Appointment of Hari by Board of Directors will be Valid if it is made within 30 days of casual vacancy and such appointment is approved by the company at a general meeting within three months of the recommendations of the Board.

**Example:** M/s Young & Co. a Chartered Accountant firm and Statutory Auditors of Old Ltd, is dissolved on 1/4/2015 due to differences of opinion among the partners. The Board of Directors of Old Ltd. in its meeting on 6/4/2015 appointed another firm M/s Sharp & Co. as their new auditors for one year .

HINT : In the instant case the action of the board of directors in appointing M/s Sharp & Co. to fill up the casual vacancy due to dissolution of M/s Young & Co. is correct .

However , the board of directors are not correct in giving them appointment for one year . M/s Sharp & Co. hold office until the conclusion of next AGM only .

**Example: C.A. Ashwin was appointed as auditor of Bristo Ltd. for the year 2014 – 15 . Since he declined to accept the appointment , the Board of Directors appointed CA John as the Auditor in place of C. A. Ashwin and the appointment was accepted by C.A. John. Discuss .**  
**[MAY 15 (4 marks)]**

HINT : Board of Directors are not authorized to fill up the vacancy in case the auditors appointed at the AGM refuse to accept the appointment

**Example: M/s. Roy & Co., a Chartered Account firm, and Statutory Auditors of Hindalco Ltd., is dissolved on 01.04.2014. the Board of Directors of Hindalco Ltd. In its meeting on 06.04.2014 appointed another firm M/s Sharp & Co. as their new auditor for one year.**

**Answer**

- As per section 139(8) of the Companies Act, 2013, the Board of Directors may fill any causal vacancy in the office of an auditor provided that where such vacancy is caused by the resignation of an auditor, the vacancy shall be filled in general meeting.
- The expression “casual vacancy” may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the firm etc.
- Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.
- In the present case, the action of the board of directors in appointing M/s. Sharp & Co. to fill up the casual vacancy due to dissolution of M/s. Roy & Co., is in accordance with law.
- However, M/s. Sharp & Co. can hold office until the conclusion of next AGM only. Thus , board of directors can not appoint them for one year.

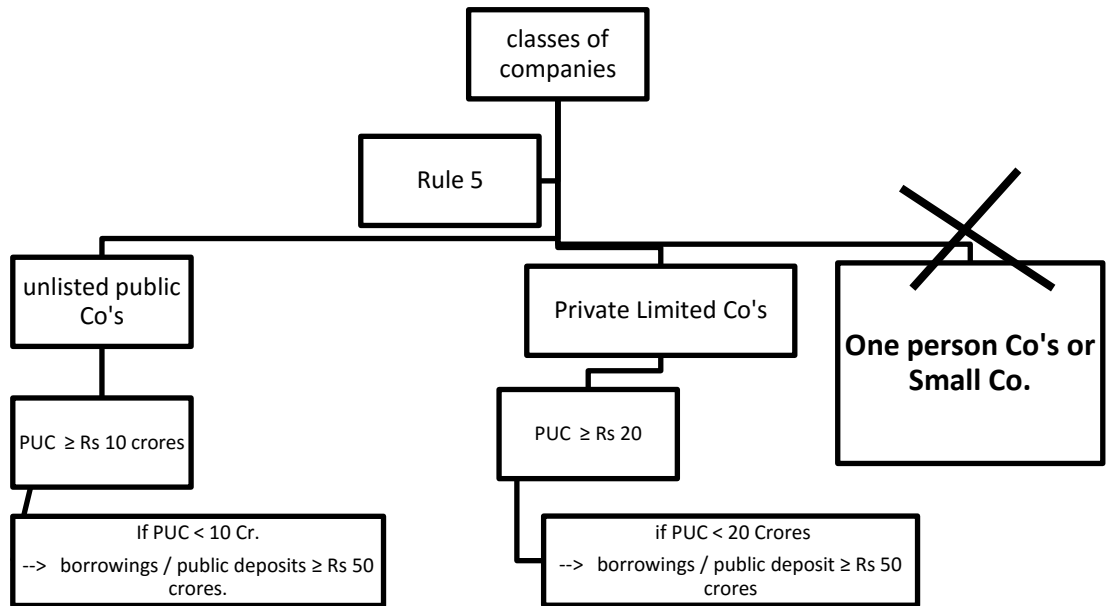
<b>139(9) &amp; 139 (10) REAPPOINTMENT OF RETIRING AUDITOR</b>	
<b>Reappointment of retiring auditor</b>	<p>A retiring auditor <b>may be re-appointed</b> at an <b>AGM</b>, if – (KEY – RUI)</p> <p><b>R</b> : a <b>special RESOLUTION</b> has not been passed at that meeting <b>appointing some other auditor</b> or <b>providing expressly that he shall not be re-appointed.</b></p> <p>a notice in writing</p> <p><b>U</b> : of his <b>UNWILLINGNESS</b> to be re-appointed ;and</p> <p><b>I</b> : he is <b>not disqualified / INCOMPETENT</b> for re-appointment;          he has <b>not</b> given the company</p>
<b>No auditor is appointed at AGM</b>	<ul style="list-style-type: none"> <li>➤ Where at any <b>AGM</b>,</li> <li>➤ <b>No auditor is appointed or re-appointed,</b></li> <li>➤ the <b>existing auditor shall continue to be the auditor</b> of the company.</li> </ul> <p><b>Example: No AGM was held for the year ended 31<sup>st</sup> March , 2014 in XYZ Ltd. Mr. X is the auditor for the previous 3 years , whether he should continue to hold office for current year or not .</b></p> <p>HINT : Mr. X shall continue to hold office till the conclusion of the AGM</p>
<b>Section 139 CERTIFICATE AND CONSENT BY AUDITOR, AND NOTICE OF APPOINTMENT BY COMPANY</b>	
<b>Certificate and Consent to be given by the Auditor</b>	<p>Before any appointment of auditor is made, the auditor shall furnish to the company –</p> <p>(a) His <b>written consent</b> for such appointment; and</p> <p>(b) A <b>certificate</b> that –</p> <p>(i) The appointment, if made, shall be in accordance with the <b>conditions</b> as may be <b>prescribed</b>; and</p>

	(ii) The auditor satisfies the criteria provided in section 141.
<b>Notice of Appointment to be given by the company</b>	The company shall (a) Inform the auditor concerned of his or its appointment; and (b) File a notice of such appointment with the Registrar With 15 days of the meeting in which the auditor is appointed.

**[Sec. 139(2) & 139 (4)] ROTATION OF AUDITORS**

1. Applicability of rotation of auditors [Sec. 139(2)]


- (a) The concept of rotation of auditors is applicable to –  
 (i) Listed companies; and  
 (ii) All companies belonging to such class or classes of companies as may be prescribed.
- (b) Following classes of companies have been prescribed for the purpose of rotation of auditors **[Rule 5 of the Companies(Audit and Auditors) Rules, 2014]:**



- (i) All unlisted public companies having paid up share capital of ` 10 crore or more;
- (ii) All private limited companies having paid up share capital of ` 20 crore or more;
- (iii) All companies having paid up share capital below the limits mentioned in (a) and (b)above, but having public borrowings from financial institutions, banks or public deposits of Rs.50crore or above.
- (c) The concept of rotation of auditors shall not apply to One Person Companies or Small Companies.

<p><b>2. Manner of rotation of auditors</b></p>	<p><b>In case of an individual as an auditor</b></p> <p>(a) No individual shall be appointed or reappointed as auditor <b>for more than 1 term of 5 consecutive years.</b></p> <p>1 term = 5 years .</p> <p>(b) An individual auditor who has completed his term of 5 consecutive years, <b>shall not be eligible for re-appointment</b> as auditor in the same company for 5 years from the completion of his term.</p>	<p><b>in case of a firm as an auditor</b></p> <p>(a) No audit firm shall be appointed or reappointed as auditor <b>for more than 2 terms of 5 consecutive years.</b></p> <p>2 terms = 10 years</p> <p>(b) An audit firm has completed its 2 terms of 5 consecutive years, <b>shall not be eligible for re-appointment</b> as auditor in the same company for 5 years from the completion of such terms.</p>
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<p><b>3. Restriction on other audit firm (s) having common partner(s)</b></p>	<p>An audit firm having one or more common partner to the other audit firm, whose tenure has expired, shall not be appointed as the auditor of the same company for a period of 5 years.</p> <p>In other words, if two or more audit firms have common partner(s), and one of these firms has completed its 2 terms of 5 consecutive years, none of such audit firms shall be eligible for reappointment as auditor in the same company for 5 years.</p> <p><b>Firm A + Firm B = Ineligible for reappointment.</b></p>
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<p><b>4. Time period for compliance for existing companies</b></p>	<ol style="list-style-type: none"> <li>Every company, existing on the commencement of this Act,</li> <li>Which is required to comply with provisions relating to rotation of auditors,</li> <li>Shall comply with these requirements</li> <li><b><u>Within 3 years from the date of commencement of this Act,</u></b></li> </ol> <p><b>Example:</b> Mr. Raj, a chartered Accountant, is an individual auditor of M/s Binaca Ltd for last 5 years as on March,2013 (existing on before the date of commencement of companies Act,2013), here a break in the term for continuous period of five years will not be considered as fulfilling the requirement of rotation, Thus Mr Raj can continue the audit of M/s Binaca for another 3 years due to transitional effect, I.e aggregate period of 8 years.</p>
<p><b>5. Right of removal or resignation not affected</b></p>	<ol style="list-style-type: none"> <li>The <b><u>right of the company to remove an auditor before expiry</u></b> of one/two term(s) of 5 consecutive years <b><u>shall not be affected</u></b> due to any provision contained in Sec. 139(2)</li> <li>The <b><u>right of the auditor to resign from the office of auditor before expiry</u></b> of one/two term(s) of 5 consecutive years <b><u>shall not be affected</u></b> due to any provision contained in Sec. 139(2).</li> </ol>
<p><b>6. Strict provisions w.r.t. rotation may be imposed by members</b></p>	<p>Members of a company may resolve to provide that-</p> <ol style="list-style-type: none"> <li>In the audit firm appointed by it, the <b>auditing partner</b> and his team shall be <b>rotated</b> at such intervals as may be resolved by members; or</li> <li>The audit shall be conducted by more <b>than one auditor.</b></li> </ol> 
<p><b>7. In case of joint Auditors</b></p>	<p>Where a company has appointed 2 or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all the joint auditors, as the case may be, do not complete their term in the same year.</p>
<p><b>8. Rules for rotation of auditors</b></p>	<p>CG may, by rules, prescribe the manner of <b>rotation of auditors.</b></p> <p><b><i>Manner of rotation of auditors by the companies on expiry of their term (Rule 6)</i></b></p> <ol style="list-style-type: none"> <li>In case the company is required to constitute an Audit Committee, the procedure shall be as follows;       <ol style="list-style-type: none"> <li>The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may <b><u>replace the incumbent auditor on expiry of the term of such incumbent.</u></b></li> <li>The Board shall consider the recommendation of the Audit Committee.</li> <li>The Board shall consider the recommendation for appointment of the next auditor by the members in the AGM</li> </ol> </li> <li>In case the company is <b><u>NOT</u></b> required to constitute an Audit Committee, the procedure shall be as follows;       <ol style="list-style-type: none"> <li>The Board shall itself consider the matter of rotation of auditors.</li> <li>The Board shall make its own recommendation for appointment of the next auditor by the members in the AGM.</li> </ol> </li> <li><b><u>In case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of 5 consecutive years or 10 consecutive years, as the case may be.</u></b></li> <li>The incoming auditor of audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms. ‘Same network’ includes the firms operating or functioning, under the same brand name, trade name or common control.</li> <li><b>A break in the term for a continuous period of 5 years shall be considered as</b></li> </ol>

	<p><b>fulfilling the requirement of rotation.</b></p> <p>6. If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accounts, such other firm shall also be intelligible to be appointed for a period of 5 years.</p>
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**Note 1:** Audit firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partner.


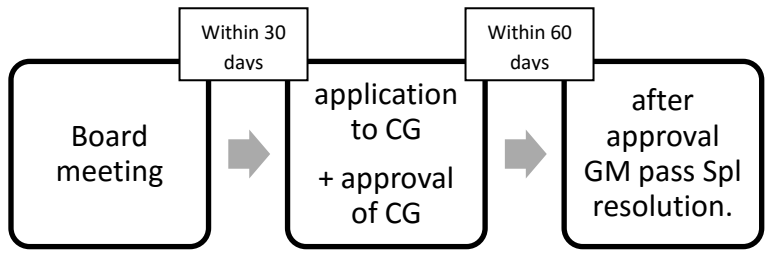
**Note 2 :** Consecutive years shall mean all the preceding financial years for which the firm has been the auditor until there has been a break by five years or more.

**Section 139 (3) and Rule 6 CAAR**



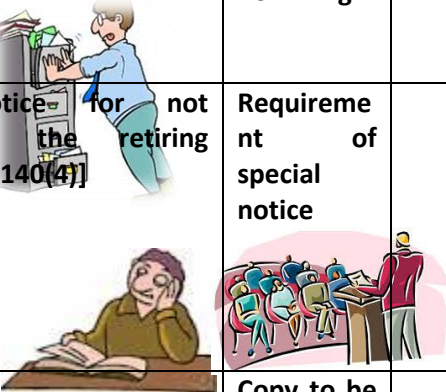


Internal rotation of auditor (voluntarily)

Example : Firm ABCDE & Associates has 5 partners

- ➔ Company passes a resolution to change partners every year
- ➔ Company may appoint joint auditors
- ➔ Where a company has appointed 2 or more individuals or firms a combination thereof as joint auditors , the company may follow the rotation of auditors in such a manner that both or all of the joint auditors as the case may be do not complete their term in the same year
- ➔ Eg: Firm A is auditor then appointed B as auditor from the 9<sup>th</sup> year so that when firm A goes under rotation Firm B may continue.

<b>Section 140 REMOVAL, RESIGNATION OF AUDITOR AND GIVING OF SPECIAL NOTICE</b>		
	<b>Removal of auditor before expiry of his term[Sec. 140(1)]</b>	<p><b>Resolution</b> Such removal requires a <b>special resolution</b>.</p> <p><b>Approval</b> <b>Previous approval of CG</b> must be obtained in the manner prescribed.</p> <p>Procedure for obtaining approval of CG and passing SR (Rule 7)</p> <p>(a) An <b>application shall be made to CG in Form ADT-2</b>. The application shall be accompanied with the prescribed fees.</p> <p>(b) The application shall be made to CG <b>within 30 days of passing of the Board resolution</b>.</p> <p>(c) The company shall hold the <b>general meeting within 60 days</b> of receipt of approval of CG for passing the special resolution.</p> <div style="text-align: center;">  <pre> graph LR     A[Board meeting] -- "Within 30 days" --&gt; B[application to CG + approval of CG]     B -- "Within 60 days" --&gt; C[after approval GM pass Spl resolution.]                     </pre> </div>
	<b>Opportunity of being heard</b>	Before taking any action for removal, the auditor shall be given a reasonable opportunity of being heard.
	<b>Resignation by Auditor [Sec.1402(2) and 140(3)]</b>	<b>Duty of auditor</b> When an auditor resigns, he is required to <b>file a Statement</b> in the prescribed form.



	<p><b>Contents of Statement</b></p> <p><b>Filling with whom?</b></p> <p><b>Time limit for filing</b></p> <p><b>Fine for non filing</b></p>	<p>The Statement shall <b>indicate the reasons and other facts</b> as may be relevant with regard to his resignation.</p> <ul style="list-style-type: none"> <li>• <b>The company</b></li> <li>• <b>The Registrar</b></li> <li>• <b>The CAG (in the case of a Government company).</b></li> </ul> <p>The Statement shall be <b>filed within 30 days</b> from the date of registration</p> <ul style="list-style-type: none"> <li>• Minimum : Rs.50,000</li> <li>• Maximum: Rs. 5,00,000</li> </ul> 
<p><b>Special Notice for not reappointing the retiring auditor [Sec. 140(4)]</b></p> 	<p><b>Requirement of special notice</b></p>	<p>(a) At an <b>AGM, special notice</b> shall be required for –</p> <ol style="list-style-type: none"> <li>appointing as auditor a person other than the retiring auditor; or</li> <li>providing expressly that the retiring auditor shall not be re-appointed,</li> </ol> <p>(b) However, special notice shall not be required if the retiring auditor has completed consecutive tenure of 5 years/10 years, as provided u/s 139 (2).</p>
	<p><b>Copy to be sent to retiring auditor</b></p>	<ul style="list-style-type: none"> <li>➤ On receipt of notice of such a resolution,</li> <li>➤ The <b>company shall forthwith send</b>, a copy thereof to the retiring auditor.</li> </ul>
	<p><b>Right of auditor to make a representation and to get it circulated</b></p>	<ol style="list-style-type: none"> <li>The retiring <b>auditor is entitled to make a representation against his removal.</b></li> <li>The representation (not exceeding a reasonable length) shall be in writing and shall be sent to the company.</li> <li>He may <b>request</b> the company <b>to circulate</b> the representation <b>to the members of the company.</b></li> </ol>
	<p><b>Duties of the company w.r.t. representation</b></p>	<ol style="list-style-type: none"> <li>The <b>company shall state the fact</b> that the retiring <b>auditor has made a representation</b> against his removal, in any notice of the resolution that is given to members of the company.</li> <li>The <b>company shall send a copy</b> of the representation <b>to every member</b> of the company to whom notice of the meeting is sent (unless the representations is received by the company too late).</li> <li>If a <b>copy of the representation is not sent</b> because it was received too late or because of the company's default, then-             <ol style="list-style-type: none"> <li>The auditor may require that the representation <b>shall be read out at the meeting;</b></li> <li>A copy of the representation shall be <b>filled with the Registrar.</b></li> </ol> </li> </ol>
	<p><b>Proviso to Sec. 225</b></p>	<ul style="list-style-type: none"> <li>➤ Provided that copies of the representations need not be sent out.</li> </ul>



	<b>(3) of the Companies Act, 1956]</b>	<ul style="list-style-type: none"> <li>➤ And the representations need not be read out at the meeting if,</li> <li>➤ On the application either of the company or of any other person who claims to be aggrieved,</li> <li>➤ The Company Law Board is satisfied that the rights conferred by this sub-section are being abused to secure needless publicity for defamatory matter; and</li> </ul>
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At an AGM of a listed company , Mr. R a retiring auditor after completing the tenure of 5 consecutive years of his service claims that he has been reappointed automatically , as the intended resolution of which a notice has been given to appoint Mr. P could not be proceeded with , due to Mr. P's death.

HINT : Claim of Mr. R would not hold goods . Vacancy will be filled by the Board of Directors .

PQR Company Ltd. removed their first auditor by passing a resolution in the meeting of the Board of Directors for his removal without obtaining prior approval from the Central Government. Offer your comments in this regard .

HINT : Removal of Auditor is Invalid as Special Resolution has not been passed and approval of Central Govt. not obtained

<b>Section 141 QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS</b>	
<b>Eligibility for appointment as an auditor</b>	Eligibility for an <b>individual</b> An individual shall be eligible for appointment as an auditor of a company only if he is <b>chartered accountant</b> .
	Eligibility for a <b>firm</b> <ul style="list-style-type: none"> <li>• A firm shall be eligible for appointment as an auditor of a company (i.e. the appointment shall be made in the name of the firm) only if <b>majority of its partners practicing in India</b> are qualified for appointment (i.e. they are <b>chartered accounts</b>).</li> <li>• Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.</li> </ul>
Disqualifications of Auditor [Sec.141 (3)] And Rule 10 of Companies (Audit and Auditors)Rule,2014	The following persons <b>shall not be eligible for appointment</b> as an auditor of a company: (a) A <b>body corporate</b> other than a limited liability partnership. (b) An <b>officer or employee</b> of the company. (c) Partners / Employee of Officers or Partners Section 2(59) of the Companies Act,2013, the term <b>officer</b> includes: <ul style="list-style-type: none"> <li>■ Director</li> <li>■ Manager</li> <li>■ Key Managerial Personnel</li> <li>■ Shadow directors</li> </ul> <b>Example</b> → <b>Miss Aradhya is Chartered Accountant. She is a part-time employee of Partition Ltd. State whether she is disqualified to be the auditor of Partition Ltd.</b> <b>Ans. As per Section 141(3), An employee (whether full time or part time ) is disqualified to be an auditor . Accordingly, Ms. Aradhya is disqualified to be an auditor of Partition Ltd.</b> → <b>Example Mr A, a chartered account has been appointed as auditor of X Ltd. In the AGM of the company held in October, 2013. Subsequently in February, 2014 he joined B, another chartered accountant , whose the Manager of X Ltd., as partner.</b> <b>Answer</b>

	<ul style="list-style-type: none"> <li>▪ In the present case, A, an auditor of M/s X Ltd., joined as partner with B, who is Manager Finance of M/s. X Limited Therefore, he has attracted disqualification under Section 141. <b>Thus, this disqualification results in vacation of office of the auditor of M/s X Limited.</b></li> <li>➔ <b>M, a CA in practice is director in RST Ltd, .</b> On combined reading section 141(3)(b) and section 2(59), it may be concluded that CA M would be disqualified to be appointed as an auditor of RST Ltd.</li> <li>➔ <b>G, a CA in practice is director in Zed Ltd. , Holding company of RST Ltd.</b> On Combined reading of section 141(3)(b) and Section 2(59), it may be concluded that CA G would be disqualified to be appointed as an auditor of Zed Ltd but would not be disqualified in case of RST Ltd.</li> </ul>	
	<p>(d) A person whose relative is a Director or is in the employment of the company as a director or key managerial personnel.</p>	
	<p>(e) A person</p> <ul style="list-style-type: none"> <li>➤ Who, or</li> <li>➤ His relative, or</li> <li>➤ His partner</li> </ul>	<ul style="list-style-type: none"> <li>➤ Is holding any security (Relative may hold upto Face Value ` 1 Lakh)</li> <li>OR</li> <li>➤ Indebted to Co. more than ` 5 Lakhs</li> <li>OR</li> <li>➤ Has given guarantee / provided any security more than ` 1 lakh</li> </ul>

→ However, a person shall not be disqualified **if his relative holds any security or interest** in the company of face value not exceeding is ` 1 lakh **(upto 1,00,000 not disqualified)**

If a relative acquires any security exceeding ` 1 lakh, then , the auditor shall take the corrective action within next 60 days so as to maintain the limit of ` 1 lakh.

**Example: Mr. Mihir, a chartered accountant in practice, is holding debentures in D Ltd. State whether he can be appointed as an auditor of D Ltd.**

Ans. As per Section 141(3), Mr. Mihir is disqualified to be an auditor of Ltd. Since he holds debenture (a security) in the company.

**Example: Mr. Little is a Chartered Account. In practice. His father is holding shares in Praksh Ltd. The face value of share is ` 15,000. However, the market value of same is ` 1,25,000. State whether Little is disqualified to be an auditor in Praksh Ltd.**

**Ans.** As per Sec. 141(3), Mr. Little is not disqualified since holding of securities upto face value of ` 1,00,000 does not result in disqualification (market value of the security is immaterial)

**Example: Mr. Sunny is a Chartered Account in practice. His sister’s husband holds equity shares having face value of ` 50 lakhs in Amita Ltd. State whether Mr. Sunny is disqualified to be an auditor of Amita Ltd.**

**Ans.** As per Sec. 141(3), Mr. Sunny is not disqualified since sister’s husband is not covered under ‘Relative’

u/s 2(77) of the Companies Act, 2013.

**Example : BC & Co. is an Audit Firm having partners Mr. B and Mr. C and Mr. A the relative of Mr. C is holding securities of MWF Ltd. having face value of ` 1,01,000 . Whether BC & Co. is qualified from being appointed as an Auditor of MWF Ltd. ?**

HINT : In the instant case BC & Co. will be disqualified for appointment as an auditor of MWF Ltd. as the relative of Mr. C i.e. partner of BC & Co. is holding the securities in MWF Ltd. which is exceeding the limit mentioned in proviso to section 141 (3) (d) (i) .

(f) A person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.

(g) Engaged in consulting & specialised services provided in Sec. 144.

**SEC 144: AUDITOR NOT TO RENDER CERTAIN SERVICES**

**(MODI AAIO)**

M: Management Services

O: Rendering of outsource financial services.

D: Design and implementation of any financial information system.

I: Internal audit

A: Accounting and book keeping services.

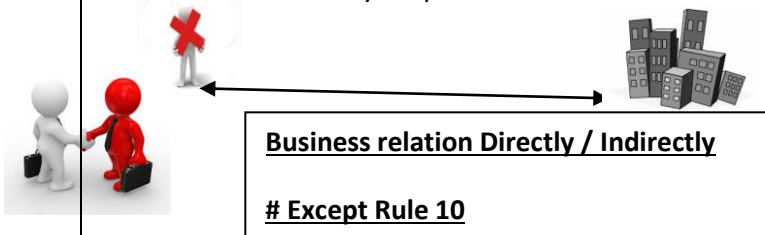
A: Actuarial services

I: Investment advisory services, Investment banking services.

O: Other kind of service may be prescribed.

(h) Holding audits of more than 20 company on the date of Appointment / Reappointment.

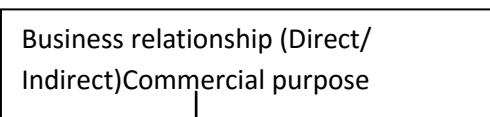
(I) A person or a firm who, whether directly or Indirectly, has business relationship of such nature as may be prescribed with




- (i) the company , or
- (ii) its subsidiary company , or
- (iii) its holding company, or
- (iv) associate company, or
- (v) a subsidiary or such holding company, or a subsidiary of such associate company



As per **Rule 10**, the term 'business relationship' shall be construed as any transaction entered into for a commercial purpose, expect-

- (i) **Commercial transactions** which are in the nature of **professional services permitted** to be rendered by an auditor or audit firm **under the Act and the Chartered Accountants Act, 1949**;
- (ii) Commercial transactions which are in the **ordinary course of business** of the company at arm's length price –
  - like sale of products or services to the auditor, as customer,
  - in the ordinary course of business, by companies engaged in the business of telecommunications , airlines, hospitals, hotels and such other similar business.





	<div style="display: flex; justify-content: space-around; align-items: center;"> <div style="text-align: center;"> <p>↓</p> <div style="border: 1px solid black; padding: 5px; width: 150px;">Disqualified</div> </div> <div style="text-align: center;"> <p>↓</p> <div style="border: 1px solid black; padding: 5px; width: 150px;">Can provide CA related services not prohibited</div> <p>↓</p> <div style="border: 1px solid black; padding: 5px; width: 150px;">Ordinary course of business HAT + arms length</div> <p>↓</p> <div style="border: 1px solid black; padding: 5px; width: 150px;">H – hotel A – airlines T telecommunication</div> </div> </div>
<p><b>Vacation of office [Sec. 141(4)]</b></p>	<ul style="list-style-type: none"> <li>▪ If after appointment, an auditor incurs any of the disqualifications mentioned in Section 143(3), he <b>shall vacated his office as such auditor.</b></li> <li>▪ Such vacation shall be <b>deemed to be a casual vacancy in the office of auditor.</b></li> </ul>
<p><b>Definition of ‘relative’ [Sec.2(77) of the Companies Act, 2013]</b></p>	<p>‘Relative’, with reference to any person, means any one who is related to another, if –</p> <ol style="list-style-type: none"> <li>(i) They are members of a Hindu Undivided Family;</li> <li>(ii) They are husband and wife; or</li> <li>(iii) One person is related to the other in such manner as may be prescribed.</li> </ol> <p>As per <b>Rule 4 of the Companies (Specification of definition details) Rules, 2014</b>, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely’</p> <ol style="list-style-type: none"> <li>(1) Father (including step-father)</li> <li>(2) Mother (including step-mother)</li> <li>(3) Son (including step-son)</li> <li>(4) Son’s wife</li> <li>(5) Daughter</li> <li>(6) Daughter’s husband</li> <li>(7) Brother (including step-brother)</li> <li>(8) Sister (including step-sister)</li> </ol> <div style="text-align: right;">  </div>


**ADDITIONAL POINT W.R.T. DISQUALIFICATION**

<p><b>Regarding indebtness</b></p> <div style="text-align: center;">  </div>	<p>(a) If an auditor purchases on credit goods of the company of a <b>value exceeding 5,00000, he shall be indebted to the company</b>, and</p> <ul style="list-style-type: none"> <li>➔ consequently he <b>shall vacate the office of auditor</b> held by him.</li> <li>➔ It is immaterial that the credit period allowed to the auditor is allowed to all the customer in the ordinary course of business.</li> </ul> <p>(b) If an <b>auditor recovers fees from the</b></p>	<div style="text-align: center;">  </div>
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	<p><b>company on a progressive basis</b>, even though the audit has not been completed, he cannot be said to be indebted to the company, and therefore, <b><u>he shall not vacate the office of auditor held by him.</u></b></p> <p><b>Example:</b>An auditor purchased goods worth ` 501 , 500 on credit from a company being audited by him . The company him one month’s credit , which it normally allowed to all known customers .</p> <p>HINT : In instant case , auditor has become indebted to the company and consequently he has deemed to have vacated his office .</p> <p><b>Example:</b> Mr. Aditya a practicing chartered accountant is appointed as a Tax Consultant of ABC Ltd., in which his father Mr, Sanghvi is the Managing Director.</p> <p>HINT : Mr. Aditya can be appointed as a tax consultant irrespective that his father is the managing director of the company .</p>
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<b>(Sec. 142)</b> <b>REMUNERATION OF AUDITORS</b>		
<b>Remuneration to be fixed in GM</b>	The remuneration of the auditor of a company shall be fixed- (a) In the general meeting; or (b) In such manner as may be decided in the general meeting.	
<b>Remuneration to be fixed by BOD</b>	→ In case, the <b>first auditor is appointed by the Board</b> , → The remuneration of the first auditor shall be fixed by the Board.	
<b>Certain sums to be included in remuneration</b>	<ul style="list-style-type: none"> <li>▪ The remuneration shall, <b>in addition to the fee payable</b> to an auditor, include- (a) The expenses, if any, incurred by the auditor in connection with the audit of the company; and (b) Any facility extended to the auditor.</li> <li>▪ However, the remuneration <b>shall not include any remuneration paid to the auditor for any other service rendered by him</b> at the request of the company.</li> </ul>	
<b>Discontinuation of existing, non-audit services [Proviso to Sec.144]</b>	<ul style="list-style-type: none"> <li>➤ An auditor or audit firm who or which <b>has been performing any non-audit services</b></li> <li>➤ On or before the commencement of this Act</li> <li>➤ <b>Shall comply</b> with the provisions of this section</li> <li>➤ <b>Before the closure of the first financial year after the date of such commencement.</b></li> </ul>	

<b>[Sec. 145] AUDITOR TO SIGN AUDIT REPORTS, ETC.</b>		
<b>Signing and certification</b>	<ul style="list-style-type: none"> <li>▪ The auditor’s report shall be <b><u>signed only by the person appointed as an auditor of the company</u></b></li> <li>▪ Any <b>other document of the company required to be signed or certified by the auditor</b>, shall be signed or certified only by the person appointed as an auditor of the company.</li> </ul>	

<b>Qualifications to be read in GM and inspection thereof</b>	<ul style="list-style-type: none"> <li>➤ The qualifications, observations or comments on financial transactions or matters,</li> <li>➤ Which have any adverse effect on the functioning of the company</li> <li>➤ Mentioned in the auditor’s report shall be-               <ul style="list-style-type: none"> <li>(a) Read before the company in general meeting ;</li> <li>and</li> <li>(b) Open to inspection by any member of the company.</li> </ul> </li> </ul>	
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**Mr. Ravi, a fellow member of the institute of Chartered Accountants of India, working as Manager of Aneja and Co., a Chartered Accountant firm, signed the audit report of Om Ltd., on behalf of Aneja & Co.**

### Answer

- As per Section 145 of the Companies Act, 2013, the person appointed as an auditor of the company shall sign the auditor’s report or sign or certify any other document of the company.
- Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accounts are authorized to sign on behalf of the firm.
- In the present case, it is given that Mr. Ravi, a fellow member of the Institute and a manager of M/s Aneja & Co., Chartered Accounts, signed the audit report on behalf of the firm.
- However, he is not authorized to sign due to the specific requirements of the Companies Act, 2013 whereby only a chartered account partner can sign.

**Therefore the auditor Aneja & Co. concerned and Mr. Ravi who signs the report, shall be punishable**

### **RIGHTS OF AUDITOR**

<b>Right of the auditor to receive notices of GM (Sec. 146)</b>	<ul style="list-style-type: none"> <li>➤ All notice of,</li> <li>➤ And other communications relating to,</li> <li>➤ Any GM shall be forwarded to the auditor of the company.</li> </ul>
<b>Duty of the auditor to attend GM (Sec. 146)</b>	<ul style="list-style-type: none"> <li>➤ The auditor shall attend the general meetings.</li> <li>➤ The auditor may attend the GM-               <ul style="list-style-type: none"> <li>(a) himself; or</li> <li>(b) through his authorized representative, who shall also be qualified to be an auditor.</li> </ul> </li> <li>➤ The company may exempt an auditor from attending the GM</li> </ul>
<b>Right of the auditor to be heard at GM (Sec. 146)</b>	<ul style="list-style-type: none"> <li>➤ The auditor shall have a right to be heard at a GM on any part of the business which concerns him as the auditor</li> </ul>
<b>Right of access to books of accounts [Sec. 143(1)]</b>	<ul style="list-style-type: none"> <li>➤ Right of access to books of accounts,</li> <li>➤ Right to access to vouchers, documents of the company and records of all subsidiary co.</li> </ul>
<b>Right to inquiry [Sec. 143 (1)]</b>	Right to inquiry and explanation from the officers and employee of the company.
<b>Right to visit branch [Sec. 143 (8)]</b>	Right to visit branches and access branch accounts <b>Note:</b> Branch Auditor cannot visit Head Office, but Statutory Auditor has right to visit Branches.
<b>Right to receive remuneration. (Sec. 142)</b>	<ul style="list-style-type: none"> <li>➤ Right to receive remuneration.</li> <li>➤ Remuneration may be on progressive basis</li> </ul>
<b>Right to have</b>	Right to have qualifications, observations, comments on. financial transactions which have any

<b>qualifications (Sec. 145)</b>	adverse effect and mention in the audit reports
<b>DUTIES OF AUDITOR</b>	
<b>Sec. 143 (1)</b>	Duties of Auditor to inquire on Certain Matters
<b>Secured Loans</b>	Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
<b>Book Entries</b>	Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
<b>Sale of Investments</b>	Where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
<b>Loans &amp; Advances</b>	Whether loans and advances made by the company have been shown as deposits;
<b>Personal Expenses</b>	Whether personal expenses have been charged to revenue account;
<b>Shares Allotted or Cash and Balance Sheet Position</b>	Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading
<b>Sec. 143 (2)</b>	True and Fair Reporting 1) Auditor shall make a Report - On the accounts examined by him. - On every financial statement 2) Every books of accounts and financial statements should be audited which are required to be laid before the Company in AGM 3) Auditor has to report to annexures and not on attachment. 4) In case of non-payment of Audit fee, Auditor does not have lien over audit report, but Auditor can lien over the books of accounts.
<b>Sec. 143 (3)</b>	<b>DUTY TO AUDIT REPORT</b> The auditor's report shall also state - <b>(KEY – BV Dd Q AS I)</b>
<b>Branch Auditor's Report</b>	Whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
<b>Verify Proper Books of Account</b>	Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
<b>Director's Disqualification</b>	Whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;
<b>Qualification &amp; Adverse effect</b>	The observations or qualification comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
<b>Accounting Standards</b>	Whether, in his opinion, the financial statements comply with the accounting standards;
<b>Information &amp; Explanations</b>	Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof

	and the effect of such information on the financial statements;	
<b>Internal Financial Controls</b>	Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;	
<b>Other matters</b>	Such other matters as may be prescribed.	
<b>[Sec. 147] PUNISHMENT FOR CONTRAVENTION</b>		
<b>Punishment for contravention of Sec. 139 to 146</b>	<b><i>Punishment for the company</i></b>	<ul style="list-style-type: none"> <li>➤ Minimum Fine: ` 25,000</li> <li>➤ Maximum Fine : ` 5,00,000</li> </ul>
	<b><i>Punishment for Officer in default</i></b>	<ul style="list-style-type: none"> <li>➤ Maximum Imprisonment : 1 year</li> <li>➤ Minimum Fine: ` 10,000</li> <li>➤ Maximum Fine : ` 1,00,000</li> </ul>
<b>Punishment for the Auditor for contravention of Sec. 139,143 or 145</b>	<ul style="list-style-type: none"> <li>➤ Minimum Fine: ` 25,000</li> <li>➤ Maximum Fine : ` 5,00,000</li> </ul>	
	<ul style="list-style-type: none"> <li>➤ If a contravention is committed knowingly or willfully</li> <li>➤ With the intention to deceive the company or its shareholders or creditors or tax authorities, then punishment shall be –</li> <li>➤ Maximum Imprisonment : 1 year</li> <li>➤ Minimum Fine: ` 1,00,000</li> <li>➤ Maximum Fine : ` 25,00,000</li> </ul>	
<b>Consequences of conviction of Auditor for contravention of Sec. 139,143,144 or 145</b>	<b><i>Refund of remuneration</i></b>	➤ The auditor shall be liable to refund to the company the remuneration received by him
	<b><i>Payment of damages by the auditor</i></b>	<ul style="list-style-type: none"> <li>➤ The auditor shall be liable to pay damages</li> <li>➤ To the company/statutory bodies or authorities any other persons</li> <li>➤ For loss arising out of incorrect or misleading statements of particulars made in his audit report.</li> </ul>
<b>Measures to ensure prompt payment of damages</b>	<ul style="list-style-type: none"> <li>➤ For ensuring prompt payment of damages by the auditor.</li> <li>➤ CG shall, by notification, specify any statutory body/authorities/an officer.</li> </ul>	
	<ul style="list-style-type: none"> <li>➤ Such statutory body/authority/ an officer</li> <li>➤ Shall pay the damages to the persons entitled to damages.</li> </ul>	
	<ul style="list-style-type: none"> <li>➤ Such statutory body/authority/an officer</li> <li>➤ Shall file a report with CG containing particulars of damages.</li> </ul>	
<b>Jointly and several liability for partners</b>	<ul style="list-style-type: none"> <li>➤ In case of auditor being an audit firm, the liability(whether civil or criminal)</li> <li>➤ Shall be of the partner(s) concerned and of the firm jointly and severally).</li> </ul>	

**[Section 177 of co's Act,2013 AUDIT COMMITTEE**

<b>1. Mandatory constitution of audit committee by certain companies</b>	<p><b><u>Constitution of an audit committee is mandatory for-</u></b></p> <p>(a) Every listed company; and</p> <p>(b) Such other class or classes of companies , as may be prescribed.</p> <p>As per <b><u>Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014.</u></b></p>
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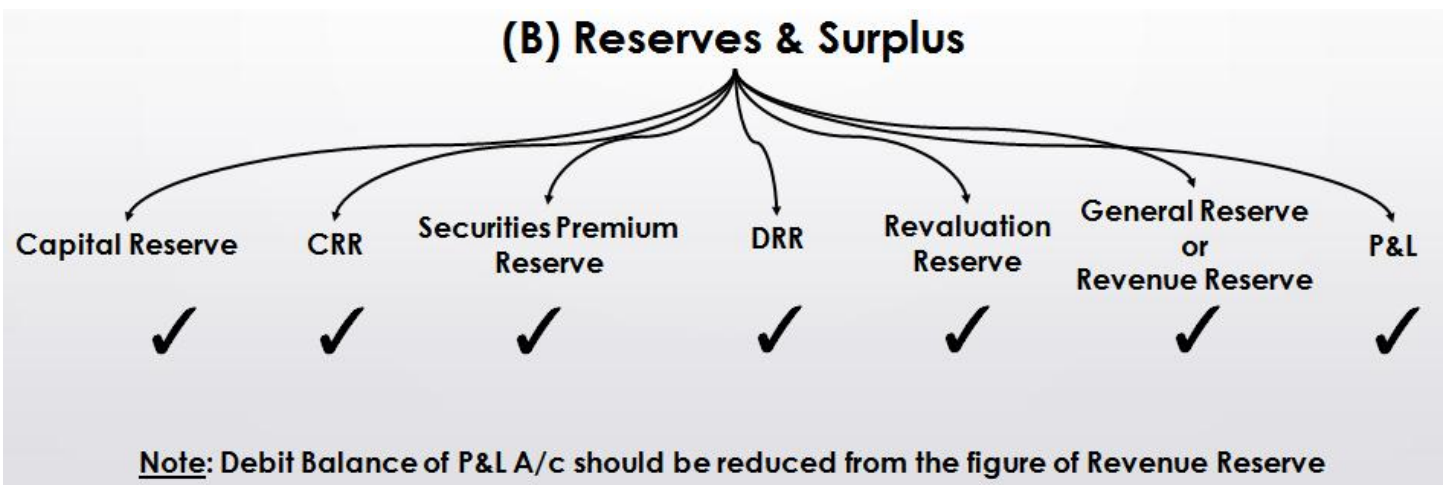
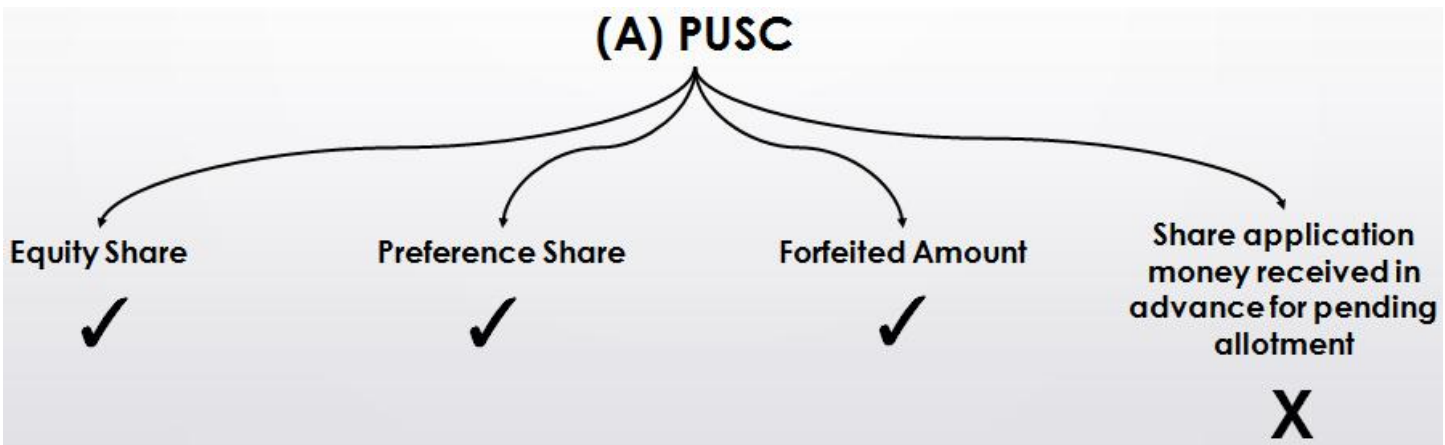


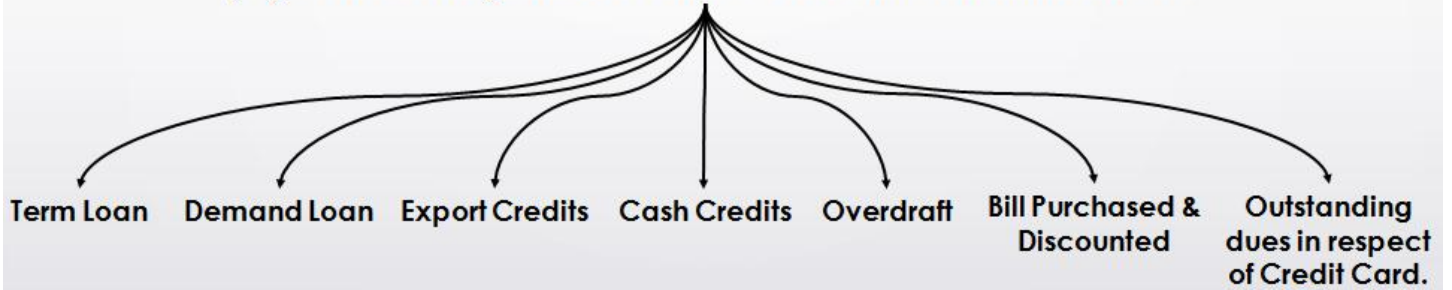
- (i) All public companies with a **paid up capital** or ` 10 crore or more
- (ii) All public companies having **turnover** of ` 100 crore or more
- (iii) All public companies, having in aggregate, **outstanding loans or borrowings**  
**or debentures or deposits** exceeding ` 50 crore or more.

**Explanation.** The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account.

**CARO 2016**

**APPLICABLE ON ALL COMPANIES EXCEPT [BIPSO]**



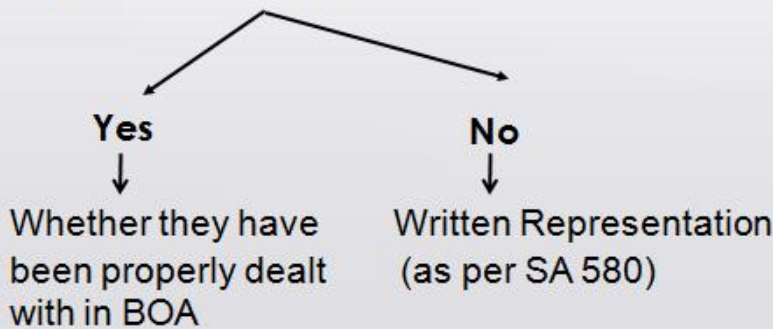
**(C) Borrowing from Bank & Financial Institution****(D) REVENUE / TURNOVER**

Sales of Goods	XXX	Service Rendered	XXX
(-) Recoverable Duties (ED, ST, VAT etc.)	(XX)		(XX)
(-) Trade Discount	(XX)		(XX)
(-) Sales Return (Related to any year)	(XX)		
<hr/>			
	XXX	+	XXX
	TO		

# (i) 1) **Fixed Assets:**

- a) Whether Co. is maintaining proper records with full particulars,
- b) Physically verified by Management at reasonable intervals
- \* Note : (Reasonable Intervals:-  
yearly / In case of sheer size business once in three years)

c) **Material Discrepancies**

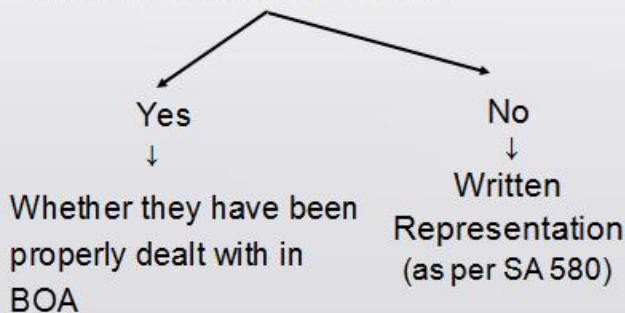


Fixed Asset

# (ii) 2) **Inventories:**

- a) Whether Co. is maintaining proper records with full particulars,
- b) Physical verification by Management at reasonable intervals
- \* Note : (Reasonable Intervals:-  
Quarterly / Half yearly / In case of sheer size business once in a year)

c) **Material Discrepancies**



Inventory / Stock

# (iii) **Loan to Sec-189 parties**

Whether the Co. has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under Section 189 of the Companies Act, 2013. if so,

- a) Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;



- b) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;
- c) 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;

### # (iv) Loans / Investment / Guarantees / Security

In respect of loans, investments, guarantees and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

#### Section 185

- a) Obtain from the management the details of directors or any other person in whom the director is interested.
- b) He may also check the details of the persons covered under this clause from the Register maintained u/s 189 of the Act.
- c) Obtain and check the details of the transactions carried out with such persons, including of any guarantee given and security provided.

#### Section 186

- a) Obtain the details of, loans given to any person or other body corporate, guarantee given or security provided in connection with a loan to any other body corporate
- b) Check whether the company has made investments through more than two layers of investment companies.
- c) Check whether the company has disclosed the full particulars of the loan given, investment made or guarantee given or security provided in the financial statement including the purpose for which the same is proposed to be utilized by the recipient.

Check whether the company has passed the board resolution as prescribed and obtained the prior approval, wherever required, from the public financial institution, etc.

### # (v) DEPOSITS [CLAUSE 3(v)] :

In case , the company has accepted deposits , whether the following has been complied with :

Directives issued by the Reserve Bank of India ( RBI ) ;

The provisions of sections 73 to 76 or any other relevant provisions of the Companies Act , 2013 and the rules framed there-under ; and

If an order has been passed by Company Law Board (CLB) or National Company Law Tribunal (NCLT) or Reserve Bank of India (RBI) or any court or any other tribunal .



However , if any of the above not complied with the nature of contraventions should be stated.

### # (vi) COST RECORDS [CLAUSE 3(vi)] :

→ If the Central Government has specified maintenance of cost records under section 148 of the Companies Act , 2013 whether such accounts and records have been and maintained.



### # (vii) STATUTORY DUES [CLAUSE 3(vii)] :

Following matters shall be reported for statutory dues and disputes for tax and duties

**a) Statutory Dues for more than 6 Months :** Whether the company is regular in depositing undisputed statutory dues with the appropriate authorities including :

Provident fund

**Employees state insurance**

**Income – tax**

**Sales – tax**

**Service tax**

**Duty of customs**

**Duty of excise**

**Value Added Tax (VAT) ;**

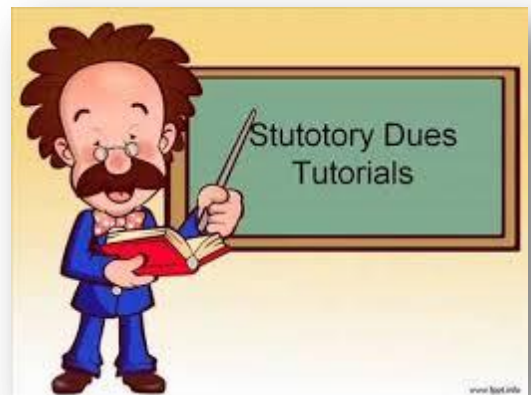
**Cess ; and**

**Any other statutory dues**

If the company is not regular in depositing such statutory dues , the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they become payable , shall be indicated by the auditor .

**b) Dispute for Tax and Duty :** In case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute , then the amounts involved and the forum where dispute is pending shall be mentioned .

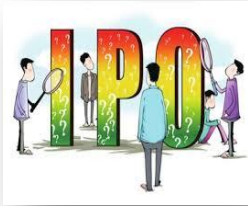
### # (viii) REPAYMENT OF LOANS [CLAUSE 3(viii)] :



→ Whether the company has defaulted in repayment of loans or borrowing to a financial institution bank , Government or dues to debenture holders ? If yes, **the period and the amount of default to be reported** .

→ Note that in case of defaults to banks financial institutions and Government lender wise details to be provided.

**# (ix) UTILIZATION OF IPO AND FURTHER PUBLIC OFFER [CLAUSE 3(ix) ] :**



→ Whether moneys raised by way of Initial Public Offer (IPO) or further public offer ( including debt instruments ) and term loans **were applied for the purposes for which those are raised** .

→ If not , the **details together with delays or default** and subsequent rectifications , if any as may be applicable be reported .

**# (x) REPORTING OF FRAUD [CLAUSE 3(x) ] :**



→ Whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year , If yes the **nature and the amount involved is to be indicated**



**# (xi) APPROVAL OF MANAGERIAL REMUNERATION [CLAUSE 3(xi) ] :**

→ Whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with the Schedule V to the Companies Act 2013 ?

If not state the amount involved and steps taken by the company for securing refund of the same .

**# (xii) NIDHI COMPANY [CLAUSE 3(xii) ] :**

→ Whether the Nidhi Company has complied with the **Net Owned Funds to Deposits in the ratio of 1 : 20** to meet out the liability and → whether the Nidhi Company is maintaining 10% unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability .



**# (xiii) Related Party Transactions [CLAUSE 3(xiii) ] :**

→ 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 .

### # (xiv) PRIVATE PLACEMENT OR PREFERENTIAL ISSUES [CLAUSE 3(vii)] :



→ Whether the company has made any **preferential allotment or private placement of shares or fully or partly convertible debentures** during the year under review

→ and if so as to whether the requirement of section 42 of the Companies Act ,2013 have been complied with and

→ the amount raised have been used for the purposes for which the funds were raised. If not provide the details in respect of the amount involved and nature of non – compliance .

### # (xv) NON – CASH TRANSACTION [CLAUSE 3(xv)] :

Whether the company has enter into any non – cash transactions with directors or persons connected with him and if so whether provisions of section 192 of Companies Act , 2013 have been completed with ;

### # (xvi) REGISTER UNDER RBI ACT 1934 [CLAUSE 3(xvi)] :

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 .

### Important Questions of CARO 2016

Sr.No.	PARTICULARS	CARO Reference	
1.	E-Tech Pvt. Ltd., which has an aggregate outstanding loan of ` 50 lakhs from Banks and ` 60 lakhs from Financial Institutions, defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the CARO, 2016 is not applicable. You are required to state the list of companies to which CARO is applicable and state how would you deal with the given situation as an auditor of the company. Hint: Applicable	Applicability	RTP NOV 2015
2.	A Pvt. Ltd. is incorporated on 1st July, 2004. During the year ended 31 <sup>st</sup> March, 2005, it had issued shares (fully paid up) of ` 80 lakhs, had borrowed ` 15 lakhs each from 2 financial institutions and its revenue (Net of excise ` 50 lakhs which is credited to a separate account) is ` 1100 lakhs. Will Companies Auditors Report Order, 2016 (CARO) be applicable to A Pvt. Ltd.? Hint: Applicable	Applicability	
3.	T Pvt. Ltd.'s paid up Capital & Reserves are less than ` 50 lakhs and it has no outstanding loan exceeding ` 25 lakhs rom any bank or financial institution.	Applicability	(4 Marks) (Nov 2007)



	Its sales are ` 12 crores before deducting Trade discount ` 10 lakhs and Sales returns ` 95 lakhs. The services rendered by the company amounted to ` 10 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss. Hint: (12 - 0.10 - 0.95 + 0.10 crore = 11.05. crore). Hence CARO, 2016 will be applicable to T Pvt. Ltd.		
4.	A Private Limited reports the following position as on 31st March, 2012: Paid up capital 60 lacs Revaluation reserve 15 lacs Capital reserve 20 lacs Revenue Reserve 15 Lacs P&L A/c [Dr. Balance] 6 lacs The Management of the Company contends that CARO 2016 is not applicable to it. Comment. Hint: Applicable	Applicability	RTP Nov 2013
5.	A Private Ltd., which has outstanding loan of ` 50 lakhs from Financial Institution defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies Auditors Report Order (CARO) is not applicable. Hint: CARO, 2016 will not be applicable to A Private Ltd.	Applicability	(4 Marks) (May 2007)
6.	X Pvt. Ltd. is a subsidiary of a listed entity incorporated outside India. The management of the company believes that since X Pvt. Ltd. is a Private Company and satisfies all conditions under the CARO, 2016, reporting under CARO is not applicable. Hint: Not Applicable	Applicability	
8.	A Private Limited Company reports the following position as on 31 <sup>st</sup> March, 2014: Paid up Capital 35,00,000 Revaluation Reserve 12,00,000 Capital Reserve 10,00,000 Profit & Loss (Dr.) Balance 12,00,000 The Management of the Company contends that CARO, 2016 is not applicable to it. Comment. Hint: Not Applicable	Applicability	(4 Marks) (NOV 2014)
10.	Physical verification of only 50% (in value) of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.	Clause ii	RTP May 2011/16

Whether physical verification of inventory has been conducted at reasonable interval by the management. Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification. In the given case, the above requirement of CARO, 2016 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

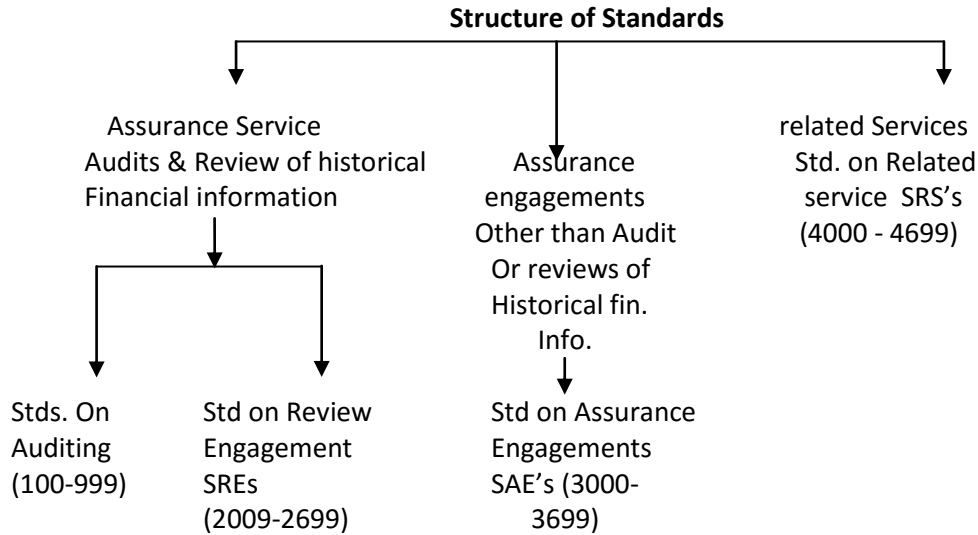
11.	ABC Pvt. Ltd. is a Manufacturer of jewelry. A senior employee of the Company informed you that the Company does not properly disclose the purity of gold used on the jewelry.	Clause ii - and x	
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In the case of ABC Pvt. Ltd. if purity of gold is not properly disclosed on the jewelry it amounts to defrauding the customers. That means the management is deceiving customers to obtain an illegal advantage. However, the auditor is concerned with fraudulent acts that cause a material misstatement in financial statements. As long as books of account are not falsified arising out of difference in the purity of gold, i.e., actual cost of the gold and the sale price of gold, it has no implication for the auditor.

Further, under CARO, 2016, the auditor may examine this from the view point of maintaining proper records of inventory. But even the requirement of maintaining proper records does not necessitate that purity as such should be mentioned on the gold itself. However, the purity of gold would have implication on the valuation of inventory. But this aspect is not required to be reported under CARO, 2016. Thus, from the view point of reporting on frauds under CARO, 2016, there is no implication for misstatement in the financial statements. Hence, no reporting is necessary for non-proper disclosure of purity of gold on the jewelry.

13.	Discuss the reporting requirements under the CARO, 2016 where a company has defaulted in compliance of Section sec 73 to sec 76 of the Companies Act, 2013 with regard to public deposits.	Clause v	
14.	The chief accountant of a public limited company contends that the auditor need not report on the defaults by the company in repayment of the deposits together with interest on the due dates for more than one year.	Refer Clause v	
15.	Under the CARO an auditor is required to report lion the regularity of payment of Provident Fund and Employees' State Insurance dues. Give alternative drafts of the report on this clause mentioning the circumstances of reporting.	Refer Clause vii	
16.	A company makes lump-sum deposit of estimated amounts of provident fund and employees state insurance dues and adjust the excess or deficit against the deposit for the following month. The company contends that it has large number of employees and it is very difficult to correctly estimate the exact liability towards these schemes. What are the duties of the auditor in this case?	Refer Clause vii	
17.	During the course of audit of Visionary Ltd. it is noticed that out of ` 12 lakhs of provident fund contribution accounted in the books, only ? 5 lakhs has been remitted to the authorities during the year. On enquiry, the Chief Accountant informed that due to financial problems they have not remitted but will remit the same as and when the position improves. As a Statutory Auditor, how would you deal? OR PQR Ltd. has not deposited Provident Fund contribution of ` 10 lakhs with the authorities till the year-end. (May 2008)	Refer Clause vii	(4 Marks) (May 2004) RTP May/2012/ 15 (May 2008)
19.	Big and Small Ltd received a show cause notice in December 2014 from the Central Excise department intending to levy a sum of ` 25 Lakhs. The Company replied to the above Notice in January 2015 contending that it is not liable for the proposed levy. No further action was initiated by the Central Excise Department up to the finalization of the audit for the year ended on 31 <sup>st</sup> March 2015. As the Auditor of the Company, how would you deal with this matter in your Report?	Refer Clause vii	(3 Marks) (Nov2014/ 11) RTP May2014

### PART III – STANDARDS ON AUDITING



**STANDARDS ON AUDITING**

- 200-299**:- Responsibilities & Principles of Auditors
- 300-330**:- Risk Assessment & Response to assessed risk
- 402-450**:- Audit consideration relating to an entity a service organisation and evaluation of mis-statement
- 500-580**:- Audit Evidence
- 600-620**:- Using work of others
- 700-720**:- Audit conclusion & Reporting
- 800-810**:- Special Consideration

**SA: 200: OVERALL OBJECTIVE OF THE INDEPENDENT AUDITOR AND THE CONDUCT AUDIT IN ACCORDANCE WITH STANDARDS ON AUDITING**

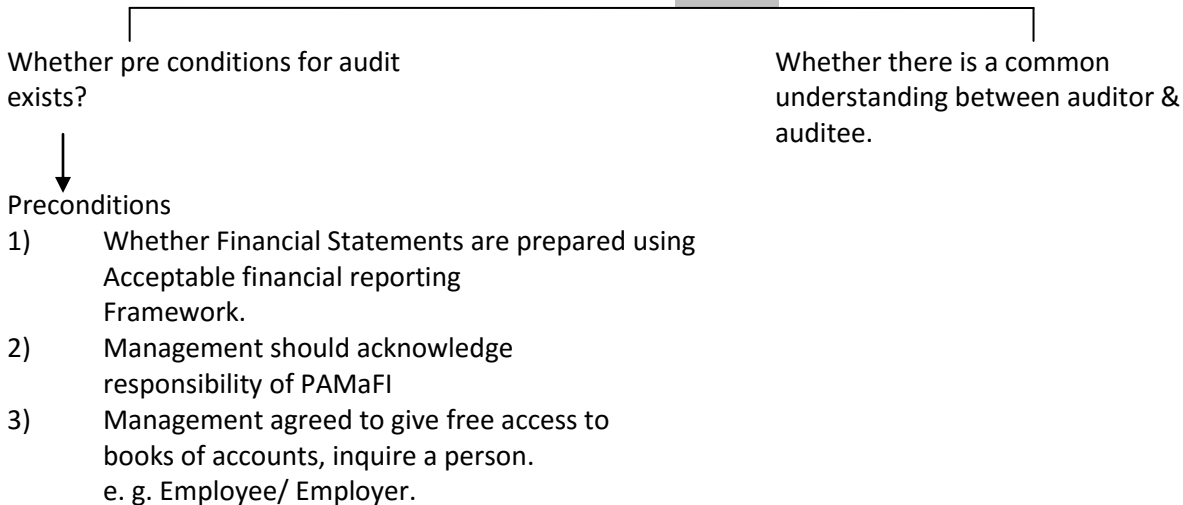
<b>PRINCIPLES</b>	<p><b>I) Ethical Requirement (KEY - COP<sup>2</sup>I)</b></p> <p>a) <u>Confidentiality</u> :- Auditor should Not disclose the information of Clients business unless it is not Legal or professional requirement to do so.</p> <p>b) <u>Objectivity</u>:- This could be achieved only by having independence of mind.</p> <p>c) <u>Professional Competence &amp; Due Care</u>:- By auditor should be updated with the latest developments in the field of Accounting &amp; Auditing.</p> <p>d) <u>Professional behaviour</u>: There must be professional relation between auditor and auditee.</p> <p>e) Integrity: Means honest behaviour, loyal attitude towards user of financial statements.</p> <p><b>II) Requirement to have attitude of professional skepticism</b>:- Auditor should always be alert towards audit evidence, reliability of documents, response to inquiries, etc.</p> <p><b>III) Professional Judgement :</b> Judgement taken by the auditor out of his professional experience in a audit situation- professional judgement is necessary in particular regarding decision about materiality, audit risks, the nature, timing &amp; extent of audit procedures.</p> <p>IV) Requirement to obtain sufficient &amp; appropriate audit evidence.</p> <p>V) Requirement to follow all standards on auditing.</p>
<b>OBJECTS</b>	<p>1) To form &amp; express an opinion on financial statement whether they are giving true and fair view or not</p>

	2) To detect fraud & Error 3) To obtain reasonable assurance about FS free from material misstatement. NOTE: User should not take opinion as guarantee about future viability & efficiency.	
<b>SCOPE</b>	I) Primary Scope a) Terms of Engagement e.g. branch auditor H.O Auditor etc. b) Pronouncement of ICAI e.g. SA's c) legislation e.g. CARO, Tax Audit LFAR (Long Form Audit Report) II) Secondary Scope	
	<b>Inclusion (Responsibilities of Auditor)</b>	<b>Exclusion (Responsibilities of Management)</b>
	1) Auditor should plan in such a manner that all aspect of F.S. are covered. 2) Auditor should verify: - Reliability - Sufficiently - Presentation & Disclosure Financial information. 3) To verify Accounting Estimates. 4) Determine & Segregate Material & immaterial items.	(Key : PAMaFI) P: Policies: Selection & application & accounting policies. A: Assets: Safeguarding of Assets M: Maintenance of Books of Accounts F: F.S.: Preparation of F.S. I: Internal Control: Formulation & Implementation of Internal Control

**SA 210 : AGREEING WITH THE TERMS OF AUDIT ENGAGEMENT**

Considerations to be given before acceptance of an audit?

**Decision**



**LETTER OF ENGAGEMENT :**

Audit engagement letter is a letter issued by auditor to the management. It shall contain **COS t MP Fee**

- C:** Confirmation of Acceptance
- O:** Objective of Audit
- S:** Scope of Audit
- M:** Management Responsibilities
- P:** Tentative Plan
- F:** Fees

**RECURRING AUDITS**

On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The standard prescribes that auditor may decide not to send a new engagement letter for each period.

However, in following circumstances, the auditor may think it appropriate to send a new engagement letter to client.

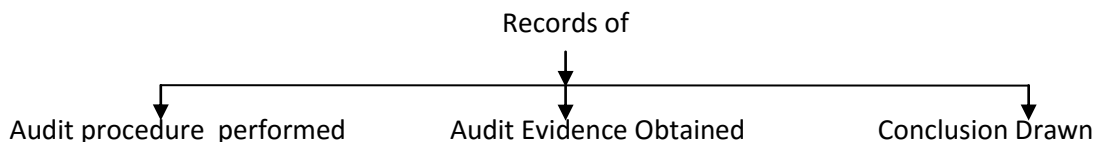
- Any indication that the entity that misunderstood the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in ownership.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

**(SA220) QUALITY CONTROL FOR AUDIT WORK**

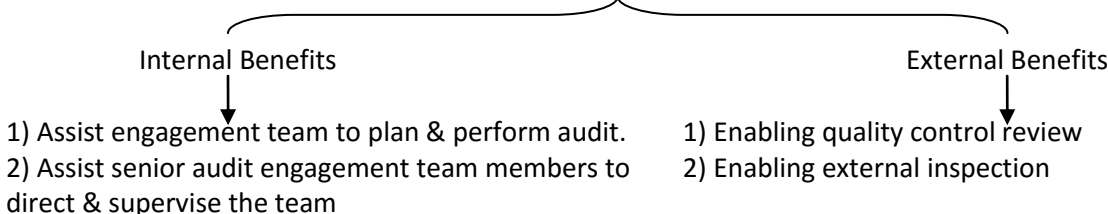
- 1) The purpose of this Standard is to establish standards on the quality control regarding:
  - Policies and procedures of an audit firm regarding audit work generally.
  - Procedures regarding the work delegated to assistants on an individual audit.
- 2) The objective of issuing auditing standards is to provide similar quality of services to the client by every auditor so that it should not make any difference to the client, with whatever firm of auditor; client is getting his books of accounts audited.
- 3) For providing similar quality of services, Institute has advised that every firm of auditor should follow all standards on auditing issued by the Institute and accordingly their quality of services will be similar.
- 4) Moreover, such quality control should be maintained not only at firm level but also at individual level and for the purpose it becomes responsibility of the auditor to communicate, to guide, to supervise, to control necessary auditing standards to the subordinates working under him.
- 5) **Following are the essential factors for incorporating quality control audit work:**
  - Professional Requirements – Adherence to basic principles such as independence, integrity, objectivity, confidentiality, etc.
  - Skills and competence – Audit personnel should have required degree of skill and competence.
  - Assignment – Audit work should be assigned only to competent personnel.
  - Delegation – There is to be sufficient direction, supervision and review of work at all levels.
  - Consultation – Consultancy within and outside the firm with experts.
  - Acceptance and retention of clients – Evaluation of prospective client and review of existing client should be done.
  - Monitoring – Continued adequacy and effectiveness of quality control policies should be monitored.

**SA – 230 AUDIT DOCUMENTATION (REVISED)**

**Meaning of Audit Documentation:**



**Benefits of Audit Documentation**

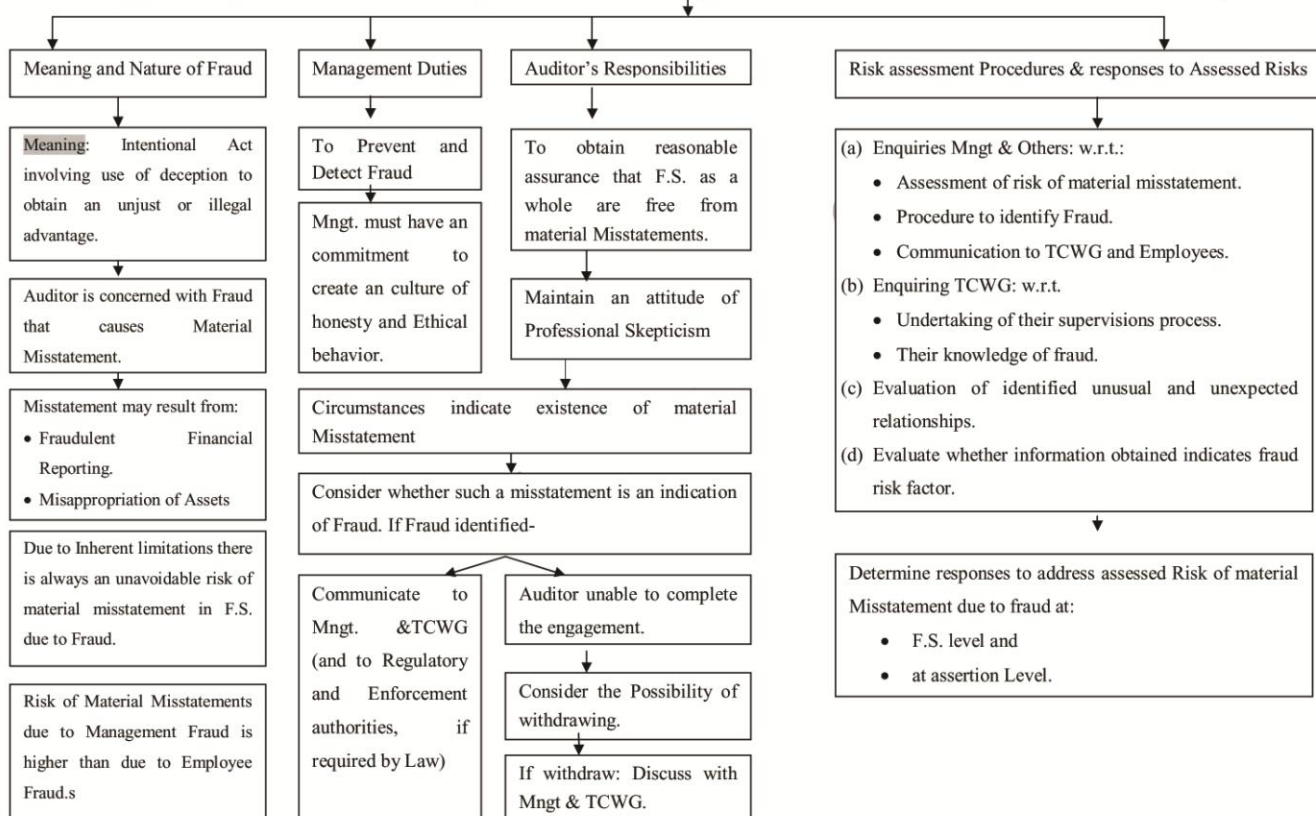


3) Establishing the accountability of engagement team.

**Do You Know :-**

- 1) Working papers are property of auditor
- 2) He can make available copy of working paper to client on request at his discretion
- 3) Preserve upto 7 yrs.
- 4) Working papers should be prepared within 60 days after the date of audit report
- 5) Auditor shall not delete or discard audit documentation but he can modify → explain reason for modification & when & by whom they were made or reviewed?

**SA 240 (Revised) – The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements**



**Some example how fraudulent financial reporting and misappropriation of an asset can be done.**

**Fraudulent Financial Reporting**

- 1) Manipulation, falsification or correlation of accounting records.
- 2) Misrepresentation/ Omission of events, transactions or other significant inform actions.
- 3) International misapplication of accounting principles.
- 4) Recording fictitious journal entries.

**Misappropriation of Assets**

- 1) Embasseling receipts (e. g. misappropriating collection on account receivables)
- 2) Stealing physical assets (e. g. Stock for personal use)
- 3) Causing an entity to pay for goods and services not received. (e. g. payment to fictitious vendor or employee)

- |   |   |
|---|---|
| 5) Inappropriately adjusting assumptions.                               | 4) Using an entity assets for personal use. |
| 6) Omitting, advancing or delaying recognition in FS of entries/events. | (e. g. loan to related parties)             |

## SA 250: CONSIDERATION OF LAWS & REGULATION IN AN AUDIT OF FINANCIAL STATEMENT

### Impact of Non compliance of Laws & Regulations

- 1) Non compliance of which effect Going Concern.
- 2) Non compliance of which resulting in misstatement in F. S.
- 3) Non compliance of which attract entity towards heavy penalty.

### Responsibility of Auditor:- (Audit Procedure)

Auditor should consider the risk of non-compliance with Laws & Regulation & should obtain Sufficient & Appropriate Audit Evidence that all Laws & Regulations have been followed.

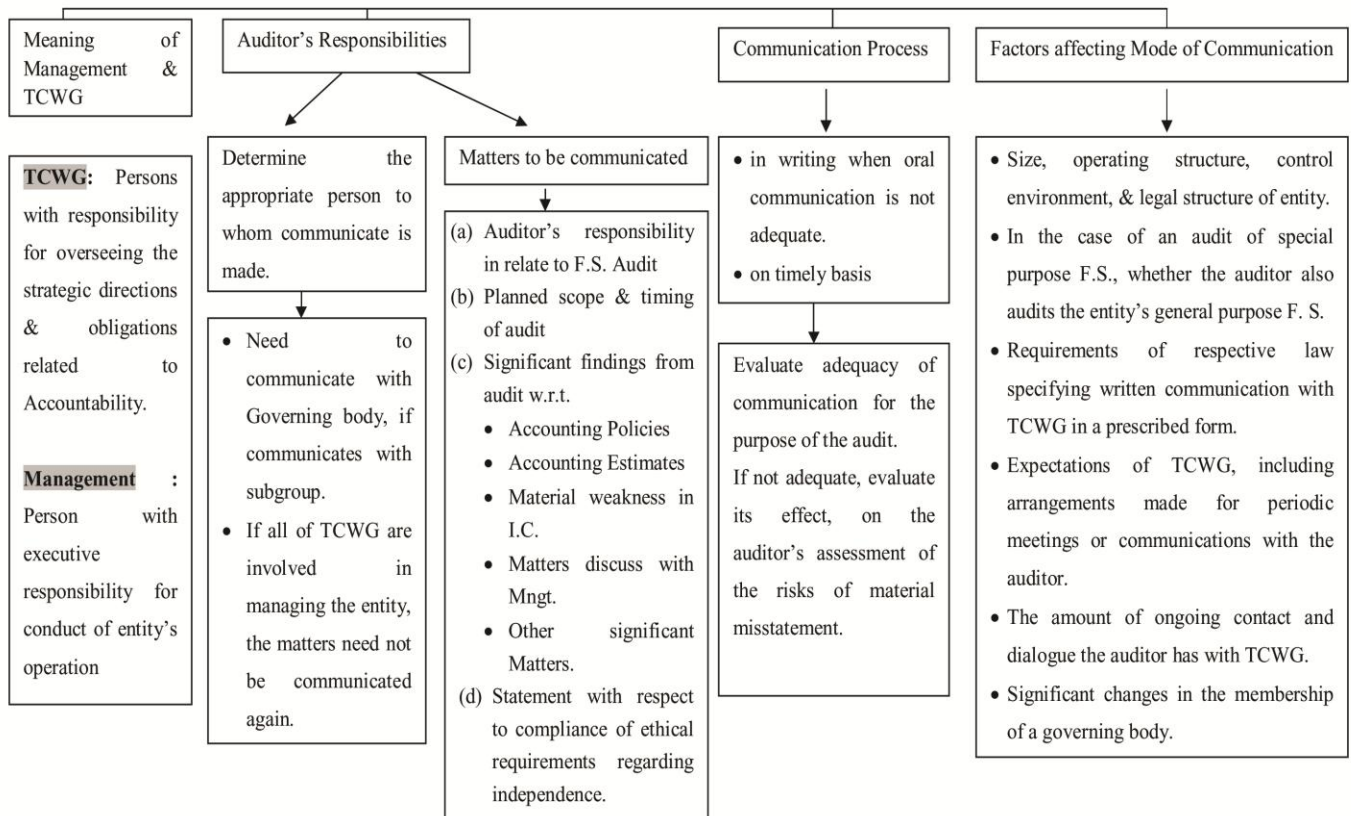
### Audit Procedure

- 1) Understand the entity's environment.
- 2) Obtain exhaustive list represented by management of applications of laws and regulations.
- 3) Discussion with - .  
Branch Auditor, Internal Auditor, Legal Consultant, Legal officers.
- 4) Obtain/expert's opinion
- 5) Verification of correspondence with departmental authority?
- 6) Auditor should verify whether management has developed the system by which it can be informed about non-compliance.
- 7) Verification or computation of:
  - Figure
  - Return
  - Challan
  - Duty paying documents
- 8) Obtain Sufficient & Appropriate Audit Evidence

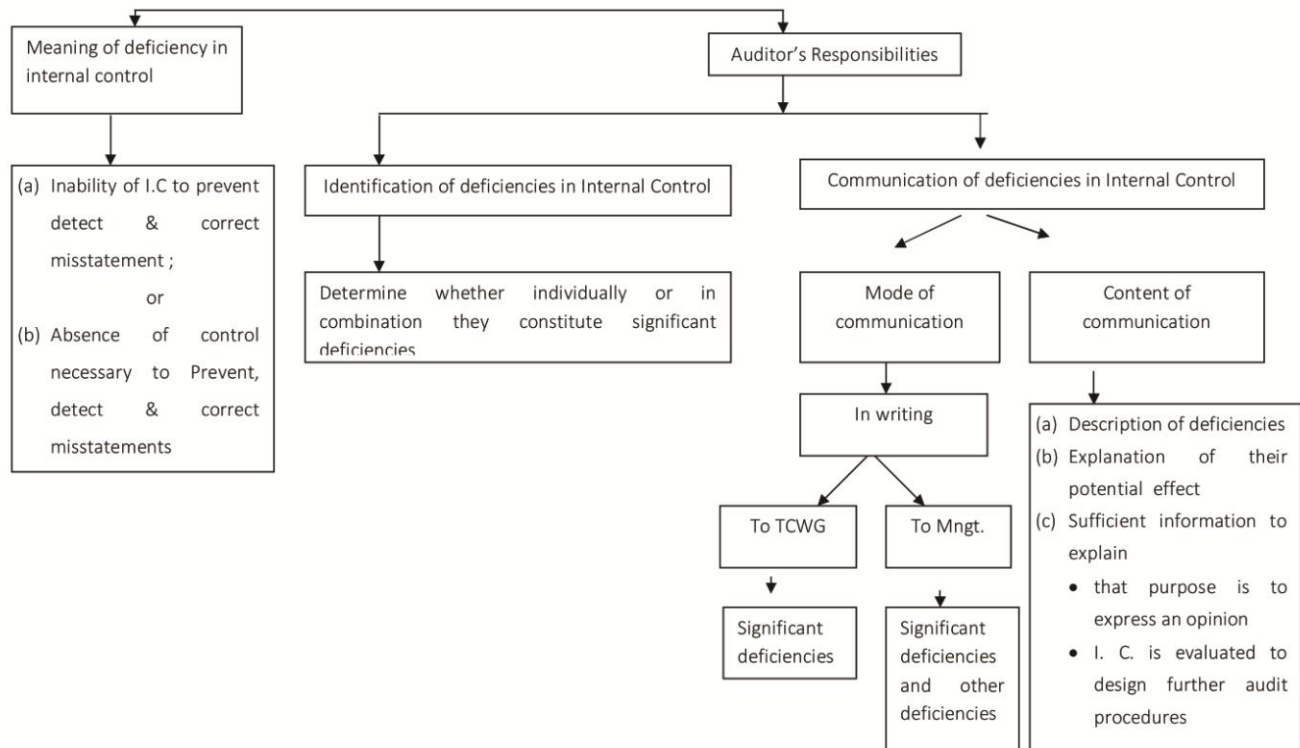
### What if non Compliance is Found?

- 1) Immediately inform to management and those charged with governance.
- 2) Ask management to comply & issue qualified opinion report.

## SA 260 (Revised) – “Communication with TCWG”



## SA-265 “Communicating Deficiencies in Internal Control to TCWG & Management





**SA 299: RESPONSIBILITIES OF JOINT AUDITOR:**

**Jointly & Severally Resp.**

- 1) Discussion of work, overall audit plan and decision taken regarding audit procedure.
- 2) Matters raised by one of the joint auditor but solved mutually by all joint auditors.
- 3) Unallocated and undivided work
- 4) Verification of compliance of statutes relating to Financial Statement, accounting policies and format of FS
- 5) Disclosure requirements regarding FS
- 6) For obtaining an evaluation written representation of mgmt.

**Individually Resp.**

- 1) Individually divided working area.
- 2) Audit procedure decide by him.
- 3) Use of other’s work.
- 4) Conclusion of his procedure.
- 5) Reviewing the reports-, of the branches allocated to him
- 6) Written representation by mgmt for a particular area. .

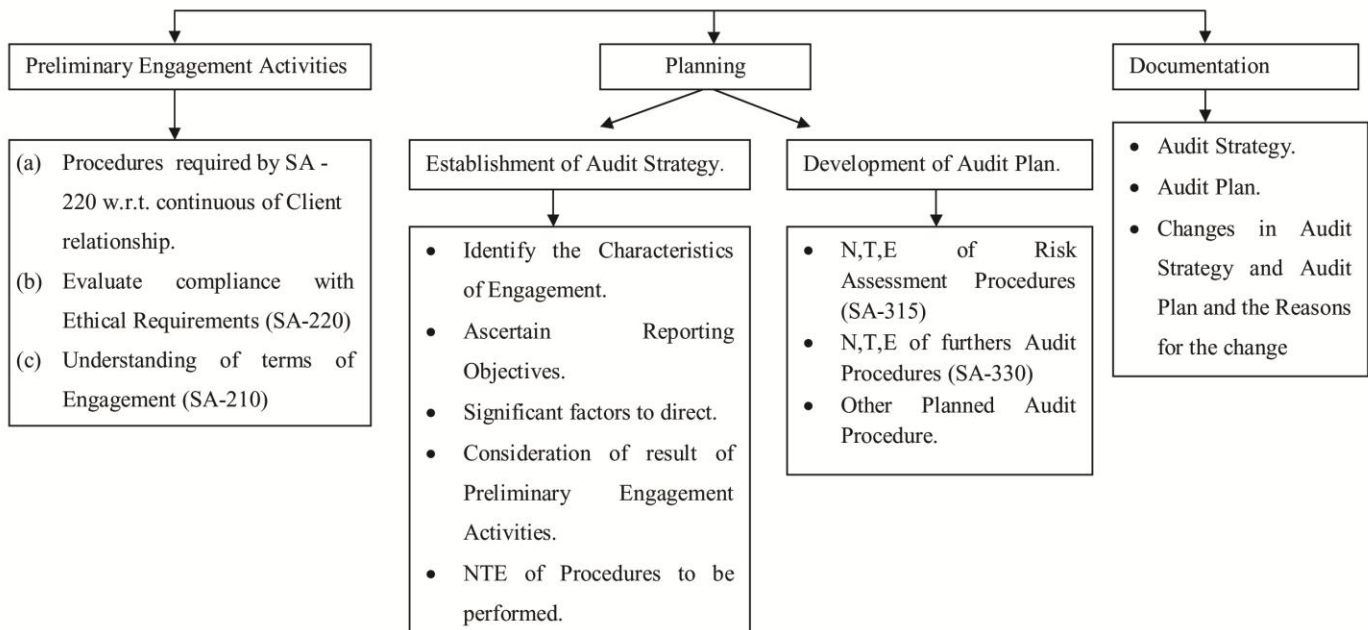
**Points to be noted :**

- 1) Each Joint auditor is entitled to rely on the other and need not evaluate the work of the joint Auditor.
- 2) Each Joint auditor is entitled to assume that the other Joint auditor inform him about significant matters related to his area.

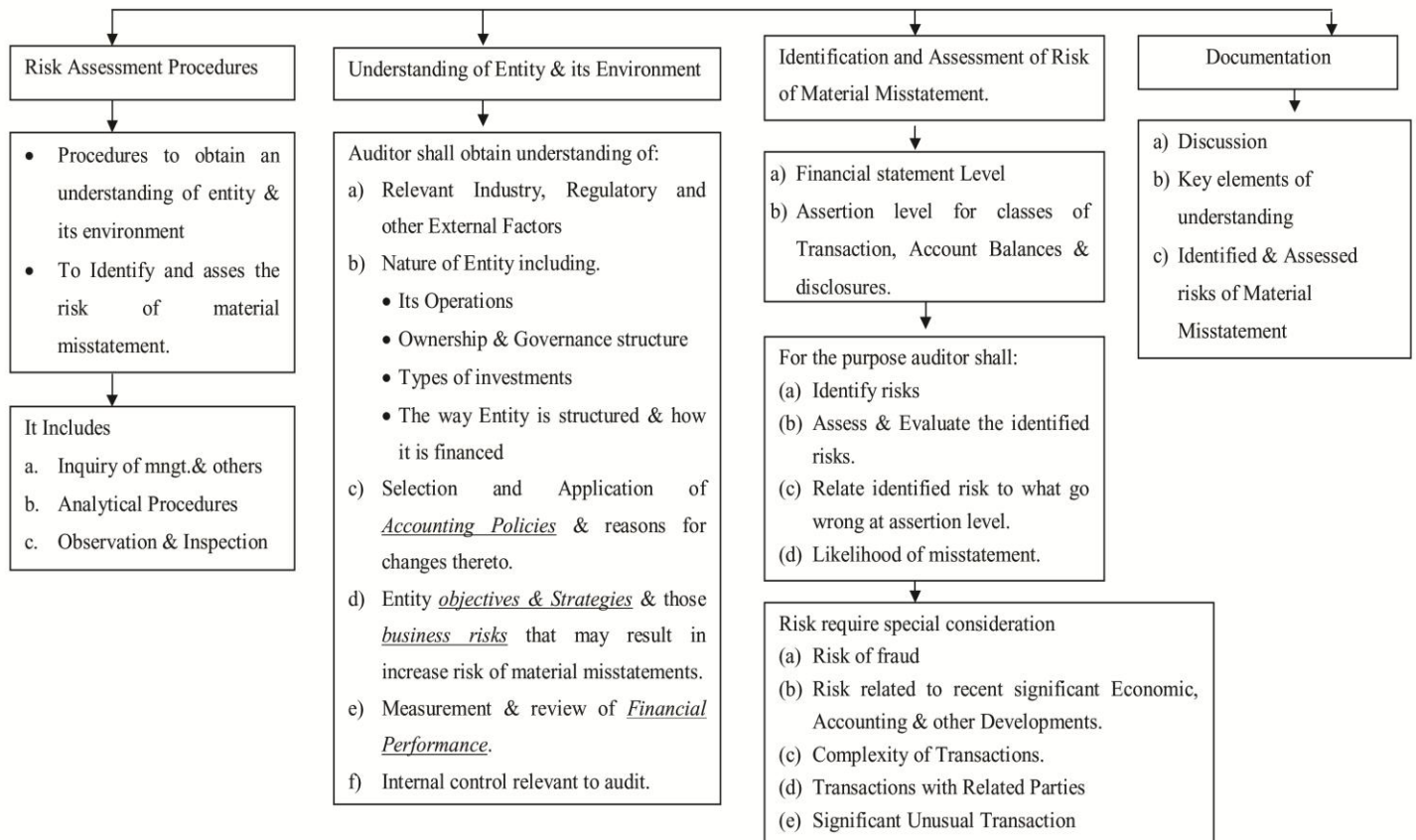
**JOINT AUDIT REPORT :**

Usually Joint auditor are of unanimous opinion but if one or more joint auditor are not in agreement over the opinion, each disagreed joint auditor may submit his report on the disagreed point separately

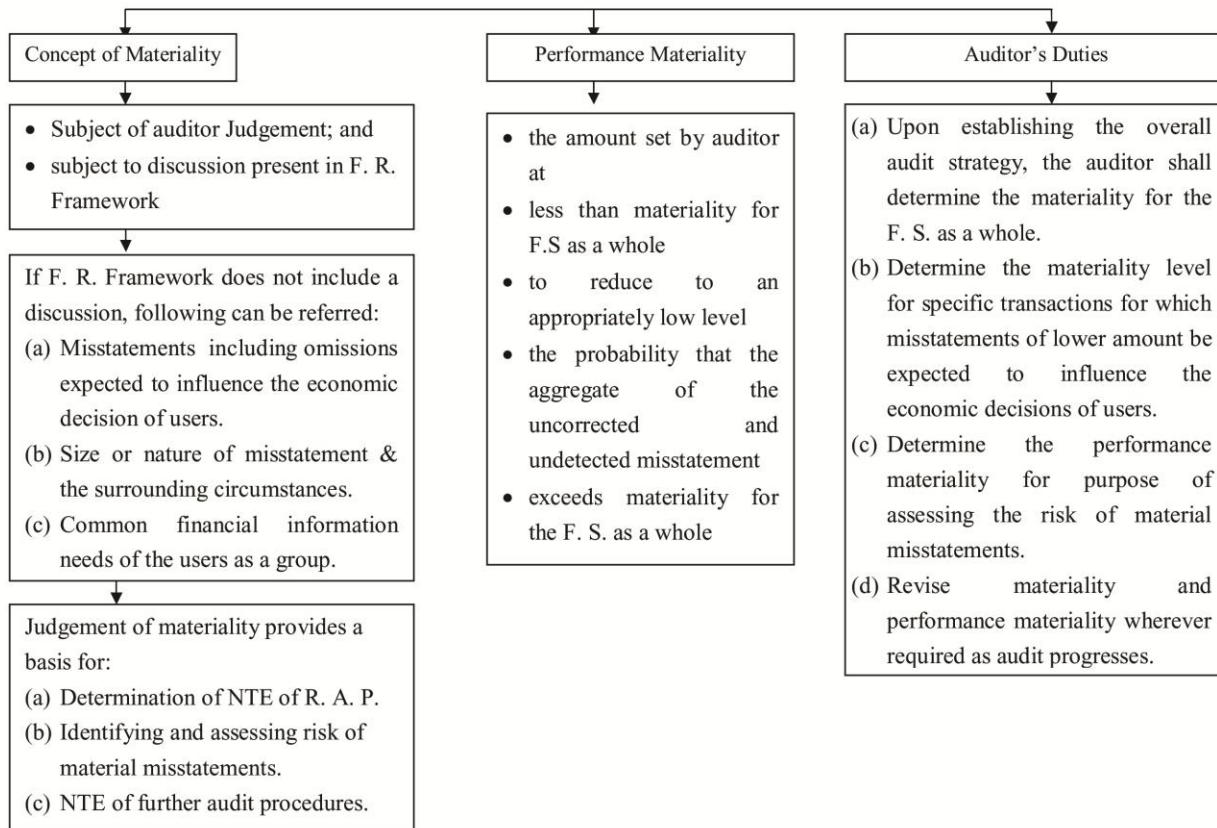
**SA 300 (Revised) – Planning in an audit of Financial Statements**



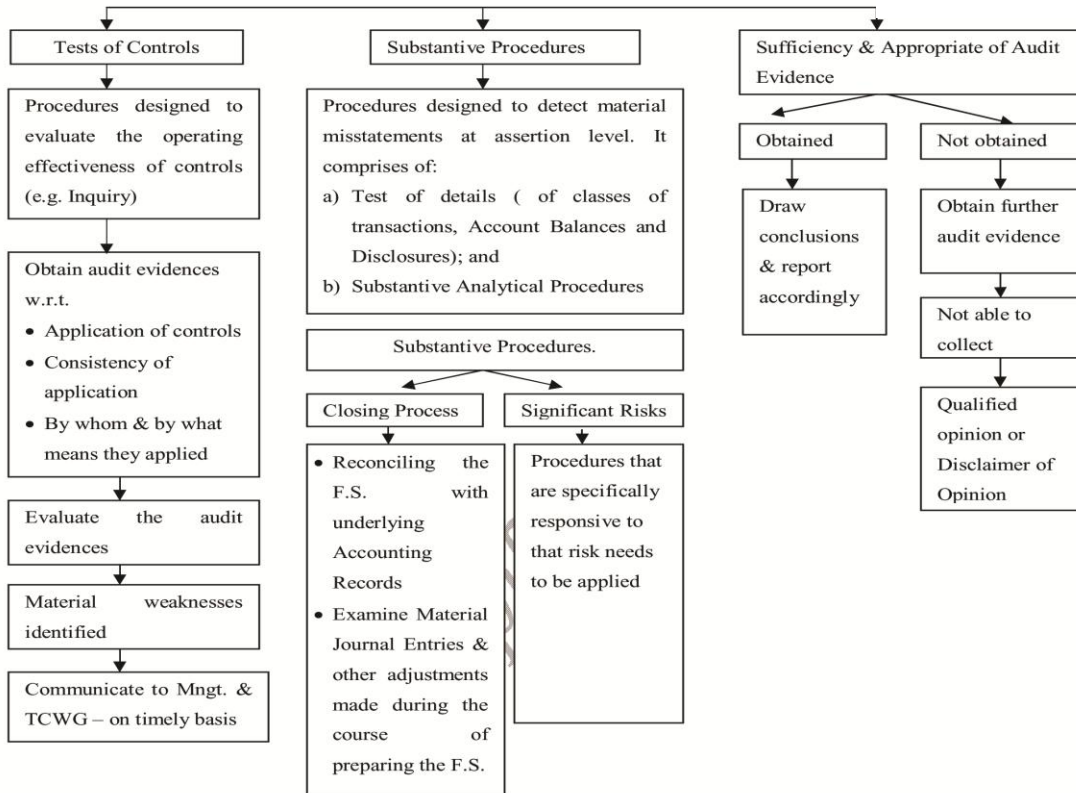
## SA – 315 (Revised) – Identifying and Assessing the Risk of Material Misstatements through understanding the Entity and Its Environment.



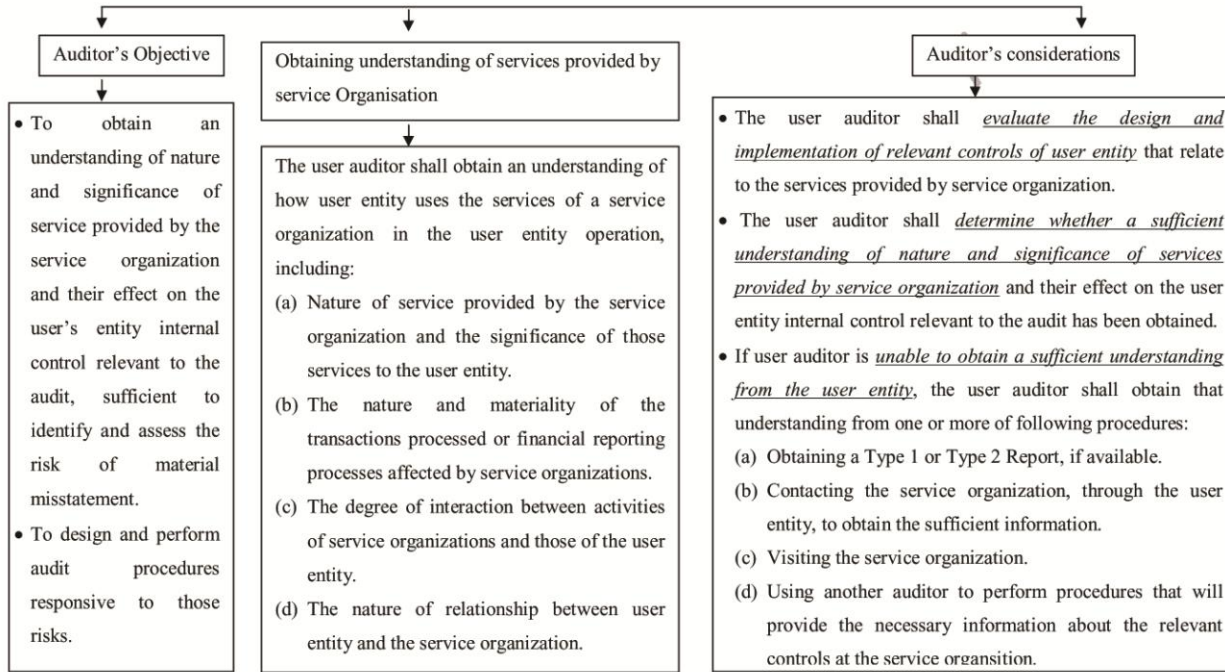
## SA 320 (Revised) “Materiality in Planning and Performing an Audit”



***SA – 330 “Responses to assessed Risks”***



**SA 402 (Revised) – Audit Considerations relating to an Entity Using a Service Organisation**



**User Auditor:** An auditor who audits and Reports on the financial statements of a user entity.

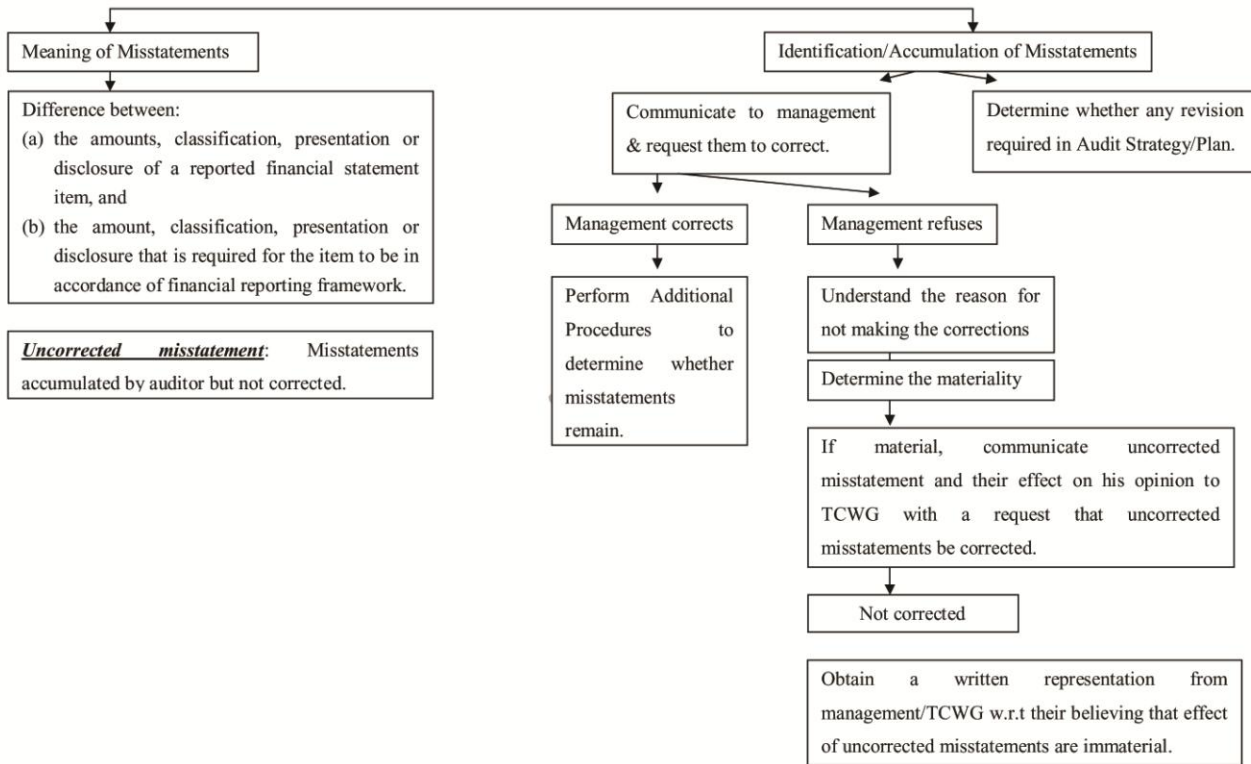
**User Entity:** An Entity that uses a service organization and whose financial statements are being audited.

**Type 1 Report:** Report on the description and design of internal controls at a service organization.

**Type 2 Report:** Report on the description, design and operating effectiveness of controls at a service organisation.



## SA 450 “Evaluation of Misstatements Identified during the Audit



### SA 500: AUDIT EVIDENCE

#### Methods to obtain Audit Evidence:- (KEY: O I C A I)

**O:** Observation → Process

**I:** Inspection → Documents, books of accounts, inventory, cash, minutes book etc.

**C:** Computation → Data

**A:** Analytical Review (SA 520) → Current Ratio, GP ratio etc.

**I:** Inquiry & Confirmation → employee, employer, third party confirmation (SA 505)

#### Judgement of Sufficient & Appropriate Audit Evidence:-

It is auditor's professional judgement.

Judgement may depend on the materiality of item, risk; of misstatement, strength of Internal control, nature and complexity of business.

#### Types of Audit Evidence

A) On the basis of Nature	B) On the basis of Source
<ul style="list-style-type: none"> <li>• Oral</li> <li>• Visual</li> <li>• Documentary</li> </ul>	<ul style="list-style-type: none"> <li>• External</li> <li>• Internal</li> </ul>

#### Audit Procedure

COMPLIANCE PROCEDURE	SUBSTANTIVE PROCEDURE
----------------------	-----------------------

Test for Internal Control whether - - Exists - Effective - Is it in continuation in operation during the year	Substantive test for Evaluating - validity - accuracy - completeness - proper disclosure of data e.g. Verify accounting system, ratio analysis, vouching, verification of assets and liabilities etc.
--	--

**Do You Know ?**

**RELIABILITY:**

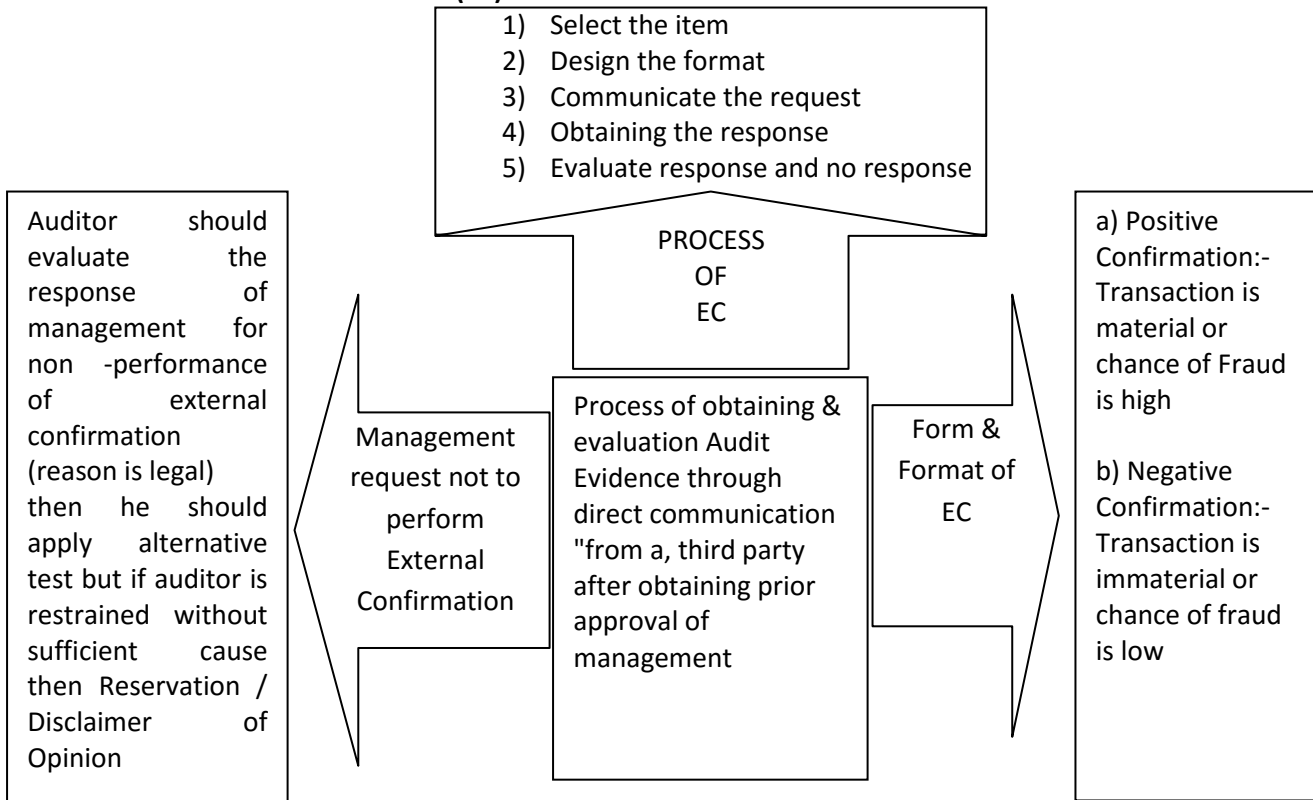
- 1) External audit evidence are more reliable than Internal audit evidence.
- 2) Internal audit evidence are reliable when Internal control is effective.
- 3) Documentary evidence are more reliable than oral.
- 4) Evidence obtained by an auditor is more reliable than evidence obtained from others.

**NOTE:** Auditor gets increased assurance related to an item of financial statement. If he finds consistent audit evidence from different different sources.

**SA 501: AUDIT EVIDENCE (ADDITIONAL CONSIDERATION FOR SPECIFIC ITEMS)**

Physical verification of stock [KEY – YAC 2 TP]	Litigation & Claims (UVW)	Segment Reporting
<p><b>Y:</b> Year End: Auditor should verify the stock physically atleast once in a year. Existence of stock Conditions <b>A:</b> Additional audit Procedure: Auditor shall apply additional audit procedure if he has obtained from physical verification. Additional Audit procedure may include: 1) Reconciling the changes in inventory (if any) .. 2) Verify the procedure) adopted by the management for physical verification 3) He should ensure that appropriate off procedure we re followed by the mgmt. 4) Obtain Written representation from management about Completeness of information regarding the inventory <b>C:</b> Control Internal Control over inventory, records, issues, receipts. slow moving stock, non-moving stock. <b>2:</b> Follow AS-2 <b>TP:</b> Third Party: Third party confirmation as per the SA-505. (in case of mortgage, cease of goods by Dept.)</p>	<p><b>U:</b> updates: Inquiry with management how management updates itself of litigations and claims. <b>V:</b> Verify: Discuss matters and verify the facts given by mgmt with -expert -legal consultant -branch auditor -Internal auditor -Employees -Officers -Review of books of accounts -Minutes of Board Meeting / EGM/ AGM. <b>W:</b> Written Representation': Obtain written representation from management about exhaustive list of litigations and claims, and their latest updates, management accounting estimation etc.</p>	<p>Refer AS 17</p>

**SA 505: EXTERNAL CONFIRMATION (EC)**



NOTE: EC depends on auditor's personal judgement to use or not But generally the following area require EC:

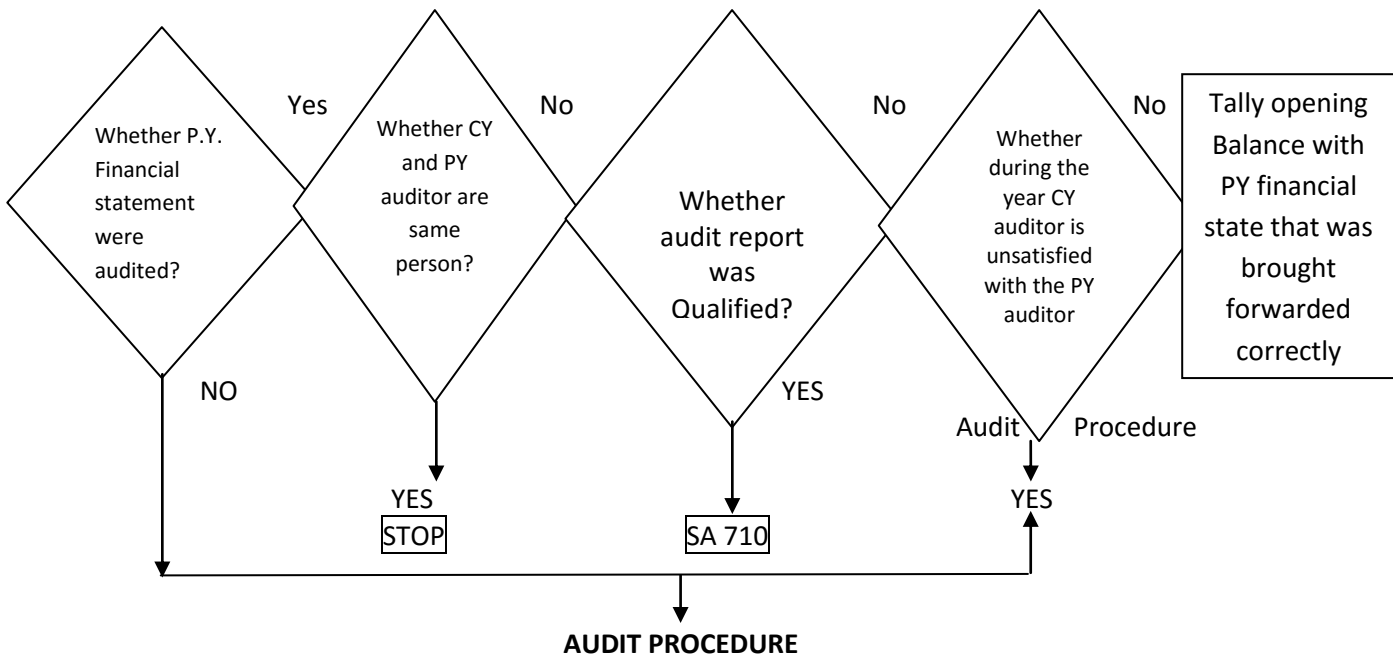
- 1) Confirmation of Bank balance
- 2) Debtors/ Creditors
- 3) Stock/Assets held by third party and
- 4) Documents mortgaged with bank



**SA 510: INITIAL AUDIT ENGAGEMENT (OPENING BALANCE)**

**Auditors duty in relation to opening balance**

- To read the latest audited financial statement
- To obtain sufficient and appropriate audit evidence about the prior period closing balance have been correctly brought forward to the current period



Auditor should check LY Closing Balance (**Key - IFRS LC<sup>2</sup>D**)

I: Investment: Verify registry, demat A/c, external confirmation, physical verification etc.

F: Fixed Assets: Verify registry, valuation, expert’s report.

R: Reserves: Check balance sheet of Previous Year.

S: Share Capital: Check share capital register

L: Loans

Cash & Bank Balances:

C2: Creditors

D: Debtors

} Obtain sufficient & appropriate audit evidence + Confirmation

**SA 520: ANALYTICAL PROCEDURES :**

**I) MEANING:**

Analysis of ratio and trends and resulting investigation of deviation from predetermined set of standard of performance

OR

Relationship between two sets of financial statements.

**II) WHEN TO USE: (SPA)**

S: May be used a substantive procedure.

P: At the time of planning.

A: To investigate unusual fluctuation at the time of concluding audit.

III) RELIABILITY: Reliability depends upon:

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9320473019

**CA Vidhi Chedda**  
8879377367

**Prof Khushboo Sanghavi**  
8082736683

- 1) Materiality of item.
- 2) Risk of Misstatement
- 3) Assessment of internal control risk.
- 4) Reliable financial information and reliable financial information depends upon adequacy of internal control system.

**IV) SPECIAL NOTE:**

In case of material item, analytical procedure may be used as additional audit procedure but not substituted audit procedure.

**PROCEDURE FOR CHECKING TRANSACTION:**

- 1) Apply analytical procedure
- 2) Apply test of control (Compliance procedure)
- 3) Apply detailed & substantive procedure,
  - i) Verification of invoice
  - ii) Verification of authorization
  - iii) Verification of total of invoices
  - iv) Verification of Debit/ Credit note
  - v) Analysis of increase/ decrease in price
  - vi) Reconciliation of accounts etc.

**SA 580 : WRITTEN REPRESENTATION:****I) MEANING:**

Clarification, confirmation, explanation given by management to auditor during the course of his audit.

II) Usually written representation are treated as additional audit evidence, and cannot be treated as substitute audit evidence. But in some exceptional circumstances they might be the only, audit evidence available.

E.g. Long term/ short term investments intention to hold the asset.

III) Written representation should be checked in the light of other audit evidence available.

IV) Reassess the reliability of already received written representation if:-

- i) management denied to provide written representation on any other matter.
- ii) if person providing written representation appear to be fake.
- iii) if person providing written representation found in a fraud.

V) If auditor ask management and if they give only oral consent, then the auditor can make a letter of is understanding and get it acknowledged by the management.

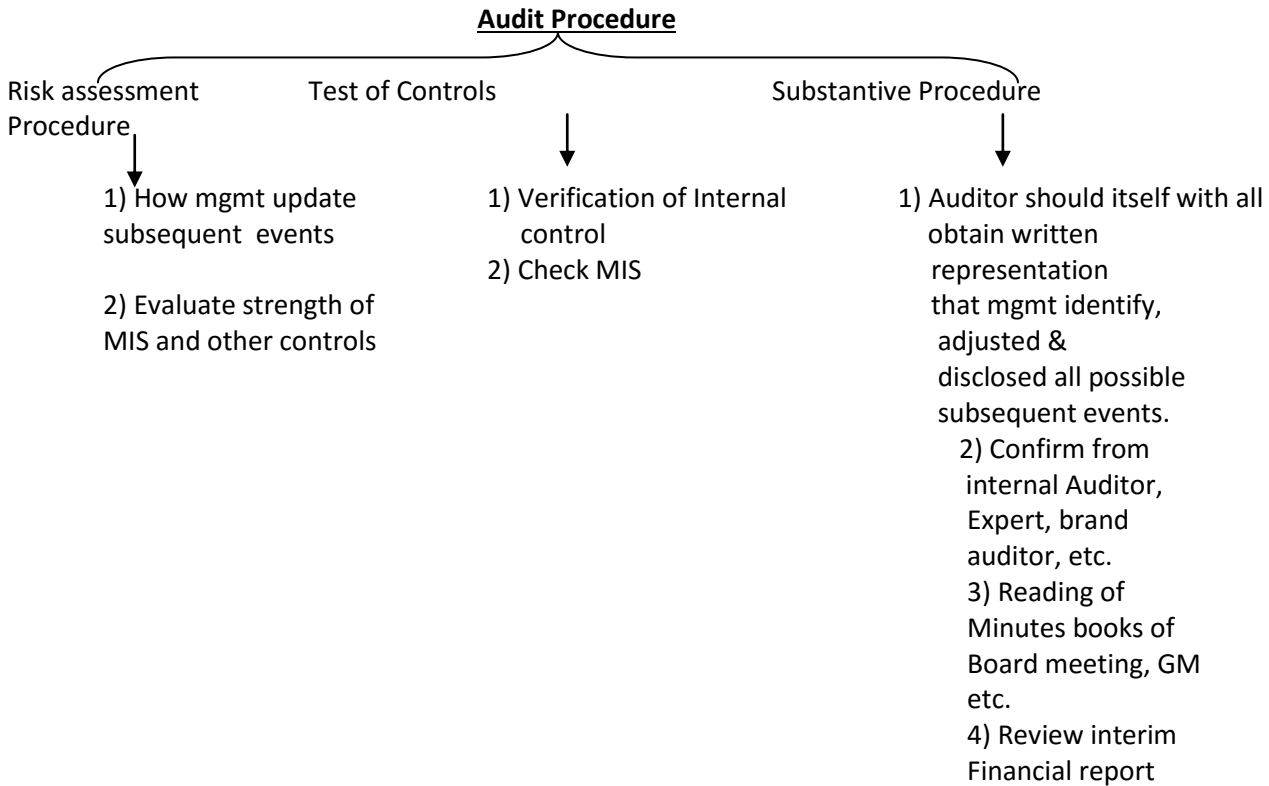
**SA 560: SUBSEQUENT EVENTS:**

**I) MEANING:**

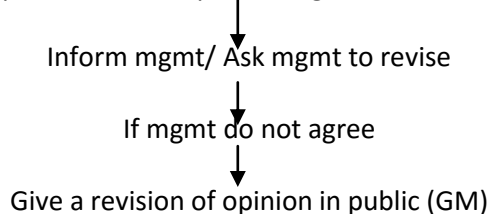
Events occurring in between balance sheet date and date/of auditor's report.

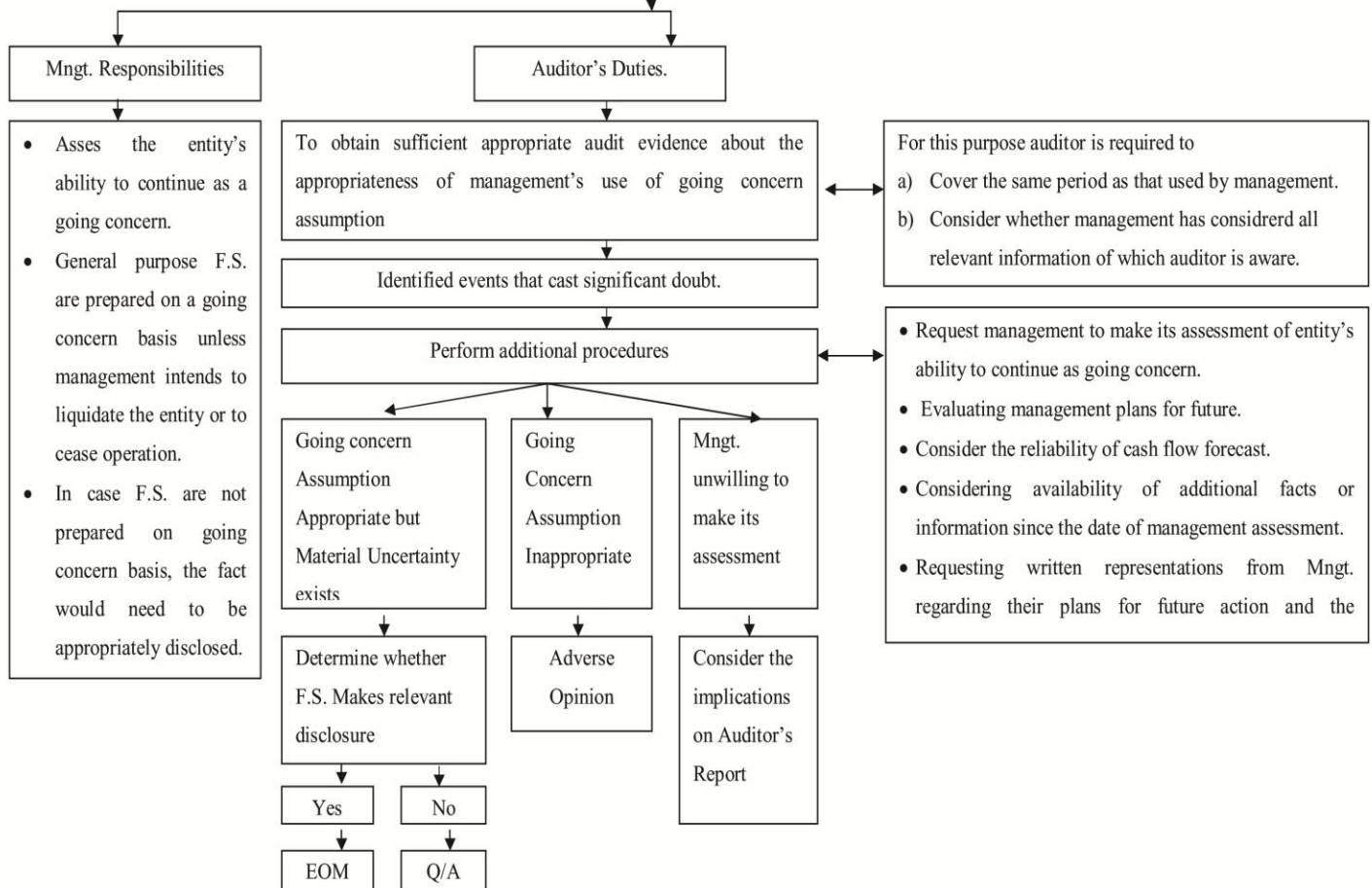
**II) AUDITOR'S DUTY:**

He should obtain sufficient and appropriate audit evidence that all subsequent events identified and disclosed properly.



**NOTE:** Subsequent events after audit report and before presenting in AGM



**SA – 570 (Revised) “Going Concern”****SA 550 : RELATED PARTIES:****I) MEANING :**

Related parties (RP) either defined by Financial Reporting Framework (AS-18) or if inadequately defined then-

- 1) Holding Co.
- 2) Subsidiary Co.
- 3) Fellow Subsidiary Co.
- 4) Associated
- 5) Investors
- 6) Key Managerial Personnel ,

**II) AUDITOR'S DUTY :**

- 1) Understand relationship
- 2) Asses the risk in relation to RP transaction
- 3) Professional Skeptism.

**III) PROCEDURE :****STEP I:**

- 1) RISK ASSESSMENT PROCEDURE: (Inquiry from mgmt)

[NRTC]

N-Name of RP

R- Relationship,/ T - Transactions

C - Change in relationship compared to previous year.

**STEP II :**

INQUIRY ABOUT CONTROL: [IA]

I- Identification of RP

A- Authorised and approval

**STEP III :**

OTHER AUDIT PROCEDURE: (SWATI ViR)

S - Share Capital Register

W- Written Representation

A- Last year annual report

T -Tax Audit Report

I- Investment register

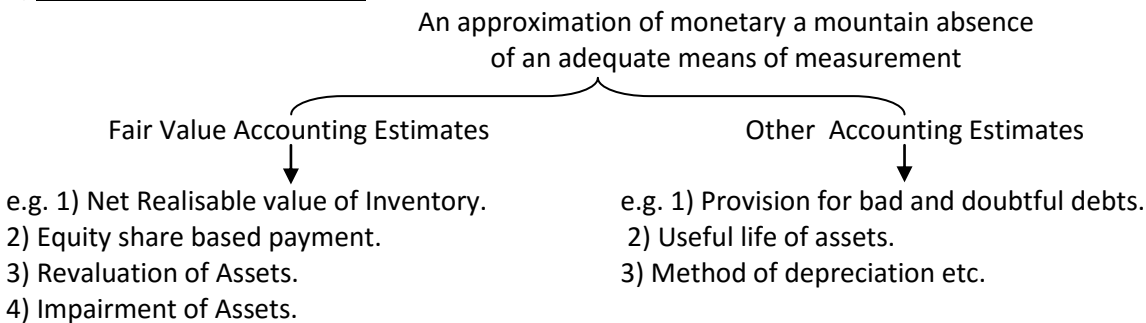
V-Verification of transactions authorised transactions & pricing is fair.

R - Review of DAMR

D - Director's' Report / Register  
 A – Articles of Association  
 M - Memorandum of Association  
 R- Register u/s 189 of Companies Act, 2013  
 (old Cos Act, 1956 Sec 301)

**SA 540: ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES AND RELATED DISCLOSURE**

**1) ACCOUNTING ESTIMATION**



**III) DUTIES OF AUDITOR :**

Auditors should obtain S & A A/E that accounting estimates are reasonable and disclosed properly.

**PROCEDURE**

Risk assessment procedure Inquiry with mgmt) (DR. ACE)  
 D: **Determine:** How they determine items requiring estimates?  
 R - **Reliable Information** How they get reliable information related to accounting estimation ?  
 A- **Assumptions:** How they establish Appropriate "assumptions?  
 Change in method or assumptions.  
 C- **Change:** Change in method or assumptions.

Further procedures (Very Close Wife)  
 V: **Verify:** Verify the judgement of mgmt. independently by the auditor himself or by use of expert.  
 C: **Compare:** Compare Estimate in light of other accounting estimates.  
 W: **Window dressing:** If accounting estimates are related to current assets and current liabilities- check window dressing

E - Experts: How they assess need of experts?

NOTE: General provisions are required on the basis of historical data.  
e.g. warranty claims.

### SA 600

<b>NAME:</b>	Using work of another auditor.
<b>DEFINITION:</b>	Using work of branch auditor and auditor of subsidiary company.
<b>WHY ?:</b>	Under Co's Act principal auditor is required to consider and incorporate branch auditor's report.
<b>CO-ORDINATION :-</b>	[Key - PIC] <b>P:</b> Planning stage: Meeting at planning stage/suggestion/important consideration at the planning state from principal auditor to branch auditor. <b>I:</b> Information: Mutual exchange of information for relevant importance. <b>C:</b> Completion date: Expected date of completion and reporting.
<b>EVALUATING-WORK &amp; USE:</b>	1) Review all branch auditors report (Not evaluate) branch auditors , report (Not evaluate) 2) Ask explanation if required. 3) Document followings: i) Branch auditor's name ' ii) Significant findings Significant findings iii) Treatment of significant findings in his report. iv) Procedure applied by other auditor.

### SA 610

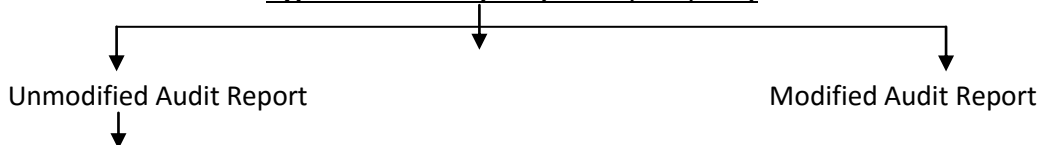
<b>NAME:</b>	Using work of Internal auditor.
<b>DEFINITION:</b>	Auditor to satisfy management needs and mainly appointed to review internal control, propriety of transaction, safeguarding of assets.
<b>WHY ?:</b>	CARO, 2003 require evaluation of internal controls or if management to found appropriate, much of his work will be useful for external auditable, (statutory / branch auditor) which increase the efficiency of external auditor.
<b>CO-ORDINATION :-</b>	[Key - AP ki PIC] A; Area: Any specific area to be checked. P: Procedure: Any specific procedure to be followed. PIC → Same as SA – 600
<b>EVALUATING-WORK &amp; USE:</b>	<b>Evaluate whether:</b> 1) The work performed by internal auditor is having competence and skill. 2) the work was properly supervised reviewed and documented (check due diligence of internal auditor) 3) Confirm from internal auditor whether strictly followed all rules and regulations. 4) Evaluating the audit procedure. 5) Mgmt action on its objection in report. 6) In case of material items when using his work, external auditor may apply supplementary tests. *MAIN ASPECTS THAT WOULD BE CONSIDERED TO FIND OUT THE EFFECTIVENESS OF INTERNAL AUDIT DEPT:

	<ol style="list-style-type: none"> <li>1) Organisational status</li> <li>2) Scope of Work</li> <li>3) Technical Competence</li> <li>4) Due professional</li> <li>5) Evaluation of plan documentation</li> <li>6) Collection of S &amp; A A/E RELIABILITY OF INTERNAL AUDITOR'S REPORT: Auditor shall consider following before relying on the internal auditor's report whether:-             <ol style="list-style-type: none"> <li>1) the internal auditors are free of any conflicting responsibilities (maker- Cheker)</li> <li>2) There are any constraints placed on the internal audit functions by mgmt or those charged with governance. There placed on functions by mgmt or those charged with governance.</li> <li>3) To what extent mgmt acts on the recommendation of internal audit.</li> <li>4) Activities of the internal audit function are properly planned, supervised and documented. Activit</li> <li>5) Internal auditors have a adequate technical training and knowledge.</li> </ol> </li> </ol>
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**SA 620**

<b>NAME:</b>	Using work of an expert.
<b>DEFINITION:</b>	Specified body of knowledge other than auditing and accounting
<b>WHY ?:</b>	<p>Expert's work constitutes audit evidences m respect of matters which are:</p> <p style="text-align: center;">↓</p> <p style="text-align: center;">Complex</p> <p style="text-align: center;">↓</p> <p style="text-align: center;">Material</p>
<b>CO-ORDINATION :-</b>	<p>[Key - FD]</p> <p>F: Form: Expected form and content of his report. (e.g. flow chart, pie diagram etc.)</p> <p>D: Date:Expected date of completion.</p>
<b>EVALUATING-WORK &amp; USE:</b>	<ol style="list-style-type: none"> <li>1)Check membership no. From authorised institute/ licence no.</li> <li>2) Experience and reputation.</li> <li>3) Relationship with client.</li> <li>4) Restrictions on scope.</li> <li>5) Evaluate whether data given to expert were reliable and sufficient.</li> <li>6) If data is complex, ask experts to explain how he relied on data.</li> <li>7) Evaluate method and assumptions and their consistency</li> </ol> <p style="text-align: center;">↓</p> <p>If change in method explanation required from expert.</p> <ol style="list-style-type: none"> <li>8) Evaluate expert’s work in the light of other audit evidence.</li> </ol> <p>* SHALL AUDITOR MENTION NAME OF THE EXPERT IN HIS AUDIT REPORT ?</p> <p>When expressing an unqualified opinion- auditor should not refer to the work of an expert in his report. If auditor express other than an unqualified opinion-it may be beneficial to reader of the report if the auditor, in explaining the nature of their reservation, describe the work of expert. Name of the expert in his audit report, he can do so only after obtaining the prior consent of the expert.</p>

**Types of Audit Report (SA 700, 705, 706)**



In the same format specified by

institute  
↓  
Unqualified Report  
**SA 700**

Modification does  
not affect Opinion

Unqualified  
+  
But Emphazing  
The matter  
**SA 706**

When affect  
entire FS  
↓  
Adverse

Modification affect  
opinion **SA 705**

Disagreed  
With mgmt.

Limitation  
of Scope

Reservation /  
Disclaimer Opinion

Otherwise  
↓  
Qualified

### SA 700: FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS:

#### BASIC ELEMENTS OF AUDITORS REPORT:

##### 1) TITLE:

“Independent Auditor Report”

OR

“Independent Auditor’s Report”

(in case of joint Auditor)

##### 2) ADDRESSEE: (Shareholders, Govt. etc.)

##### 3) OPENING & INTRODUCTORY PARA:

We have audited the accompanying financial statements of ABC Ltd.

Comprises of:

(i) Balance Sheet as at 31st March, 2015

ii) State the profit and loss and cash flow statement for the year ending

iii) And Summary of significant accounting policies and other explanatory notes.

##### 4) MANAGEMENT RESPONSIBILITY FOR THE FINANCIAL

##### STATEMENT:

→ Books of accounts prepared in accordance with accounting standard  
(financial reporting framework)

→ and other responsibilities of Management

##### 5) AUDITOR(S) RESPONSIBILITY:

→ Followed accounting standards, standards on auditing and other guidelines

→ Other responsibilities (SA 200)

##### 1) OPINION:

In our opinion and the best of our information and according to explanation given to us, the financial statement gives the information required by the act in a manner so required and gives true and fair view in conformity with the accounting principles generally accepted in India.

##### 2) SIGN

##### 3) DATE

**CA Dr Mahesh Gour**  
**9320473019**

**CA Vidhi Chedda**  
**8879377367**

**Prof Khushboo Sanghavi**  
**8082736683**



## 9) PLACE OF SIGNING THE REPORT

### SA 710 (Revised): Comparative Information– Corresponding Figures and Comparative Financial Statements (April 1, 2011)

- The objectives of the auditor are to obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework; and to report in accordance with the auditor's reporting responsibilities
- The frameworks and methods of presentation that are referred to in this SA are corresponding figures where amounts and other disclosures for preceding period are included as an integral part of current period financial statements and Comparative Financial Statements where amounts and other disclosures for preceding period are included for comparison with financial statements of current period
- Auditor should obtain sufficient appropriate audit evidence that the comparative information meet the requirements of relevant financial reporting framework. This involves verifying whether accounting policies used for corresponding figures are consistent with those of current period and whether corresponding figures agree with amounts and other disclosures presented in prior period
- If the financial statements of the prior period were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report that the financial statements of the prior period were audited by the predecessor auditor; the type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and the date of that report. When auditor's report on prior period, as previously issued, included a qualified opinion or a disclaimer of opinion or an adverse opinion and concerned matter is not resolved, auditor's report should also be modified regarding corresponding figures
- When prior period financial statements are not audited, incoming auditor should state the fact in auditor's report in an Other Matter paragraph
- When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed

### Comparative Information – Corresponding Figures and Comparative Financial Statements

#### Q.1. What do you mean by Comparative Information and its types?

**Ans.:** According to SA 710 Comparative information means the amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework. Mainly these can be presented in either of the following way.

**By way of Corresponding figures** – Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as “current period figures”). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

**By way of Comparative financial statements** – Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

#### Q.2. What is objective of the auditor under this SA?

**Ans.:** According to SA 710 The objectives of the auditor are:

- To obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework; and

(b) To report in accordance with the auditor’s reporting responsibilities.

**Q.3. What are the requirements of Audit Reporting under this SA?**

**Ans.: In relation to Corresponding Figures following may be the different situation:-**

**Situation – 1 Current years report is unqualified and previous auditor’s report was also unqualified:-** When corresponding figures are presented, the auditor’s opinion usually shall not refer to the corresponding figures. Unqualified opinion as such implies auditors satisfaction related to corresponding figures.

**Situation – 2: If 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 modification is resolved:-** the auditor shall modify the auditor’s opinion on the current period’s financial statements.

**Situation – 3: If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued:-** the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor’s report on the current period financial statements, modified with respect to the corresponding figures included therein.

**Situation – 4: If the prior financial statements were not audited:-** the auditor shall state in an Other Matter paragraph in the auditor’s report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period’s financial statements.

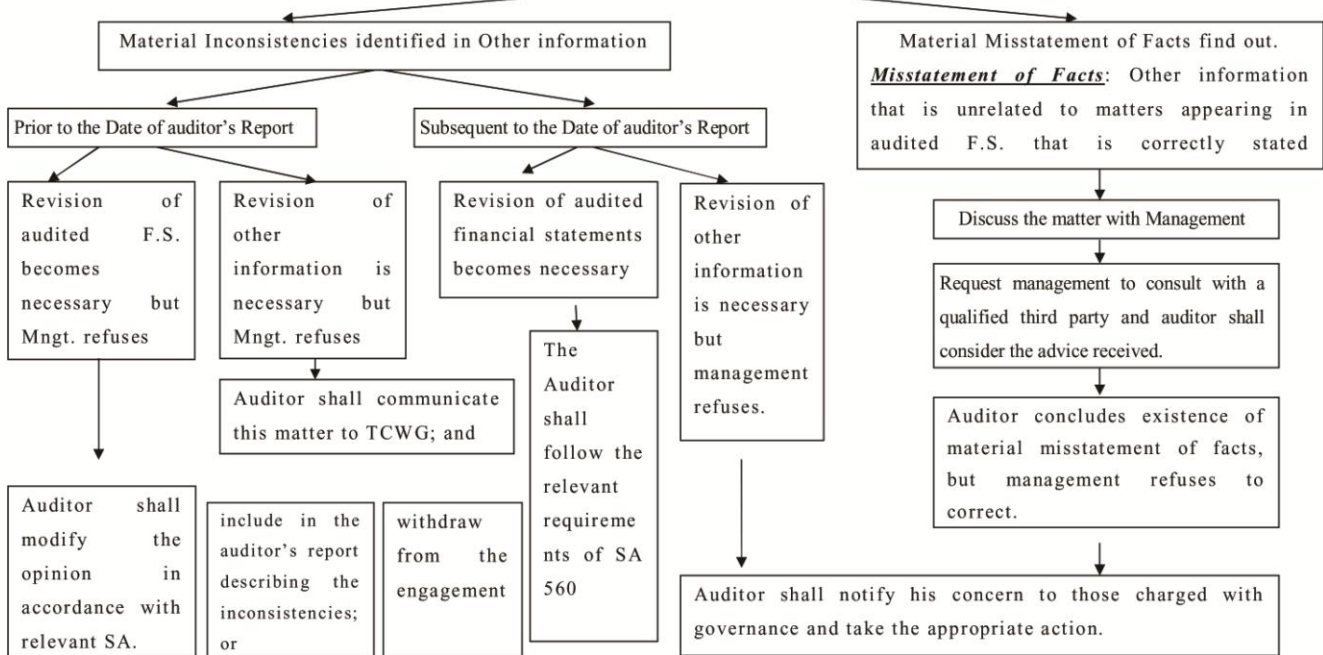
As in Indian FRF no corresponding FS are there we are not discussing the same.

**SA 720 (Revised) - THE AUDITOR’S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS**

**Purpose:** Auditor is not required to express an opinion on other information in documents containing audited F.S. (Ex. Annual Report), however, auditor reads the pother information because credibility of F.S. may be undermined by Material inconsistencies between the audited financial statements and other information.

**Auditor’s Procedures:**

Make appropriate arrangements with Management & TCWG to obtain the other information prior to the date of auditor report & Read the information so obtained. If Information is not available prior to date of auditors report, read the other information as soon as practicable.



**SA 800 SPECIAL CONSIDERATIONS**

**Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks**

According to SA-800 A financial reporting framework designed to meet the financial information needs to specific users. The financial reporting framework may be a fair presentation framework or a compliance Framework. For example if an entity is presenting the cash receipts and disbursements basis of accounting for cash flow information that an entity may be requested to prepare for creditors; or another example may be? The financial reporting provisions established by a regulator to meet the requirements of that regulator; suppose for the purpose of sanctioning a grant.

Consideration are required to conduct audit of such special purpose financial statements

In an audit of special purpose financial statements, the auditor shall obtain an understanding of:

- (a) The purpose for which the financial statements are prepared;
- (b) The intended users; and
- (c) The steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

SA 700 (Revised) deals with the form and contents of the auditor's report. In the case of an auditor's report on special purpose financial statements:

- (a) The auditor's report shall also describe the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information; and
- (b) If management has a choice of financial reporting frameworks in the preparation of such financial statements, the explanation of management's responsibility for the financial statements shall also make reference to its responsibility for determining that the applicable reporting framework is acceptable in the circumstances.

**Single financial statement means a part of complete set of financial statement** (for example, a cash flow statement) **and special elements** (for example, cash and bank balances). Sometimes management requires an audit of the same for example **The financial statement has been prepared by management of the entity in accordance with the cash receipts and disbursements basis of accounting to respond to a request for cash flow information received from a creditor. Now auditor is required to audit the same.** This kind of requirement of audit may found in special items like audit of Accounts receivable, allowance for doubtful accounts receivable, inventory, the liability for accrued benefits of a private pension plan, the recorded value of identified intangible assets, or the liability for "incurred but not reported" claims in an insurance portfolio, including related notes.

#### **Considerations are required to conduct such an audit**

Auditor shall follow all SAs applicable to circumstances and should report accordingly. How to and express opinion and how to emphasize the matter is illustrated below.

#### **Opinion**

In our opinion, the financial statement presents a true and fair view of the cash receipts and disbursements of ABC Company Ltd. For the year ended March 31, 20X1 in accordance with the cash receipts and disbursements basis of accounting described in Note X.

#### **Basis of Accounting**

Without modifying our opinion, we draw attention to Note X to the financial statement, which describes the basis of accounting. The financial statement is prepared to provide information to XYZ Creditor. As a result, the statement may not be suitable for another purpose.

### **SA 810 ENGAGEMENT TO REPORT ON SUMMARY FINANCIAL STATEMENTS**

According to SA 806 Historical financial information that is derived from financial statements but that contains less detail than the financial statements, while still providing a structural representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time 3. Different jurisdictions may use different terminology to describe such historical financial information.

#### **Auditors duty**

The auditor shall, ordinarily, accept an engagement to report on summary financial statements in accordance with this SA only when the auditor has been engaged to conduct an audit in accordance with SAs of the financial statements from

which the summary financial statements are derived. Before accepting an engagement to report on summary financial statements, the auditor shall:

- (a) Determine whether the applied criteria are acceptable;
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
  - i. For the preparation of the summary financial statements in accordance with the applied criteria;
  - ii. To make the audited financial statements available to the intended users of the summary financial statements without undue difficulty and
  - iii. To include the auditor's report on the summary financial statements in any document that contains the summary financial statements and that indicates that the auditor has reported on them.

### **Procedure for the audit**

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:

- (a) Evaluate whether the summary financial statements adequately disclose their summarized nature and identify the audited financial statements.
- (b) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:
  - (i) From whom or where the audited financial statements are available; or
  - (ii) The law or regulation that specifies that the audited financial statements need not be made available to the intended of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.
- (c) Evaluate whether the summary financial statements adequately disclose the applied criteria.
- (d) 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.
- (e) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.
- (f) 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 to be misleading in the circumstances.
- (g) 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.

SQC - 1

**QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION AND OTHER ASSURANCE AND RELATED SERVICE ENGAGEMENTS**

**SQC – 1 “Quality Control for Firms that Perform Audits & Reviews of Historical Financial Information, and Other Assurance & Related Services Engagements”**

All firms to have system of quality control that provides reasonable assurance that: (a) Firm & personnel comply with professional standards, regulatory & legal requirements, and (b) Reports issued by firm or partners are appropriate in the circumstances.

Leadership Responsibilities for Q. C.	Ethical requirements	Independence	Client Acceptance/Continuance	Human Resources	Engagement Performance	Monitoring
(a) Promote internal culture w.r.t.: <ul style="list-style-type: none"> <li>essential of quality in engagements.</li> <li>Compliance with professional standards, regulatory/legal requirements.</li> <li>Issue of reports appropriate in circumstances.</li> </ul> (b) Require CEO/managing partner to assume ultimate responsibility for QC.                     (c) Recognise & reward high quality work.	Establish policies & procedures to reasonable assure that Firm & personnel comply with relevant ethical requirements of <ul style="list-style-type: none"> <li>Integrity.</li> <li>Objectivity.</li> <li>Professional competence &amp; due care.</li> <li>Confidentiality.</li> <li>Professional behaviour.</li> </ul>	Policies & procedures should enable: <ul style="list-style-type: none"> <li>Communication of independence requirements to personnel &amp; others.</li> <li>Identification of circumstances threatening independence.</li> <li>Take appropriate action for elimination of threats / withdrawal from engagement.</li> <li>Resolution of breaches of independence.</li> </ul> <u>Maintenance of independence of personnel</u> <ul style="list-style-type: none"> <li>Engagement partners to provide firm with relevant information about client.</li> <li>Prompt notification of threats to independence.</li> <li>Accumulation &amp; communication of relevant information to appropriate personnel.</li> </ul> Other Points: <ul style="list-style-type: none"> <li>Firm should obtain Annual written confirmation as to compliance with independence requirements.</li> <li>Create policies to reduce Familiarity threat: e.g. rotation of engagement partner atleast every seven years in case of audit of listed entities.</li> </ul>	Establish policies/procedures to reasonable assure that clients are accepted/continued only where: <ul style="list-style-type: none"> <li>Client integrity has been considered.</li> <li>Firm is competent to perform engagement w.r.t. capability, time &amp; resources.</li> <li>firm can comply with ethical requirements.</li> </ul> If any issue raised, document how it resolved.                     Establish Policies w.r.t. withdrawal from engagement and communication requirements, if circumstances warrant.	Establish policies/procedures to reasonable assure that: <ul style="list-style-type: none"> <li>Firm has sufficient personnel with capabilities, competence &amp; commitment to ethical principles; &amp;</li> <li>Responsibility of engagement partner clearly defined &amp; communicated to him/ her.</li> </ul>	Establish policies/procedures to reasonable assure w.r.t.: <ul style="list-style-type: none"> <li>Compliance with professional standards.</li> <li>Compliance with laws/ regulations.</li> <li>Engagement partner issues reports appropriate in the circumstances.</li> </ul> <u>Important aspects of engagement performance:</u> <ul style="list-style-type: none"> <li>Supervision.</li> <li>Review.</li> <li>Consultation.</li> <li>Differences of opinion.</li> <li>Engagement Q. C. review.</li> <li>Engagement documentation.</li> </ul>	Establish Policies & procedures to reasonable assure that QC policies/procedures are: <ul style="list-style-type: none"> <li>Relevant.</li> <li>Adequate.</li> <li>Operating effectively.</li> <li>Complied with in practice.</li> </ul> It also includes on going consideration & evaluation of QC system, periodic inspection of completed Assignments.

**STANDARDS ON REVIEW ENGAGEMENTS (SRES)**

**SRE 2400: Engagements to Review Financial Statements**

- To establish standards and provide guidance on the practitioner’s professional responsibilities when a practitioner, who is not the auditor of an entity, undertakes an engagement to review financial statements and on the form and content of the report that the practitioner issues in connection with such a review
- The objective of a review of financial statements is to enable a practitioner to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the practitioner’s attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (negative assurance)
- The practitioner should comply with the *Code of Ethics* issued by the ICAI

- The procedures required to conduct a review of financial statements should be determined by the practitioner having regard to the requirements of this SRE, relevant professional bodies, legislation, regulation and, where appropriate, the terms of the review engagement and reporting requirements
- A review engagement provides a moderate level of assurance that the information subject to review is free of material misstatement; this is expressed in the form of negative assurance. For the purpose of expressing negative assurance in the review report, the practitioner should obtain sufficient appropriate evidence primarily through inquiry and analytical procedures to be able to draw conclusions
- The practitioner and the client should agree on the terms of the engagement • When using work performed by another practitioner or an expert, the practitioner should be satisfied that such work is adequate for the purposes of the review
- The practitioner should document matters which are important in providing evidence to support the review report, and evidence that the review was carried out in accordance with this SRE
- The practitioner should apply judgment in determining the specific nature, timing and extent of review procedures. The practitioner should apply the same materiality considerations as would be applied if an audit opinion on the financial statements were being given
- Based on the work performed, the practitioner should assess whether any information obtained during the review indicates that the financial statements do not give a true and fair view in accordance with the applicable financial reporting framework

### **SRE 2410: Review of Interim Financial Information Performed by the Independent Auditor of the Entity**

- To establish standards and provide guidance on the auditor’s professional responsibilities when the auditor undertakes an engagement to review interim financial information of an audit client, and on the form and content of the report
- The auditor should comply with the ethical requirements relevant to the audit of the annual financial statements of the entity. The auditor should implement quality control procedures that are applicable to the individual engagement. The auditor should plan and perform the review with an attitude of professional skepticism
- The objective is to enable the auditor to express a conclusion whether, on the basis of the review, anything has come to the auditor’s attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with an applicable financial reporting framework
- The auditor and the client should agree on the terms of the engagement
- The auditor should have an understanding of the entity and its environment, including its internal control, as it relates to the preparation of both annual and interim financial information, sufficient to plan and conduct the engagement
- The auditor should make inquiries, primarily of persons responsible for financial and accounting matters, and perform analytical and other review procedures to enable the auditor to conclude whether, on the basis of the procedures performed, anything has come to the auditor’s attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework
- The auditor should obtain evidence that the interim financial information agrees or reconciles with the underlying accounting records and 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
- The auditor should inquire whether management has changed its assessment of the entity’s ability to continue as a going concern. If adequate disclosure is made in the interim financial information, the auditor should add an emphasis of matter paragraph to the review report 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
- When a matter comes to the auditor’s attention that leads the auditor to question whether a material adjustment should be made, the auditor should make additional inquiries or perform other procedures to enable the auditor to express a conclusion in the review report

- The auditor should evaluate, individually and in the aggregate, whether uncorrected misstatements that have come to the auditor's attention are material to the interim financial information
- The auditor should obtain written representations from management
- The auditor should read the other information that accompanies the interim financial information to consider whether any such information is materially inconsistent with the interim financial information. If a matter comes to the auditor's attention that causes the auditor to believe that the other information appears to include a material misstatement of fact, the auditor should discuss the matter with the entity's management
- When, as a result of performing the review of interim financial information, a matter comes to the auditor's attention that causes the auditor to believe that it is necessary to make a material adjustment to the interim financial information, the auditor should communicate this matter as soon as practicable to the appropriate level of management. When, in the auditor's judgment, management does not respond appropriately within a reasonable period of time, the auditor should inform those charged with governance
- The auditor should issue a written report that contains the nature, extent and results of the review of interim financial information
- The auditor should express a qualified or adverse conclusion when a matter has come to the auditor's attention that causes the auditor to believe that a material adjustment should be made to the interim financial information for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework
- When the auditor is unable to complete the review, the auditor should communicate, in writing, to the appropriate level of management and to those charged with governance the reason why the review cannot be completed, and consider whether it is appropriate to issue a report
- The auditor should consider modifying the review report by adding a paragraph to highlight a significant uncertainty (other than a going concern problem) that came to the auditor's attention, the resolution of which is dependent upon future events and which may affect the interim financial information
- The auditor should prepare review documentation that is sufficient and appropriate to provide a basis for the auditor's conclusion and to provide evidence that the review was performed in accordance with this SRE and applicable legal and regulatory requirements

## **STANDARDS ON ASSURANCE ENGAGEMENTS (SAE) — Other than Audits or Reviews of Historical Financial Information**

### **SAE 3400 (AAS 35): The Examination of Prospective Financial Information**

- In an engagement to examine prospective financial information, auditor should obtain sufficient appropriate evidence as to whether:
  - a. management's best-estimate assumptions are not unreasonable and, in the case of hypothetical assumptions such assumptions are consistent with the purpose of information
  - b. prospective financial information is properly prepared on the basis of assumptions
  - c. prospective financial information is properly presented and all material assumptions are adequately disclosed, including whether they are best-estimate assumptions or hypothetical assumptions, and
  - d. prospective financial information is prepared on a consistent basis with historical financial statements, using appropriate accounting principles
- While evidence may be available to support assumptions on which prospective financial information is based, such evidence is itself generally future-oriented and, therefore, speculative in nature, as distinct from evidence ordinarily available in examination of historical financial information. Auditor is, therefore, not in a position to express an opinion as to whether the results shown in prospective financial information will be achieved

#### **Auditor should:**

o not accept, or should withdraw from, an engagement when assumptions are clearly unrealistic or when s/he believes that prospective financial information will be inappropriate for its intended use o obtain a sufficient level of knowledge of business and become familiar with entity's process to be able to evaluate whether all significant assumptions required for preparation of prospective financial information have been identified o consider extent to which reliance on entity's historical financial information is justified.



Auditor should consider period of time covered by prospective financial information.

- Sufficient appropriate evidence supporting such assumptions would be obtained from internal and external sources
- o would consider whether, when hypothetical assumptions are used, all significant implications of such assumptions have been taken into consideration
  - o should obtain written representations from management regarding intended use of prospective financial information, completeness of significant management assumptions and management's acceptance of its responsibility for prospective financial information
  - o should assess the presentation and disclosures in prospective financial statement are adequate
  - o should document matters, which are important in providing evidence to support his/ her report on examination of prospective financial information, and evidence that such examination was carried out in accordance with this SA
    - When auditor believes that presentation and disclosure of prospective financial information is not adequate, the auditor should express a qualified or adverse opinion in the report on prospective financial information, or withdraw from engagement as appropriate
    - When auditor believes that one or more significant assumptions do not provide a reasonable basis for prospective financial information prepared on basis of best–estimate assumptions or that one or more significant assumptions do not provide a reasonable basis for prospective financial information given the hypothetical assumptions, the auditor should either express an adverse opinion setting out reasons in the report on prospective financial information, or withdraw from engagement
    - When examination is affected by conditions that preclude application of one or more procedures considered necessary in the circumstances, auditor should either withdraw from engagement or disclaim the opinion and describe the scope limitation in the report on prospective financial information

### **SAE 3402: Assurance Reports on Controls at a Service Organization**

- This SAE deals with assurance engagements undertaken by a professional accountant in public practice to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities' internal control as it relates to financial reporting
- The objectives of the service auditor are: (a) To obtain reasonable assurance about whether, in all material respects, based on suitable criteria: (i) The service organization's description of its system fairly presents the system as designed and implemented throughout the specified period; (ii) The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period; (iii) Where included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved throughout the specified period; (b) To report on the matters in (a) above in accordance with the service auditor's findings
- The service auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to assurance engagements
- Where this SAE requires the service auditor to inquire of, request representations from, communicate with, or otherwise interact with the service organization, the service auditor shall determine the appropriate person(s) within the service organization's management or governance structure with whom to interact
- If the service organization requests a change in the scope of the engagement before the completion of the engagement, the service auditor shall be satisfied that there is a reasonable justification for the change
- The service auditor shall assess whether the service organization has used suitable criteria in preparing the description of its system, in evaluating whether controls are suitably designed, and, in the case of a type 2 report, in evaluating whether controls are operating effectively
- When planning and performing the engagement, the service auditor shall consider materiality with respect to the fair presentation of the description, the suitability of the design of controls and, in the case of a type 2 report, the operating effectiveness of controls
- The service auditor shall obtain an understanding of the service organization's system, including controls that are included in the scope of engagement



- The service auditor shall obtain and read the service organization’s description of its system, and evaluate whether those aspects of the description included in the scope of engagement are fairly presented
- The service auditor shall determine which of the controls at the service organization are necessary to achieve the control objectives stated in the service organization’s description of its system, and shall assess whether those controls were suitably designed
- If the service organization has an internal audit function, the service auditor shall obtain an understanding of the nature of the responsibilities of the internal audit function and of the activities performed in order to determine whether the internal audit function is likely to be relevant to the engagement
- In order for the service auditor to use specific work of the internal auditors, the service auditor shall evaluate and perform procedures on that work to determine its adequacy for the service auditor’s purposes
- The service auditor shall request the service organization to provide written representations
- The service auditor shall inquire whether the service organization is aware of any events subsequent to the period covered by the service organization’s description of its system up to the date of the service auditor’s assurance report that could have a significant effect on the service auditor’s assurance report
- The service auditor’s assurance report shall include the basic elements prescribed by this SAE

## **STANDARDS ON RELATED SERVICES (SRS)**

### **SRS 4400 (AAS 32): Engagements to Perform Agreed–upon Procedures Regarding Financial Information**

- In an engagement to perform agreed–upon procedures, auditor is engaged by client to issue a report of factual findings, based on specified procedures performed on specified matters of a financial statement. As the auditor simply provides a report of factual findings of agreed–upon procedures, no assurance is expressed by them in the report. Report is restricted to those parties that have agreed to procedures to be performed since others, unaware of reasons for the procedures, may misinterpret results
- To comply with *Code of Ethics*, issued by ICAI
- Where Auditor is not independent, a statement to that effect should be made in the report of factual findings. Terms of engagement should be well defined so as to avoid any misunderstandings
- To plan the work so that an effective engagement will be performed and documentation of important matters to be done which provides evidence to support the report of factual findings
- The report describes the purpose and agreed–upon procedures of engagement in sufficient detail to enable the reader to understand the nature and extent of work performed. The report should also clearly mention that no audit or review has been performed

### **SRS 4410 (AAS 31): Engagements to Compile Financial Information**

- In such types of engagements, accountant uses accounting expertise as against auditing expertise to collect, classify and summarise financial information
- The accountant should comply with the "Code of Ethics", issued by ICAI. However, where accountant is not independent, a statement to that effect should be made in the accountant’s report. It should be ensured that there is a clear understanding between the client and accountant regarding terms of engagement by means of an engagement letter or such other suitable form of contract
- To obtain an acknowledgement from management of its responsibility for appropriate preparation and presentation of financial statements or other information and of its approval of such information to be compiled
- Accountant should also obtain an acknowledgement from management of its responsibility for accuracy and completeness of underlying accounting data and complete disclosure of all material and relevant information
- To plan the work so that an effective engagement will be performed. Accountant should obtain a general knowledge of business and operations of the entity and should be familiar with accounting principles. Accountant should request management representation letter covering significant information or explanations given orally on which they consider representations are required

• There are few special considerations which the accountant has to take care of i.e. s/he should ensure that financial statements or other financial information compiled, comply with requirements of identified financial reporting framework & where there is no specific financial reporting framework, client may specify that accounts should be compiled on, for example, based on requirements of Income Tax Act. If any accounting standard is not complied with, the fact should be disclosed in the notes to accounts

If accountant becomes aware of any material misstatement, s/he must report this to management or must withdraw from engagement if management doesn't act. Financial information compiled should be approved by client before compilation report is signed by accountant

**PART IV – MISCELLANEOUS TOPICS****Chapter # 1****Audit under CIS Environment**

<p><b>The role of an auditor in collecting audit evidences under EDP system is more complex than under the manual system— Discuss.</b> 2009 - Nov</p>	<p>Collecting evidence on the reliability of an EDP system is more complex than collecting on the reliability of manual system. Auditors can be faced or confronted with and sometimes complex range of EDP systems depending upon technology did not exist in manual systems. For example, accurate and complete operation of required a set of hardware controls not used in a manual system. Similarly, development controls include procedures for testing programs that would not be found in the development of manual system. Auditors must understand these if they are to be able to collect evidence competently on the reliability of the controls.</p> <p>Unfortunately, understanding the changing technology is not easy. Hardware and continue to evolve rapidly and although there is some time lag, the associated evolve rapidly also. Auditors must keep upto-date with the developments if they to be able to evaluate the reliability of accounting system.</p> <p>The continuing evolution of computer technology also makes it more difficult for auditors to collect evidence on the reliability of controls. It may be impossible for auditors to obtain the evidence using manual means. Thus auditors need EDP systems themselves if they are to be able to collect the necessary evidence. The development of generalised audit software occurred, for example, because auditors needed access to data maintained on magnetic media. Similarly, new audit tools may be required, in due course, to evaluate the controls.</p>
<p><b>IT systems also pose specific risks to an entity's internal control? What are those risks?</b> 2010 – May</p>	<p>Specific Risk to an Entity's internal Control: As per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", IT system also poses specific risks to entity's Internal Control. They are-</p> <ul style="list-style-type: none"> <li>(i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both.</li> <li>(ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including 'the recording of unauthorized or non-existent' transactions, or inaccurate recording of transactions. Particular risk may arise when multiple users access a common database.</li> <li>(iii) The possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.</li> <li>(iv) Unauthorised changes to data in Master files</li> <li>(v) Unauthorised changes to systems or programs.</li> <li>(vi) Failure to make necessary changes to systems or programs.</li> <li>(vii) In appropriate manual intervention</li> <li>(viii) Potential loss of data or inability to access data as required.</li> </ul>
<p><b>Different types of controls which operate over data/moving into, though and out of the computer. Auditor is required to review such controls.</b> Comment. 2010 – Nov</p>	<p><b>The review process for controls in a computerized information system (CIS) environment.</b></p> <p>In a CIS environment there are different types of control which operate over data moving into, through and out of the computer. These are designed in such a way that the correct, complete and reliable processing and storage is ensured. It is necessary for the auditor to review such controls in order to get the correct result from the data entered. The review process can be laid down as follows:</p> <ol style="list-style-type: none"> <li>1. <b>Organisation structure and control:</b> The entity may have different functions under the CIS environment. There will be Data Administrator who will formulate data policies, plans the evaluation of the corporate data bases and maintain the data documentation. The data base administrator will be responsible for operational</li> </ol>

	<p>efficiency of the database, the system Analyst will manage the information requirements for new and existing applications, and designs the information system, the System programmer will maintain and enhance the Operating system software, application programmer will design the Programme to meet the information requirement, Operation Specialist plans and control day-to-day operations, monitors and improves operational efficiency along with capacity planning and Librarian maintains library of magnetic media and documentation. The auditor will see that the responsibilities of each job position are clear and that the person understands the duties, authority and responsibilities. The duties have to be separated to ensure the internal control is established.</p> <ol style="list-style-type: none"> <li>2. <b>Documentation Control:</b> The auditor has to see that there is proper and adequate documentation for approval of system flowcharts Programme flowcharts, Programme changes, operator’s instructions and programme description and the changes made in the above are also documented and approved by the authorized persons.</li> <li>3. <b>Access Control:</b> The auditor has to ensure the system prevents the persons who are authorized for access from accessing restricted data and programme and also prevents unauthorized persons gaining access to the system as a whole.</li> <li>4. <b>Input controls:</b> The control in respect of input has to be effective to ensure that only properly authorized and approved data goes in the input into the CIS system. For validation of input controls the auditor can apply some procedures like Check digit control, completeness totals control, reasonableness checks, field checks, record checks, file checks etc.</li> <li>5. <b>Processing controls:</b> These controls are must for integrity of data. Processing validation checks should be applied.</li> <li>6. <b>Recording Controls:</b> This is tor enabling the records to be kept free of errors.</li> <li>7. <b>Storage Controls:</b> The data is the heart of the CIS system. Backup and recovery facilities will ensure the proper data availability to the management.</li> <li>8. <b>Output controls:</b> The data processed must go to the authorized person in the manner it is required and for this purpose input controls are maintained. The auditor is interested to know whether the audit trail relating to output is provided.</li> </ol>
<p>You are a member of an audit team of B &amp; C Associates, auditors of a Multinational Company YB Co. Ltd. The company is working in CIS environment. The partner in charge of B &amp; C Associates asked you to draw out the audit plan for evaluating the reliability of controls. 2011 – Nov</p>	<p><b>Audit Plan for Evaluating the Reliability of Controls in CIS Environment:</b> In evaluating the effects of a control, the auditor needs to assess the reliability by considering the various attributes of a control. Some of the attributes for example are that the control is in place and is functioning as desired, generality versus specificity of the control with respect to the various types of errors and irregularities that might occur, general control inhibit the effect of a wide variety of errors and irregularities as they are more robust to change controls in the application sub-system which tend to be specific control because component in these sub-system execute activities having less variety, that whether the control acts to prevent, detect or correct errors etc.</p> <p>The auditor focuses here on</p> <ol style="list-style-type: none"> <li>1. <b>Preventive controls:</b> They stop errors or irregularities from occurring.</li> <li>2. <b>Detective controls:</b> They identify errors and irregularities after they occur.</li> <li>3. <b>Corrective controls:</b> They remove the effects of errors and irregularities after they have been identified.</li> </ol> <p>The auditors are expected to see a higher density of preventive controls at the early stages of processing or conversely they expect to see more detective and corrective controls later in system processing.</p> <p>Further, while evaluating the reliability of controls. The auditor should:</p> <ol style="list-style-type: none"> <li>(i) Ensure that authorized, correct and complete data is made available for processing;</li> <li>(ii) Provide for timely detection and correction of errors.</li> </ol>

	<ul style="list-style-type: none"> <li>(iii) Ensure that the case of interruption in the work of the CIS environment due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records;</li> <li>(iv) Ensure that accuracy and completeness of output;</li> <li>(v) Provide adequate data security against fire and other calamities, wrong processing, frauds etc.</li> <li>(vi) Ensure that there is no unauthorized amendments to the program;</li> <li>(vii) Provide for safe custody of source code of application software and data files.</li> </ul>
<p><b>In the audit of K Ltd. its auditor wants to use CAATs for performing various audit procedures. Guide him as to what procedures can be performed using CAATs.</b> 2012 – May</p>	<p><b>Auditing procedures using CAATs:</b> CAATs may be used in performing various auditing procedures, as following:</p> <ol style="list-style-type: none"> <li>1. Tests of details of transactions and balances, for example, the use of audit software for recalculating interest or the extraction of invoices over a certain value from computer records;</li> <li>2. Analytical procedures, for example, identifying inconsistencies or significant fluctuations;</li> <li>3. Tests of general controls, for example, testing the set-up or configuration of the operating system or access procedures to the program libraries or by using code comparison software to check that the version of the program in use is the version approved by management;</li> <li>4. Sampling programs to extract data for audit testing;</li> <li>5. Tests of application controls, for example, testing the functioning of a programmed control; and</li> <li>6. He-performing calculations performed by the entity’s accounting systems.</li> </ol>
<p><b>Z Ltd. has its entire operations including accounting computerized. As the audit partner you are concerned about inherent and control risk for material financial statement assertions. What could be the areas you look forward for deficiencies and risk identification?</b> 2011 - May</p>	<p>The auditor in accordance with SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment”, should make an assessment of inherent and control risk for material financial statement assertions. In a CIS environment the risk of a Material financial statement ascertain being erroneously stated could arise from the deficiencies in the following case as</p> <ul style="list-style-type: none"> <li>(i) Program Development and maintenance.</li> <li>(ii) System Software supports.</li> <li>(iii) Operations including processing of data.</li> <li>(iv) Physical CIS security.</li> <li>(v) Control over access to specialized utility program.</li> </ul> <p>These deficiencies would tend to have a negative impact on all application systems that are processed through the computer.</p>
<p><b>Write short notes on the following: Factors to consider in determining the use of Computer Assisted Audit Techniques (CAATs).</b> 2007 – May</p>	<p><b>In determining whether to use CAATs, the auditor should consider the following factors:</b></p> <ol style="list-style-type: none"> <li>1. <b>Availability of sufficient IT knowledge and expertise:</b> It is essential that members of the audit team should possess sufficient knowledge and experience to plan, execute and use the results of CAAT. The audit team should have sufficient knowledge to plan; execute and use the results of the particular CAAT adopted.</li> <li>2. <b>Availability of CAATs and Suitable Computer facilities and data in Suitable format:</b> The auditor may plan to use other computer facilities when the use of CAATs on an entity’s computer is uneconomical or impractical for example, because of an incompatibility between the auditor’s package programme and entity’s computer.</li> <li>3. <b>Impracticability of manual Tests due to lack of evidence:</b> Some audit procedures may</li> </ol>

	<p>not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.</p> <p><b>4. Impact on effectiveness and Efficiency in extracting data:</b> It includes selection of samples, applying analytical procedures, time involved in application of CAAT, etc.</p> <p><b>Time Constraints in certain data:</b> Such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make arrangements for the retention of data required, or may need to alter the timing of the work that requires such data.</p>
<p><b>What is an Audit Trail? Briefly describe the special audit techniques using the computer as an audit tool.</b> 2000- Nov</p>	<p><b>Audit Trail:</b> Audit trail refers to the facility to trace individual transactions through a system from source to completion. In the manual system of accounting, the audit trail is distinct and can be followed by the auditor through the distinct stages of accounting process. A proper audit trail ensures audit checking for proper processing and accumulation of data. However in computerized system audit trail is often missing or is sketchy. This is due to following reasons.</p> <ul style="list-style-type: none"> <li>(i) Source documents once transcribed in machine readable form are not retained in a manner that permits subsequent access.</li> <li>(ii) Master files may replace ledger summaries</li> <li>(iii) Transaction listing is often not provided.</li> <li>(iv) Reports may be only on exceptions.</li> </ul> <p><b>Special Audit Techniques:</b> In the absence of audit trail, the auditor needs the assurance that the programmes are functioning correctly in respect of specific items by using special audit techniques the absence of input documents or lack of visible audit trail may require the use of computer Assisted Audit techniques i.e using the computer as an Audit tool. The effectiveness and efficiency of auditing procedures may enhanced through the use of CAATs. Two common types of CAATs are in vogue, VIZ.. Test packs or test data and audit software or computer audit programmes. Normally special audit techniques may be used under the following circumstances.</p> <ul style="list-style-type: none"> <li>(a) To ensure the correct functioning of important programme controls;</li> <li>(b) To overcome losses of audit trail.</li> <li>(c) To reduce audit costs or increase the efficiency of the audit.</li> </ul> <p>The most common types of CAATs used for audit purposes are discussed as follows:</p> <ul style="list-style-type: none"> <li>(i) <b>Audit software:</b> It consists of computer programs used by the auditor as a part of his audit procedures to process data of audit significance it may consists of: <ul style="list-style-type: none"> <li>(a) <b>Package Programs:</b> These are generalised computer programs designed to perform data processing function which includes reading computer files, selecting information performing calculations, creating data files &amp; printing reports in the format as specified by the auditor.</li> <li>(b) <b>Purpose written programs:</b> These are computer programs designed to perform audit tasks in specific circumstances.</li> <li>(c) <b>Utility programs:</b> These are used by the organisation to perform common data processing functions such as sorting creating and printing files.</li> </ul> </li> <li>(ii) <b>Test Data:</b> Test data techniques are used in conducting audit procedures by entering 'data into the computer system of the organization and comparing the results obtained with predetermined results when test data is processed with the organisations normal processing the auditor should ensure that the test transactions are subsequently eliminated from accounting records of the organisations.</li> </ul>
<p><b>"On-line real time processing system and batch processing</b></p>	<p>On-line computer systems are computer systems that enable users to access data and programmes directly through terminal devices. Such systems may comprise mainframe computers, minicomputers or a network of connected PCs. When the entity uses an on-line</p>

<p>system are their inherent strengths and weaknesses." Please comment. 2001 – Nov</p>	<p>computer system, the technology is likely to be complex and linked with the entity's strategic business plans. On-line computer systems may be classified according to how information is entered into the system, how it is processed and when the results are available to the user. In an on-line real-time processing system, individual transactions are entered at terminal devices, validated and used to update related computer files immediately. For example, application of cash receipts directly to customer's accounts. The results of such processing are then available immediately for inquiries or reports. In an on-line real-time (OLRT) processing system, transactions are entered as they occur and are processed as they are entered. These systems form the heart of management information systems.</p> <p>In a system with on-line Batch Processing, individual transactions are entered at a terminal device, subjected to certain validation checks and added to a transaction file that contains other transactions entered during the period. Later, during a subsequent processing cycle, the transaction file may be validated further and then used to update the relevant master - file. For example journal entries may be entered and validated on-line and kept on a transaction file, with the general ledger master file being updated on monthly basics. Inquiries of or reports generated from, the master file will not include transactions entered after the last master - file update.</p> <p>In a batch processing system which is not on-line, transactions are accumulated and processed in group sales orders for the day, invoices to be recorded and daily cash receipts might each be viewed as a "batch" of transactions, to be processed as a group. Batch processing systems are distinguished by their relative simplicity and reliability. But they do not possess the potential for providing timely information concerning the files updated by transactions processing. Batch processing systems are rarely found in today's systems environment.</p> <p>OLRT systems are more complex than batch processing systems. Moreover, they ordinarily do not provide the extent of audit trail documentation produced by batch system and for this they are more difficult in terms of obtaining satisfaction concerning the existence of necessary controls, and of designing substantive testing procedures.</p> <p>Conversely, in batch processing system, the transactions are accumulated and processed in batches or groups. Control totals, both monetary and documentary, are also available for review to ensure completeness and accuracy of data being processed the system is simple and 'reliable. However, its deficiency lies in the MIS is not updated on a concurrent basis and therefore, information is not available on a timely basis. Accordingly, It is a question of cost-benefit analysis as to which system will be more preferable to an entity.</p>
<p>Indicate the control procedures which the auditor should adopt in applying CAAT (Computer Assisted Audit Technique) in an audit under EDP environment. 2002 – May</p>	<p><b>Controlling the CAAT Application:</b> The use of a CAAT should be controlled by the auditor to provide reasonable detailed specifications of the CAAT have been met and that the CAAT is not improperly manipulated by the entity staff. The specific procedures necessary to control the use of a CAAT will depend on the particular application in establishing audit control which require the auditor should consider the need to:</p> <p>(a) Approve the technical specifications and carry out a technical review of the work involving the use of CAAT.</p> <p>(b) Review the entity's general IT controls which may contribute to the integrity of CAAT.</p> <p>(c) Ensure appropriate integration of the output by the auditor into the audit process.</p> <p><b>Procedures Carried out by the Auditor to Control Audit Software Application:</b></p> <p>(i) Participating in the design and testing of the computer programmes.</p> <p>(ii) Checking the coding of the programme to ensure that it conforms with detailed programme specifications.</p> <p>(iii) Requesting the entity's Computer staff to review the operating system instructions to ensure that the software will run in the entity's computer installation.</p>

	<p>(iv) Obtaining evidence that the audit software functioned as planned, for e.g. returning output and control information.</p> <p>(v) Running the audit software on small test files before running on the main data files.</p> <p>(vi) Ensuring that the correct files are used.</p> <p>(vii) Establishing appropriate security measures to safeguard against manipulations of the entity's data files.</p> <p>The presence of the auditor is not necessarily required at the computer facility during the running of a CAAT to ensure appropriate control procedures. However, it may provide practical advantages, such as being able to control distribution of the output and ensuring the timely corrections of errors.</p> <p>Procedures carried out by the Auditor to control test Data Applications</p> <p>(i) Controlling the Sequence of submissions of test data where it spans several processing cycles.</p> <p>(ii) Predicting the results of the test data and comparing it with the actual test data output, for the individual transactions and in total.</p> <p>(iii) Performing test runs containing small amounts of test data before submitting the main audit test data.</p> <p>(iv) Confirming that the answered version of the programmes used to process the test data.</p> <p>(v) Obtaining reasonable assurance that the programmes used to process the test data.</p> <p>When using a CAAT, the auditor may require the co-operation of the entity's staff who have extensive knowledge of the computer installation. In such cases, auditor should have reasonable assurance that the entity's staff did not improperly influence the results of the CAAT. Finally, the standard of working papers and retention procedures for a CAAT should be consistent with that on the audit as a whole, It may be convenient to keep the technical papers relating to the use of the CAAT separate from the other audit working papers. The working papers should contain sufficient documentation to describe CAAT application.</p>
<p><b>Discuss some problems that will be encountered in an EDP system in implementation of internal control.</b> 2002 – Nov</p>	<p>The internal control over computer processing which help to achieve the overall objectives of internal control, include both manual procedures and procedures designed into computer programs. Such manual and computer control procedures comprise the overall controls affecting the EDP Environment and specific controls over the accounting applications (EDP application controls).</p> <p>The following problems normally arise in implementation of internal control in an EDP system.</p> <p>(i) <b>Separation of duties:</b> In a manual system. Separate individuals are responsible for initiating transactions, recording transactions and custody of assets. Due to automation in the system, such controls are not possible in computer system.</p> <p>(ii) <b>Delegation of Authority and Responsibility:</b> Due to use of resources by multiple users. It becomes difficult to delegate authority and responsibility in a precise manner. For example, as many users access the database, it may not be possible to trace the person making unauthorized changes in it.</p> <p>(iii) <b>Competent and Trustworthy Persons:</b> Organisation finds it difficult to find and retain competent and trustworthy personnel to take charge of their EDP setup. However, getting competent and trustworthy personal as well as trained and experienced people in this field is in short supply.</p> <p>(iv) <b>System of Authorisation:</b> As against the manual system automation of the authorization procedure is an important feature of EDP system. For example, the computer system may determine the price to be charged to customers. Thus the auditor has to verify the veracity of computer processing.</p> <p>(v) <b>Adequate documents &amp; Records:</b> In computer systems documents may not be used to</p>



	<p>support the initiation, execution, and recording of some transactions. Thus, no visible audit trail may be available. This absence of visible audit trail will not hinder the auditors work if systems are designed to maintain a record of all events and means of accessing these records.</p> <p>(vi) <b>Physical control over assets and records:</b> As the data processing assets and records are concentrated at a place, the risk of loss and unauthorized access is high. Hence it is important that a good EDP environment restricts access to the data processing assets and records.</p> <p>(vii) <b>Adequate Management Supervision:</b> In the computer system, data communication may be used to enable the employees to be closer to the computer service. Thus supervision of employees may have to be carried out remotely.</p> <p>(viii) <b>Comparing records with Physical assets:</b> Unlike in manual system, the records may be automatically reconciled with assets. Thus. Unauthorized modification to programs or data files that these programs use, may be difficult to detect. Therefore care must be taken that there is no unauthorized modifications to this programs or to any of the data files database programs use otherwise the irregularity may not be discovered.</p>
<p><b>State the important characteristics of an effective computer audit program system.</b> 2004 – May</p>	<p><b>Characteristics of an Effective Computer Audit Program System:</b> Computer audit program developed for general purposes shall have to customised according to the needs of the organisation. However an examination of following features is necessary to ensure that it is effective:</p> <ol style="list-style-type: none"> <li>1. <b>Simplicity:</b> The system should be simple to use and eliminate the need for remembering countless details normally required in writing or revising computer programs.</li> <li>2. <b>Understandability:</b> The system should be understandable by the members of the audit staff, even those with little computer expertise. The capabilities of the system should be known and it should be easy to use. Coding forms provided should not be difficult to understand.</li> <li>3. <b>Adaptability:</b> The system should be capable of writing computer audit programs for the various types of computers used in the company or expected to be acquired. Thus the package will be usable if the equipment is changed in the future.</li> <li>4. <b>Vendor technical support:</b> In considering the types of package to be acquired, it is important that the vendor provides adequate support. This includes assisting in the initial installation and providing adequate documentation, in addition, training provided for the audit staff is important.</li> <li>5. <b>Statistical sampling Capability:</b> Statistical sampling is an important Application in auditing; the package should be able to perform the various statistical routines. This should include the selection of items on a random basis, determination of sample size, and evaluation of results at different confidence levels.</li> <li>6. <b>Acceptability:</b> The system should be acceptable to both the auditors and to Computer centers. For the auditors the programs should be easily carried to the site and practical to use. For the computer centre the programs should be compatible with the system and capable of minimum interference with normal routines.</li> <li>7. <b>Processing Capabilities:</b> The package should be able to process many different types of application. For example, it should accept all common file media and process multiple file input. It should have the capability for extended data selection and stratification. It should have powerful, generalized audit commands.</li> <li>8. <b>Report writing:</b> The <b>package</b> should have a strong report writing function. This should include the ability to prepare multiple reports in a single program run and to generate flexible output report formats.</li> </ol>

<b>Explain Tagging and Tracing.</b> <b>2004 - Nov</b>	<b>Tagging and Tracing:</b> It is a technique better than integrated Test Data Facility. It involves tagging the client's input data in such a way that relevant information is displayed at key points. It uses the actual data, and so the question of elimination of 'special entries' test data designed under Integrated Test Data Facility does not arise. The hard copy, so produced is available only to the auditor and may describe such inputs as hours worked in a pay period in excess of 50; or sales orders processed in excess of Rs. 1,00,000. This enables the auditor to examine transactions at the intermediate steps in processing. The advantage of the tagging and tracing approach lies in the use of actual data and elimination of the need for reversing journal entries. The disadvantage is that the erroneous data will not necessarily be tagged. An effective combination approach may be to use the ITF approach (integrated test facility) for a few hypothetical transactions and the tagging and tracing approach to follow line data through a complex system.
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## Chapter#2

## Corporate Governance and Clause 49

### CORPORATE GOVERNANCE-MEANING

- Corporate governance is the system by which companies are directed and controlled by management in the best interest of shareholders and others.
- The BOD are responsible for governance of their companies.
- A number of reports and codes of corporate governance has been published internationally.
- SEBI also has introduced clause 49 in the "Listing Agreement" entered between a stock exchange and a company who desires to list its securities on stock exchange.
- As per this clause, if a company desires to list its securities on a stock exchange, then it has to agree and implement the code of corporate governance.
- The company is also required to obtain a certificate from the auditor/ practicing company secretary as regard compliance of the conditions of corporate governance as given in this clause.
- The various items of this clause are:
  - Composition of BOD
  - Setting up of audit committee
  - Remuneration of directors
  - Meeting of BOD, etc.

### CONTENTS OF CLAUSE 49 OF LISTING AGREEMENT (Corporate Governance)

<b>1. Board of Directors</b>	<p>(a) The Board of Directors shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the Board of Directors comprising of non-executive directors.</p> <p>(b) At least half of the Board should comprise of independent directors.</p> <p>It is very much clear that the overall shift is on comprising the Board with independent person, who can take unbiased decisions for the welfare of the stakeholders.</p>	
	<b>Who is an Independent Director?</b>	<p>It shall mean a non-executive director of the company who-</p> <ul style="list-style-type: none"> <li>(i) apart from receiving director's remuneration, does not have any material pecuniary relationship or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiary/(s) and associates which may affect independence of the director;</li> <li>(ii) is not related to promoters or persons occupying management positions at the Board level or at one level below the Board;</li> <li>(iii) has not been an executive of the company in the immediately</li> </ul>

		<p>preceding three financial year;</p> <p>(iv) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:</p> <ul style="list-style-type: none"> <li>• the statutory audit firm or the internal audit firm that is associated with the company, and</li> <li>• the legal firm(s) and consulting firm(s) that have a material association with the company.</li> </ul> <p>(v) Is not a material supplier, service provider or customer or lesser/ lessee of company.</p> <p>(vi) Is not a substantial shareholder of the company, i.e. owing two percent or more of the block of voting shares.</p>
<b>2. Audit Committee</b>		<ul style="list-style-type: none"> <li>• Minimum 3 members (any director) with 2/3 independent.</li> <li>• All members financially literate &amp; at least one director having expertise in accounts/financial management.</li> <li>• Chairman should be an independent director.</li> <li>• Minimum number of meetings in a year is FOUR. One meeting should be held before finalisation of Accounts. Maximum gap between 2 meetings is FOUR months.</li> <li>• Quorum → 2 members or 1/3 of members (whichever is higher) &amp; out of which minimum 2 should be independent directors.</li> <li>• Company secretary of the company shall act as secretary of Audit committee.</li> <li>• Audit committee should invite financial executive of the company in its meeting. However, they can meet without his presence too.</li> <li>• Audit committee: <ul style="list-style-type: none"> <li>Will maintain liaison with the company &amp; auditor. It shall consider: <ul style="list-style-type: none"> <li>(a) Matters to be included in director's responsibility statement.</li> <li>(b) Functioning of whistle blower mechanism (if any).</li> <li>(c) Performance of statutory / internal auditors.</li> </ul> </li> </ul> </li> <li>• Audit committee shall review on mandatory basis: <ul style="list-style-type: none"> <li>(a) Management discussion &amp; analysis of financial statements.</li> <li>(b) Statement of significant related party transaction.</li> <li>(c) Management letter / letters of internal control weaknesses issued by statutory auditors.</li> <li>(d) Internal audit reports relating to internal control weaknesses.</li> </ul> </li> <li>• Appointment / Removal / Terms of remuneration of chief internal auditor.</li> </ul>
<b>3. Remuneration</b>		<p>(i) Remuneration of non-ED is decided by BOD, after obtaining prior approval of shareholders.</p> <p>(ii) However, sitting fee as per The Companies Act, paid to non-ED doesn't require previous approval of shareholders.</p> <p>(iii) If stock option is given to non-ED, limit for maximum number to be granted to non-ED in one Financial Year &amp; in aggregate is to be disclosed along with disclosure of elements of remuneration package, details of incentives &amp; service contract in the annual report.</p>
<b>4. Board Procedures</b>		<p>(i) Meeting shall be held at least 4 times in a year with maximum gap 4 months between two meetings.</p> <p>(ii) Code of conduct for Board / Senior management shall be laid by BOD. It shall be posted on the website of the Company.</p> <p>(iii) A director not to be a member in more than 10 committees or chairman in more than 5 committees across all companies in which he is a director. (Committee for this</p>

	purpose includes audit committee and shareholders redressing committee)
<b>5. Regarding Shareholder</b>	<p>(i) In case of Appointment / re-appointment of a director, shareholders must be provided with its brief resume, nature of his expertise &amp; names of companies in which he holds directorship.</p> <p>(ii) Information like quarterly results to be put on companies web site or on site of Stock Exchange.</p> <p>(iii) Board committee under chairmanship of non-E.D to look into redressing of shareholders &amp; investors complaints.</p> <p>(iv) To expedite the process of share transfer, this work is to be delegated to an officer or share transfer agent.</p>
<b>6. Subsidiary Company</b>	<p>(i) At least one independent director of holding company shall be a director in material non-listed Indian subsidiary company (whose turnover / net worth exceeds 20% of consolidated turnover / net worth of holding and its subsidiary in immediately preceding accounting year).</p> <p>(ii) Audit committee of holding shall review the financial statement (particularly investment) by material non-listed Indian subsidiary company.</p> <p>(iii) Minutes of Board meeting of material non-listed Indian subsidiary company to be placed at board meeting of holding company.</p>
<b>7. CEO /CFO Certification</b>	<p>The CEO or the CFO or any other person heading the finance function discharging that function shall certify to the Board that:</p> <p>(a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:</p> <ul style="list-style-type: none"> <li>• These statements do not contain any materially untrue statement or omit any material fact.</li> <li>• These statements together present a true and fair view of the company's affairs.</li> </ul> <p>(b) There are no transactions entered that are fraudulent, illegal and violative of the company's code of conduct.</p> <p>(c) They accept responsibility for establishing and maintaining internal controls w.r.t. financial reporting.</p> <p>(d) They have indicated to the auditors and the Audit committee:</p> <ul style="list-style-type: none"> <li>• Significant changes in internal control during the year;</li> <li>• Significant changes in accounting policies during the year.</li> <li>• Instances of significant fraud.</li> </ul>
<b>8. Report on Corporate Governance</b>	There shall be separate section on Corporate Governance in the Annual Reports of company with a detailed compliance report on Corporate Governance.
<b>9. Compliance</b>	The company shall obtain a certificate either from the auditors or practicing company secretaries regarding compliance of conditions of corporate governance.

## Chapter#3

## Bank Audit

## AUDIT OF COMPLIANCE WITH SLR REQUIREMENT

<b>Meaning</b>	<ul style="list-style-type: none"> <li>Statutory Central Auditor to verify compliance with SLR requirements on 12 odd dates in different months of a financial year not being Fridays.</li> <li>Report to Management and RBI.</li> <li>Examination <b>of 2 Aspects</b> <ol style="list-style-type: none"> <li>Correctness of figures of DTL (Demand &amp; Time Liabilities) on reporting Friday (last Friday of second preceding fortnight). and</li> <li>Maintenance of liquid asset on selected date.</li> </ol> </li> </ul>
<b>Steps</b>	<ul style="list-style-type: none"> <li>See circulars of RBI regarding composition of DTL</li> <li>Provision for Expenses and Liabilities not to be included in DTL</li> <li>It is examination on test basis consolidation regarding DTL position already prepared by the Bank</li> <li>Review Return from un-audited branches</li> <li>Branch auditor to verify correctness of cash on 12 odd dates (Branch do not maintain assets / securities)</li> <li>Verify computation of liquid Assets and following are treated as cash :             <ol style="list-style-type: none"> <li>Deposits with RBI by Banking Company incorporated outside India.</li> <li>Cash/Balance by Banking Companies with itself or with RBI.</li> <li>Balance maintained by Scheduled Bank with RBI in excess of balance required to be maintained.</li> <li>Net Balance in current account in India by Scheduled Bank.</li> <li>Balance by RRB with Sponsor Bank.</li> </ol> </li> <li>Price of gold shouldn't exceed current market price.</li> <li>Verify amount of unencumbered approved security.</li> <li>Number of unaudited branch and reliance on returns, etc. to be disclosed by central</li> </ul>

## CONCURRENT AUDIT

**“Audit or verification of transactions or activities of an organization concurrently as the transaction or activity takes place.”**

- It is early warning system for timely detection of irregularities
- It is done on regular Basis.
- Mandatory for Banks to cover at least: -
  - 50% of total deposits &
  - 50% of total advances
- Following should be considered:
  - Large / very Large branches y
  - Special branches
  - Large problem branches
  - H.O. department dealing with treasury/funds management & handling Investment Portfolio
  - Any other branch/department at discretion of bank
- It can be undertaken by internal inspection staff or independent C.A.

<b>Scope of Concurrent Audit</b>	<b>Cash</b>	<ul style="list-style-type: none"> <li>Any abnormal receipts and payments</li> <li>Proper accounting of cash remittances</li> <li>Proper accounting of cash receipts</li> <li>Expenses by cash involving sizeable amount.</li> </ul>
	<b>Investment</b>	<ul style="list-style-type: none"> <li>Purchase and sale of securities within its delegated power.</li> <li>Securities held in the books of the branch are physically held by it.</li> </ul>

		<ul style="list-style-type: none"> <li>Investments are as per RBI's guidelines.</li> <li>Sale or purchase transactions are done at beneficial rates.</li> </ul>
	<b>Deposit</b>	<ul style="list-style-type: none"> <li>Check the transactions about deposits received and repaid.</li> <li>Test check of interest paid on deposits.</li> <li>Check new accounts opened.</li> </ul>
	<b>Advance</b>	<ul style="list-style-type: none"> <li>Ensure that loans and advances have been sanctioned properly.</li> <li>Whether the sanctions are as per delegated authority.</li> <li>Securities and documents have been received and properly charged.</li> <li>Post disbursement supervision and follow-up is proper or not.</li> <li>Whether the letters of credit issued by the branch are within the delegated power.</li> <li>Check the bank guarantees issued.</li> <li>Proper follow-up of overdue bills of exchange.</li> <li>Verify classification of advances.</li> <li>Verify that instances of exceeding 'delegated powers have been promptly reported to controlling / Head Office.</li> </ul>
	<b>Foreign Exchange</b>	<ul style="list-style-type: none"> <li>Check foreign bills</li> <li>Whether inward/outward remittance have been properly accounted for.</li> <li>Check extension and cancellation of forward contracts for purchase and sale of foreign currency.</li> <li>Ensure that balances in Nostro accounts in different foreign currencies are within the limit.</li> <li>Ensure adherence to the guidelines issued by RBI.</li> <li>Ensure verification/reconciliation of Nostro and Vostro account.</li> </ul>
	<b>Housekeeping</b>	<ul style="list-style-type: none"> <li>Ensure that the branch gives proper compliance to the internal inspection/audit reports.</li> <li>Customer's complaints are dealt with promptly.</li> <li>Verification of statements, returns, statutory returns.</li> </ul>
	<b>Other Items</b>	<ul style="list-style-type: none"> <li>Ensure maintenance and balancing of accounts.</li> <li>Carry out a test check of calculations of interest, discount, commission and exchange.</li> <li>Check the transactions of staff accounts.</li> <li>Detection and prevention of revenue leakage.</li> <li>Check cheques returned/bills returned.</li> </ul>
	<b>Objective</b>	Its objective is to see whether transactions or decisions are within the policy parameters laid down by H.O., they don't violate instructions of RBI & they are within authority.
	<b>Remuneration of auditor</b>	It is fixed by bank.
	<b>Irregularities</b>	Minor irregularities to be rectified on the spot. Serious irregularities reported to H.O. /Z.O.
	<b>Reporting</b>	Proper reporting & at proper interval. Reported on 10 <sup>th</sup> of next month/quarter but flash report can be submitted immediately. Normally, the audit report should be divided in three parts. The first part should deal with major irregularities. The second part should deal with minor irregularities which have not been attended during the course of audit. The last part should deal with compliance with earlier reports. Before submission of the report the auditor should discuss the important issues on

which he wishes to report with the branch manager and concerned officers.

## NORMS FOR INVESTMENT

<b>Basics</b>	<ul style="list-style-type: none"> <li>• Banks should frame suitable Investment policy.</li> <li>• Classification of Investment <ul style="list-style-type: none"> <li>&gt; Held to maturity</li> <li>&gt; Available for Sale</li> <li>&gt; Held for Trading</li> </ul> </li> <li>• Disclosure in account is same as present 6 categories.</li> </ul>
<b>Held to Maturity</b>	<ul style="list-style-type: none"> <li>• Intention Basis.</li> <li>• <math>HTM \leq 25\%</math> of Banks total Investment.</li> <li>• Following not to be 'Covered /Counted for 25% <ul style="list-style-type: none"> <li>&gt; Re-capitalisation Bonds from govt. of India.</li> <li>&gt; Investment in subsidiary &amp; Joint Venture.</li> <li>&gt; Investment in Debenture/Bonds if deemed to be in nature of advance i.e. <ul style="list-style-type: none"> <li>○ If issued for project finance (3 Yrs. or more) <ul style="list-style-type: none"> <li>Or</li> </ul> </li> <li>○ If issued for working capital finance (less than 1 yr.) <ul style="list-style-type: none"> <li>and</li> </ul> </li> <li>○ Banks stake is <math>\geq 10\%</math> in issue. <ul style="list-style-type: none"> <li>and</li> </ul> </li> <li>○ Issue is part of private placement.</li> </ul> </li> </ul> </li> <li>• Profit on sale of such Investment is to be taken to P&amp;L account &amp; thereafter to Capital Reserve account. Loss to P &amp; L account.</li> <li>• Carried at acquisition cost. If acquisition Cost is more than face value there amortise the premium. Recognise permanent diminution.</li> </ul>
<b>Held for trading</b>	<ul style="list-style-type: none"> <li>(i) Transfer to IFR as appropriation to net Profit "below line" after statutory Reserve.</li> <li>(ii) Intention to trade for short term price/Interest rate gain to be sold within 90 Days</li> <li>(iii) Profit or loss on sale to P&amp;L account</li> <li>(iv) Marked to Market at Monthly/Frequent intervals.</li> </ul>
<b>Available for sale</b>	<ul style="list-style-type: none"> <li>(i) If not in above 2 categories.</li> <li>(ii) Profit or Loss on sale to P/L A/c.</li> <li>(iii) Valuation → Individually script wise Marked to Market at quarterly/frequent interval.</li> <li>(iv) Fall in value to be provided (appreciation ignored for this purpose) Debit to P&amp;L A/c &amp; equivalent amount to be transferred from Investment Fluctuation Reserve account to P&amp;L account.</li> </ul>
<b>Investment fluctuation reserve (IFR)</b>	<ul style="list-style-type: none"> <li>(i) Banks are required to create IFR at minimum 5% of investment within 5 years (only w.r.t. held for trading and available for sale) and Maximum upto 10% of Portfolio(only w.r.t held for trading and available for sale)</li> <li>(ii) Transfer maximum amount of gains realised on sale of Investment in Securities to Investment Fluctuation Reserve(IFR).</li> <li>(iii) IFR is eligible for inclusion in Tier-2 Capital.</li> <li>(iv) Transfer to IFR as appropriation o net profit "below line" after statutory Reserve.</li> </ul>
<b>Shifting among categories of I</b>	<ul style="list-style-type: none"> <li>(i) To/from HTM → Approval of BOD. Shifting can take place once a year at beginning of year.</li> <li>(ii) From AFS to HFT → with approval of BOD / ALCO/ Investment Committee.</li> <li>(iii) From HFT to AFS → Generally not allowed only in exceptional situation with permission of BOD / ALCO(asset liability committee) / Investment Committee.</li> </ul>

	(iv) Transfer at acquisition Cost / Book value / Market value on date of Transfer (whichever is least).
<b>Income Recognition on I</b>	(i) Accrual Basis on securities, if guaranteed by Central govt. (ii) Otherwise, if owners right is established. (iii) From mutual funds, on cash Basis.
<b>Broken period Interest</b>	Banks not to capitalize BPI paid to seller as part of cost but treat as expenses in P & L account.

### SOME IMPORTANT MATTERS TO BE CONSIDERED BY AUDITOR

<b>Draft paid without advice</b>	<ul style="list-style-type: none"> <li>• Correctness and completeness of draft</li> <li>• Co-relate the drafts with advice subsequently received</li> <li>• Systems of sending reminders within reasonable time.</li> <li>• Record of names / address of payees.</li> </ul>
<b>Principal enactments governing Bank Audit</b>	<ul style="list-style-type: none"> <li>• Banking Regulation Act.</li> <li>• Banking Company Act.</li> <li>• State Bank of India Act</li> <li>• SBI (Subsidiary) Act</li> <li>• Regional Rural Bank Act.</li> <li>• Companies Act</li> <li>• Co-operative Societies Act</li> </ul>
<b>Vostro and Nostro A/c.</b>	<ul style="list-style-type: none"> <li>• Forex account maintained by Indian Bank at other overseas centers in NOSTRO.</li> <li>• VOSTRO is opposite of NOSTRO, i.e. foreign Bank in another country maintain Indian rupees with their Indian correspondent local banks. E.g. German Bank maintaining VOSTRO in rupees with Indian Bank.</li> <li>• Check the reconciliation.</li> <li>• Check Internal controls w.r.t. inward/outward messages</li> <li>• Balance confirmation certificate to be received, from such another bank.</li> </ul>
<b>Verification of Bills Purchased and Discounted</b>	<ul style="list-style-type: none"> <li>• These are shown separately in the balance sheet as a part of 'advances'.</li> <li>• Under the head 'advances outside India' in the balance sheet, bills purchased and discounted outside India have to be shown separately.</li> <li>• Auditor should examine bills purchased and discounted registers.</li> <li>• Check whether all the outstanding bills have been taken in the balance sheet</li> <li>• Check all the details of bills.</li> <li>• Whether the total of outstanding bills of each party is not in excess of the sanctioned limit</li> <li>• Ensure that bills purchased and discounted are in accordance with the agreements.</li> <li>• Check that the bills are not overdue.</li> <li>• The auditor should also examine bills collected subsequent to the year-end to obtain assurance regarding completeness and validity of the recorded bill amounts.</li> <li>• Check accounting treatment by bank in case of dishonored bills.</li> </ul>
<b>Credit Card Operations</b>	<ul style="list-style-type: none"> <li>• There should be a system to examine creditworthiness of applicant.</li> <li>• Strict control over storage and issue of credit cards should be ensured.</li> <li>• The on line real time system should be properly installed, so that merchant confirms the unutilized balance of the customer With the bank before accepting payment.</li> <li>• There should be prompt reporting by the merchants of all settlements accepted by them through credit cards. L</li> <li>• Customer's account should be immediately debited with the reimbursements.</li> <li>• There should be adequate follow up of items overdue beyond a reasonable period.</li> <li>• In case of delayed payments, interest should be charged.</li> </ul>



<b>Inter-office operations</b>	<ul style="list-style-type: none"> <li>• These are generally sub-divided into segments or specific areas, e.g. Demand Drafts Paid, Inter-branch Remittances.</li> <li>• Special attention should be paid to the origin and validity of old outstanding unmatched entries, particularly debit entries.</li> <li>• Examine any reversal entries indicating the possibility of irregular payments or frauds.</li> <li>• Examine any items in the nature of cash-in-transit remaining pending for more than a reasonable period.</li> <li>• Whether transactions other than those relating to inter-branch transactions have been included in inter-branch accounts.</li> <li>• Seek confirmation from the third party (other branch).</li> </ul>	
<b>Non-Banking Assets acquired in Satisfaction of claims</b>	<ul style="list-style-type: none"> <li>• It includes those immovable properties/tangible assets which the bank has acquired in satisfaction of debts due.</li> <li>• These items are held with the intention of being disposed of.</li> <li>• A banking company is prohibited from holding any immovable property, except such as is required for its own use, for any period exceeding seven years from the date of acquisition.</li> <li>• Auditor should verify relevant documentary evidence, e.g. terms of settlement with the party.</li> <li>• Verify whether ownership of the property has legally vested in the bank.</li> </ul>	
<b>Contingent liabilities including Bills for collection</b>	<b>Presentation</b>	<ul style="list-style-type: none"> <li>• Claims against the bank not acknowledged as debts.</li> <li>• Liability for partly paid investments.</li> <li>• Liability on account of outstanding forward exchange contracts</li> <li>• Guarantees given on behalf of constituents: <ul style="list-style-type: none"> <li>&gt; In India</li> <li>&gt; Outside India</li> </ul> </li> <li>• Acceptances, endorsements and other obligations.</li> <li>• Other items for which the bank is contingently liable.</li> <li>• Bills for Collection</li> </ul>
	<b>Audit procedures</b>	<p>Following should be considered:</p> <ul style="list-style-type: none"> <li>• Ascertain whether there are adequate internal controls.</li> <li>• Whether there are proper records regarding bills for collection.</li> <li>• Whether contingent liabilities are properly identified and recorded (take expert advice).</li> <li>• Establish the completeness of the recorded obligations.</li> <li>• Review the reasonableness of the 1 year-end amount of contingent liabilities.</li> <li>• Obtain MRL that all contingent liabilities have been disclosed.</li> <li>• Verify that the provisions of AS29 'Provisions, contingent liabilities and contingent assets have been complied with.</li> </ul>

**PRUDENTIAL NORMS-RECENT RBI CHANGES**

<b>Non-Performing Assets</b>	<b>Term Loan</b>	A Term Loan where interest and/or installment of principal remain overdue for a period of more than 90 days will be treated as NPA. Thus an amount which falls due on 31st December, 2012 will be 90 days old, if unpaid, as on 31st March, 2013. The requirement is that the overdue period should be more than 90 days. Therefore, such an amount need not be classified as NPA. Any amount which had become payable before 31st of December, 2012 will be NPA as at 31st of March, 2013 if it remains unpaid.
	<b>Overdraft/ Cash Credit</b>	An Overdraft/ Cash Credit will become NPA as at 31st March, 2013 under the following circumstances: <ul style="list-style-type: none"> <li>(a) If the outstanding balance remains continuously in excess of the sanctioned limit</li> </ul>

		<p>or the drawing power, or</p> <p>(b) If there are no credits continuously for 90 days as on the balance sheet date or the credits are not enough to cover the interest debited during the same period.</p> <p>The period from 1<sup>st</sup> January, 2013 to 31<sup>st</sup> March, 2013 is of 90 days. Hence, the above two requirements will have to be tested for this period of 90 days to determine whether the account becomes NPA or not as on 31<sup>st</sup> March, 2013.</p>
	<b>Bills Purchased and Discounted</b>	If the bills remain overdue for a period of more than 90 days then such bills would be classified as NPA. As mentioned before, the bills purchased and discounted before 31 <sup>st</sup> December, 2012, if unpaid as at 31 <sup>st</sup> March, 2013 will be treated as NPA.
	<b>Agricultural Advance</b>	<p>(a) With effect from September, 30, 2004 a loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA. if the installments of principal or interest thereon remains overdue for one crop season.</p> <p>(b) For the purpose of these guidelines, “Long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops, would be treated as “Short duration” crops.</p>
	<b>Any other credit facility</b>	<p>In case of any other credit facility, if the amount to be received remains overdue for a period of more than 90 days then such a facility will be classified as NPA. As discussed before, if such an amount was due before 31<sup>st</sup> of December, 2012, then it shall become NPA as at 31<sup>st</sup> March, 2013.</p> <p>Any amount due to the bank under any credit facility is said to be overdue if it is not paid on the due date fixed by the bank.</p>
<b>Income Recognition</b>		<ul style="list-style-type: none"> <li>• In case of a NPA, the interest is recognized when it is actually received and not merely on accrual basis.</li> <li>• The above general rule, however, does not apply in case of advances against term deposits. NSCs, IVPs, KVPs and Life Policies provided adequate margin is available.</li> <li>• If the Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest they been realized.</li> <li>• An advance which becomes NPA during the financial year 2012-13, interest accrued and credited to income account has to be revised or provided for if the same is not realized. This applies to Government guaranteed accounts also.</li> <li>• The RBI has in recent past advised the banks to adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.</li> </ul>
<b>Asset Classification</b>		<p>The banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realizability of the dues:</p> <p>(a) Sub-standard Assets</p> <p>(b) Doubtful Assets</p> <p>(c) Loss Assets</p>
	<b>Sub-standard Assets</b>	Substandard Asset would be one, which has remained NPA for a period less than or equal to 12 months.
	<b>Doubtful Assets</b>	If it remained in the sub-standard category for 12 months.
	<b>Loss Assets</b>	A loss assets is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its

		continuances as bankable assets is not warranted although there may be some salvage or recovery value.
	<b>Accounts with temporary deficiency</b>	<p>(a) The classification of an asset as NPA should be based on the record of recovery. An account need not be classified as NPA merely due to the existence of 'some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non submission of stock statements and non-renewal of the limits on due date etc. However, the outstanding in the account based on drawing power calculated from stock statements older than three months would be deemed as irregular. If such irregular drawings are permitted in the account for a continuous period of 90 days will render the account NPA, even though the unit may be working or the borrowers financial position is satisfactory.</p> <p>(b) Regular and ad hoc credit limits need to be reviewed/ regularized not later than three months from the due date / date of ad hoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers. the auditor should verify whether the show that renewal/ review of credit limit is already on and would be completed soon. Delay beyond six months is not considered desirable as a matter of general discipline. Hence account where the regular/Ad hoc credit limit has not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NP.</p>
<b>Provision Norms</b>		In conformity with the prudential norms, provisions are required to be made on the non-performing assets on the basis of classification of assets into prescribed categories. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks have to make provision against substandard assets, doubtful assets and loss assets as below:
	<b>Loss Assets</b>	The entire asset has to be written off. If the assets are permitted to remain in the books for any reason, 100 percent of the outstanding need be provided for.
	<b>Doubtful Assets</b>	<p>(i) 100 percent of the asset to the extent to which the advance is not covered by the realizable value of the security to which the bank has a valid recourse and the realizable value is estimated on a realistic basis.</p> <p>(ii) In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:</p> <p>(iii) With a view to bringing down divergence arising out of difference in assessment of the value of security. in cases of NPAs with balance of Rs.5 crore and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board is mandatory in order to enhance the reliability on stock valuation. Collaterals such as immovable properties charged in favour of the bank have to be valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.</p>
	<b>Period for which the advance has remained in 'doubtful' category</b>	<b>Provision requirement (%)</b>
	Upto one year	25
	One to three years	40
	More than three years	100
	<b>Sub-standard Assets</b>	A general provision of 15 percent on total outstanding required to be made without making any allowance for DICGC/ECGC guarantee cover and securities available. The 'unsecured exposures' which are identified as 'substandard' would attract additional

	provision of 10 percent, i.e. a total of 25 per cent on the outstanding balance. The infrastructure loan accounts will attract 20 % instead of 25 %
<b>Standard assets</b>	Banks should make provision for standard assets at the following RATES: 1) direct advances to agricultural and small and micro Enterprise at 0.25% 2) Advances to Commercial real estate At 1% 3)Advances to Commercial Real estate – residential Housing sector ).75% 4) Housing loans extended at teaser rate 2 % 5) Restructured accounts classified as standard advances will attract higher provisions in the first 2 years from the date of restructuring 6) All other loans and advances not included above 0.4 %
<b>Government guaranteed advances</b>	<ul style="list-style-type: none"> <li>• Advances granted under rehabilitation packages approved by BIFR / term lending institutions. <ul style="list-style-type: none"> <li>(i) In respect of advances under rehabilitation package approved by BIFR/term lending institutions, the provision should continue to be made in respect of dues to the bank on the existing credit facilities as per their classification as substandard or doubtful assets.</li> <li>(ii) As regards the additional facilities sanctioned as per package finalized by BIFR and /or term lending institutions, provision on additional facilities sanctioned need not be made for a period of one year from the date of disbursement.</li> </ul> </li> <li>• Advances against term deposits, NSCS eligible for surrender, IVPs, KVPs, and life policies would attract provisioning requirements as applicable to their asset classification status.</li> <li>• Advances against gold ornaments, government’s securities and all other kinds of securities are not exempted from provisioning requirements.</li> <li>• Advances <b>covered by ECGC / DICGC guarantee:</b> In the case of advances guaranteed by DICGC/ECGC, provisions can be made only for the balance in excess of the amount guaranteed by these Corporations. Further, while arriving at the provision required to be made for doubtful assets, realisable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by these Corporations and then provision made.</li> <li>• Advances <b>covered by CGTSI guarantee:</b> In case the advances covered by CGTSI guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided r as per the extend guidelines on provisioning for non-performing advances.</li> </ul>

**Question:**

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager:

- (a) In computing the aggregate of funded and non-funded exposure of a constituent for purpose of assigning risk weight in regard to capital adequacy, the bank "Netted off" the credit balance of Rs.10 lakhs in their Current Account against the total exposure of Rs.1 crore. (4 marks)
- (b) 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. (4 marks)
- (c) 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. (4 marks)
- (d) In case of all such advances which have been classified as non-performing for the first time during tile current financial year, only the last date of the financial year has been reckoned as the date of account becoming non-performing. (4 marks) (Final May 2000)

**Answer:**

(a)

- The banks are required to adhere to certain capital adequacy norms to ensure that they have adequate capital in relation to the risks undertaken by them.
- As per the circular issued by the RBI, while computing risk adjusted value of assets netting may be done only for advances collateralized by cash margins or deposits and in respect of assets where provision for doubtful debts have been made.
- As per this circular, banks may "net off" against the total outstanding exposure of the borrower, credit balance in current account which are free from any lien.
- In view of the above, the treatment of netting off followed by the bank is in order.

(b)

- The income from dividend on securities and units of mutual funds should be booked on cash basis.
- It is not a prudent practice to treat dividend on units of mutual funds as income unless these are actually received.
- In respect of income from government securities, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is received regularly and as such is not in arrears.
- It is also 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.
- Moreover, they can recognize dividend when their right is established.
- In the instant case, the dividends on securities and Units of Mutual Funds were declared after the end of financial year.
- Thus, the recognition of income by the bank is not in order.

(c)

- 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.
- In case of consortium, each bank may classify the advance given by it according to its own experience of recovery and other factors and not only on the basis of the certificate of lead bank that the account is performing.
- Accordingly, the amount should be shown as non-performing asset.
- Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed.

(d)

- An amount should be considered as NPA when the amount due there from remains outstanding for specified period.
- In case of terms loans, if interest or installment of principal is in arrears for more than 90 days, it should be classified as non-performing asset and from that date provision should be made.
- As per RBI Circular, if the account of the borrowers have been regularised before the balance sheet date by repayment of overdue amounts through genuine sources and not by sanction of additional facilities, the account need not be treated as NPA. Bank should, however, ensure that the account remains in order subsequently.
- NPA is to be seen throughout the year.
- Thus, it is wrong to take only the Balance Sheet date for purposes of classification.

**Chapter#4****General Insurance Company****REQUIREMENT OF SCHEDULE B TO IRDA REGULATIONS 2002**

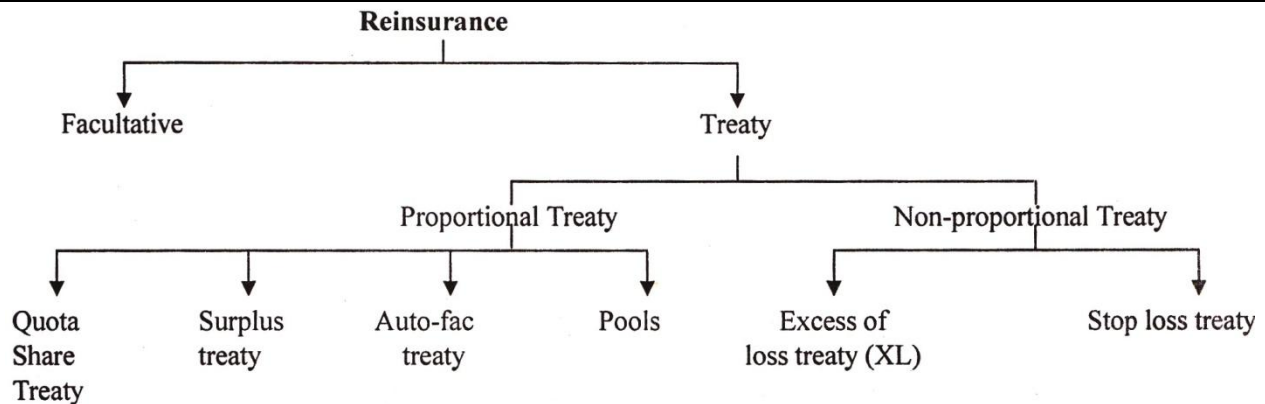
<b>Part 1</b>	<p><b>A/c principles for prep. of financial information</b></p> <p>I Applicability of AS to G.I. C. :</p> <ul style="list-style-type: none"> <li>➤ 3 → As per Direct Method only.</li> <li>➤ 4 → Not applicable w.r.t. liabilities arising out of I. Policies</li> <li>➤ 9 → Not applicable w.r.t. incomes of insurance business.</li> <li>➤ 13 → As per regulation, Apply AS — I3 where regulation is silent.</li> <li>➤ 17 → Applicable in each case irrespective of its applicability clause.</li> </ul> <ul style="list-style-type: none"> <li>• Premium</li> <li>• Premium Deficiency. Recognised if expected claim cost &gt; related reserve unexpired risk.</li> <li>• Acquisition cost. Expenses in the period in which incurred.</li> <li>• Claims. Liability for O/s claim should be provided for</li> <li>• Valuation of Investment. <ul style="list-style-type: none"> <li>➤ Real Estate - investment property: Historical cost less accumulated depreciation less impairment loss. Residual value as zero.</li> <li>➤ Debt Securities — as 'held to maturity' - Historical cost.</li> <li>➤ Equity / Derivative in Active Market — F.V. at B/S date. Impairment as expenses. changes in F.V. in "Fair Value change A/c."</li> <li>➤ 'Unlisted' and other — at H.C. provision made for diminution in value such provision may be reversed but increased carrying amount not to exceed its historical cost.</li> </ul> </li> <li>• Loan. Measured at historical cost subject to impairment provision.</li> <li>• Catastrophe Disaster Reserve. To be created as per norms prescribed by authority.</li> </ul>
<b>Part 2</b>	<b>Disclosure</b>
<b>Part 3</b>	<p><b>General Instruction</b></p> <p>(Last year figures, national income provision/Reserve)</p>
<b>Part 4</b>	<p><b>Management Report</b></p> <ul style="list-style-type: none"> <li>• Confirmation for validity of registration</li> <li>• Confirmation that all statutory dues have been paid.</li> <li>• Confirmation that shareholding pattern is in accordance with law</li> <li>• Confirmation that solvency margin is maintained</li> </ul> <p><b>(NOTE: Solvency Margin</b></p> <ul style="list-style-type: none"> <li>• To maintain excess of assets over amount of its liabilities at all times, highest of following: <ul style="list-style-type: none"> <li>• 50 crores (100 cr. For reinsurer)</li> <li>• 20% of net premium income.</li> <li>• 30% of net incurred claims.</li> </ul> </li> </ul> <p>If non-maintenance of S.M., insurer to submit a financial plan to authority indicating plan of action, else it shall deemed to be insolvent and wound up by court.)</p> <ul style="list-style-type: none"> <li>• Confirmation that valuation of Investment is as per norms.</li> <li>• Confirmation that management has not invested any money outside India.</li> <li>• Confirmation about overall risk exposure</li> <li>• Confirmation about operation in other countries</li> <li>• Confirmation about aging of claims</li> <li>• Confirmation about quality of asset &amp; portfolio</li> <li>• Confirmation about payment to parties in which directors are interested</li> <li>• Responsibility statement</li> </ul>

**INVESTMENT NORMS**

1. Investment in other than approved investment if:
  - (i) Such investment < 25% of total investment; and
  - (ii) Consent of all Directors.
2. Insurer not to invest in one insurance / investment company exceeding-
  - (i) 10% of total asset of insurer; or
  - (ii) 2% of share capital/debenture of company concerned.
 For other companies (other than insurance / investment company) 2% is replaced by 10%
3. Funds of policy holders not to be invested outside India.
4. Every insurer to keep at all times.

<ul style="list-style-type: none"> <li>• at least 20% of Assets</li> <li>• at least 30% (including (i))</li> <li>• at least 5% of total assets</li> <li>• at least 10% of total assets</li> <li>• upto 55%</li> </ul>	Central Govt. Securities. State Govt. and other guaranteed securities Housing & loan to State Government In approved securities under infrastructure / social sector Other securities.
<b>Guidelines</b>	(i) Proper Balance between infrastructure and social sector. (ii) Based on rating of assets. (iii) Rating by independent agency (iv) Should be at least "AA" grade. (v) Investment in shares in actively traded/liquid investment.

**REINSURANCE – At a glance**



- **Facultative:** Particular risk is ceded, thus consideration of each risk separately.
- **Treaty:** Within limits of treaty, covering all kinds of risks is ceded.
- **Proportional Treaty**
- **Quota Share** → Fix % of all policies issued under defined scope of business.
- **Surplus:** Cedes amount which it doesn't want to retain with itself.
- **Auto-fac:** After cession of its surplus treaties, if anything remains, then it is ceded as per auto-fac treaty
- **Pools:** Members cede to pool a portion of business directly written by them.
- **Non-proportional:** On basis of loss.
- **XL treaty:** XL on prevent: If more than one risk are affected, limit/loss is arrived at separately.
- **XL on non-prevent:** Losses considered on together basis. (Aggregate).
- **Stop Loss:** Protects the company from losing more than specified amount for given class of business.

**SOME POINTS TO BE CONSIDERED IN CASE OF GIC**

<b>Premium</b>	<ul style="list-style-type: none"> <li>➤ Credited to separate Bank account.</li> <li>➤ <b>No Risk</b> Assumption without receipt of premium.</li> </ul>
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	<p>Three types of premium — for direct business, for re-insurance business and share of co-insurance premium.</p> <p>➤ Some portion of premium is allocable to succeeding period, thus called unearned premium. Check Reserve for unexpired risk.</p> <p><b>(NOTE: Reserve for unexpired risk:</b>  Not all risk expire as on B/S date. Risk will be there in succeeding year w.r.t. premium received in this year, thus provide for-</p> <p>(i) 50% of all other types and  (ii) 100% for marine Hull. g</p> <p>% is to be taken of net premium income i.e. premium received, net of reinsurance premium paid.)</p> <p>➤ <b>Premium deficiency</b> = expected claim cost — related unearned premium. Provision to be made.  ➤ <b>Internal controls</b> and procedures w.r.t. premium should be operating effectively.  ➤ <b>Cover notes</b> should be serially numbered.  ➤ <b>Company should not assume any risk</b> for uncollected premium, short premium, not collected in time, etc.  ➤ <b>Reinsurance</b> → look for all its details.  ➤ <b>Collection after B/S date</b>, whether relating to year under audit.  ➤ <b>Co-insurance</b>, examine company's share of premium.  ➤ <b>Premium</b> register should be kept chronologically i.e. in order of time of premium received.  ➤ <b>Due date</b> and date of collection should be reconciled.  ➤ <b>Year end</b> transactions should be taken care of.  ➤ Service tax is applicable on premium, thus ensure appropriateness of same.  ➤ Refund of premium (whether made in genuine cases only).</p>
<b>Verification of claims</b>	<ul style="list-style-type: none"> <li>• Provision for all unsettled claims.</li> <li>• Only for those, company is legally liable.</li> <li>• Not to exceed insured amount.</li> <li>• Event after B/S date.</li> <li>• Average clause.</li> <li>• Co insurance, provision only for its share.</li> <li>• Reasons for long delays after claim lodged.</li> <li>• Under litigation, legal advice.</li> <li>• Provision net of salvage value.</li> <li>• No contingent liability w.r.t. claim intimated.</li> <li>• Intimation within reasonable time.</li> <li>• Claim paid duly sanctioned.</li> <li>• Claim paid for its share in co-insurance.</li> <li>• Claim paid after salvage accounted for.</li> <li>• Claim paid, discharge note from claimant.</li> </ul>
<b>Commission</b>	<ul style="list-style-type: none"> <li>• Commission should be paid only to authorized agents</li> <li>• Examine internal controls over payment of commission.</li> <li>• Examine whether it has been paid as per appropriate rate.</li> <li>• Obtain confirmation from the agents.</li> <li>• Examine accounting treatment of outstanding commission, if any.</li> <li>• Obtain management representation that all commission has been appropriately adjusted in the accounts.</li> <li>• Correlate with this year's business.</li> <li>• Check whether TDS has been properly deducted on payment of commission.</li> <li>• Verify that no commission is paid to agents for businesses directly procured by it.</li> </ul>



<b>Agent's balance</b>	<ul style="list-style-type: none"> <li>• Carefully examine the old balance, if any.</li> <li>• Obtain confirmation from agents.</li> <li>• Ensure that this head contains only balances w.r.t. agents accounts.</li> <li>• Obtain management representations w.r.t. appropriate accounting treatment of such accounts.</li> <li>• In case any amount due from them appears to be doubtful, examine whether provision has been created w.r.t. same.</li> <li>• Reconcile their balances with commission due to them.</li> </ul>
<b>Receipts and payments account</b>	<ul style="list-style-type: none"> <li>• Every insurer should prepare at the end of each financial year, a Balance Sheet, a Profit and Loss Account, account of receipts and payments and a Revenue Account.</li> <li>• Since receipts and payments account has been made a part of financial statements of an insurer it is also required to be audited.</li> <li>• Auditor of an insurance company should: <ul style="list-style-type: none"> <li>(i) Report whether the receipts and payments account of the insurer is in agreement with the books of account and returns:</li> <li>(ii) Express an opinion as to whether the receipts and payments account has been prepared on accordance with the provisions of the relevant statutes; and</li> <li>(iii) Express an opinion whether the receipts and payments account gives a true and fair view of the receipts and payments of the insures for the financial year Period under audit.</li> </ul> </li> </ul>
<b>Co-insurance</b>	<ul style="list-style-type: none"> <li>• In case of high business risks, these are shared among more than one insurance company.</li> <li>• In case of coinsurance, the leading insurer issues the documents. collects premiums and settles claims. .</li> <li>• The leader renders statements of Accounts to the co-insurers.</li> <li>• The auditor should check whether the premium account is credited on the basis of statements received from the leading insurer.</li> <li>• Auditor should obtain a written confirmation from management that all premium received from the leader has been accounted for.</li> <li>• The claims provisions and claims paid should also be verified.</li> <li>• It should be ensured that claim is paid only for its share in coinsurance.</li> <li>• For leader, the auditor should examine the relevant documents.</li> </ul>
<b>Reinsurance inwards</b>	<ul style="list-style-type: none"> <li>• He should obtain evidences as to the effectiveness of the system of control over the reinsurance inwards.</li> <li>• The agreement should be as per guidelines prescribed in the Insurance Act, 1938 and IRDA Regulations.</li> <li>• The auditor should examine the arrangements with principal insurer.</li> <li>• The auditor should ensure the appropriateness of accounting treatment of reinsurance business received, premium received and payment of commission.</li> <li>• He should examine 'whether intimation of loss has been received well in time.</li> <li>• It is also to be verified that claim has been paid as per the terms and conditions.</li> <li>• In case of principal insurer being in the foreign country, he should examine the foreign currency transactions considering the Accounting Standard (AS) 11.</li> <li>• The auditor should check whether provision has been made for all claims payable to principal insurer.</li> <li>• He should carefully examine any old outstanding.</li> <li>• Balance confirmation should also be obtained form principal insurer.</li> </ul>
<b>Reinsurance Outward</b>	<ul style="list-style-type: none"> <li>• He should obtain evidences as to the effectiveness of the system' of control over the reinsurance outwards.</li> <li>• The agreement should be as per guidelines prescribed in the Insurance Act, 1938 and IRDA Regulations.</li> </ul>

- The auditor should examine the arrangements with re-insurers.
- The auditor should ensure the appropriateness of accounting treatment of reinsurance business given, premium paid to reinsurer and receipt of commission.
- He should examine whether intimation of loss has been given to them well in time.
- It is also to be verified that claim has been received from reinsurer as per the terms and conditions.
- In case of reinsurer being in the foreign country, he should examine the foreign currency transactions considering the Accounting Standard (AS) 11.
- He should carefully examine any old outstanding.
- Balance confirmation should also be obtained from reinsurer.

## Chapter#5

## Audit of Co-operative Societies

## MULTI STATE CO-OPERATIVE SOCIETIES ACT, 2002

1. Books of A/c.	<ul style="list-style-type: none"> <li>• All sum of money received &amp; expended &amp; matters of receipt/expenses.</li> <li>• All sale &amp; Purchase of goods.</li> <li>• All assets &amp; liabilities.</li> <li>• For MSCOS engaged in production, processing &amp; manufacturing, their utilization of materials or labour or other items of cost as may be specified in by-laws of society.</li> </ul>
2. Qualification of Auditors (Sec. 72)	<p>A chartered accountant.</p> <p>Disqualification:</p> <ul style="list-style-type: none"> <li>• Body corporate.</li> <li>• Officer / Employee of MSCOS.</li> <li>• Partner / Employee of Officer / Employee of MSCOS.</li> <li>• Indebted / Guarantor for amount &gt; 1000/-</li> </ul>
3. Appointment of auditors (Sec. 70)	<ul style="list-style-type: none"> <li>• First auditor by board within one month of registration date to hold office until conclusion of 1stAGM. If board fails to appoint, then in general meeting.</li> <li>• Subsequent auditor at each AGM. He shall hold office from conclusion of that meeting until conclusion of next AGM.</li> </ul>
4. Power & Duties of Auditors (Sec. 73)	<p>Right to access at all times to books, Accounts &amp; Vouchers, to require information &amp; explanation from employee / officers, to attend GM, to send representation on removal.</p> <p><b><u>Following inquiries shall be made [73 (2)1</u></b></p> <ul style="list-style-type: none"> <li>• Loans &amp; advances made by MSCOS on basis of security, properly secured &amp; whether terms aren't prejudicial to interest of M SCOS / members.</li> <li>• Transaction of MSCOS represented merely by book entries are not prejudicial to interest of MSCOS.</li> <li>• Whether personal expenses have been charged to revenue.</li> <li>• In case it is stated in Books of MSCOS that any shares have been allotted for cash whether cash actually been received &amp; if no cash has been so received, whether positions stated in books &amp; B/s are correct &amp; not misleading.</li> </ul>
5. Special Audit of MSCOS (Sec. 77)	<p>(a) In case, Central Government or State Government either alone or both hold 51% more of paid-up share capital In such MSCOS.</p> <p>(b) Central Government may direct either a C.A or MSCOS's auditor to conducts special audit &amp; make a report to it.</p> <p>(c) If Central Government is of opinion that:</p> <ul style="list-style-type: none"> <li>• Affairs of MSCOS aren't being managed in accordance with self help &amp; Co-operative principles or sound business principles or:</li> <li>• MSCOS is managed in manner likely to cause serious injury I damage to interest of trade / industry or business to which it pertains or</li> <li>• The financial position of any MSCOS is such as to endanger its solvency.</li> </ul> <p>(d) Auditor has same powers &amp; duties as in Sec. 73.</p> <p>(e) On receipt of report of special audit, Central Government may take such action as it considers necessary.</p>
6. Inquiry and inspection by Central Registrar (Sec. 78 and 79)	<p>(a) Central Registrar may on request from</p> <ul style="list-style-type: none"> <li>• Federal co-operative to which MSCOS is affiliated or</li> <li>• A creditor or</li> <li>• At least 1/3 of member of board or</li> </ul>

- At least 1/5 of total member of MSCOS, Hold an enquiry or direct some person to enquire into constitutions, working & financial condition of MSCOS. However, before inquiry, 15 days notice is to be given to MSCOS.
- (b) Central Registrar or person authorised, shall have following powers:
- Free access to books / A/c / Cash / Properties in custody of MSCOS in event of serious irregularity, take them into custody. Summon any person to produce the same at any place specified by him.
  - Require the officer to call GM by giving notice of at least 7 days or if officers fail / refuses, he may/call it himself.
  - Summon any person having knowledge to appear before him & examine him on oath.
- (c) Central Registrar within 3 months of receipt of report communicates the report of enquiry to society, Financial Institution & to person at whose instance it is needed.

## Chapter#6

## Special Aspects

## NON-BANKING FINANCIAL COMPANY

<b>Classification of NBFC (Refer to appendix also)</b>	<b>NBFC</b>	NBFC is one whose principal business is that of receiving deposits or that of financial institution. 1. Equipment Leasing Company. 2. Hire Purchase Finance Company. 3. Investment Company. 4. Loan Company. 5. RNBC i.e. Residuary non-banking co. that receives deposits under any scheme.
	<b>MBFC (Mutual benefit Financial Co.)</b>	i.e. Nidhi Co. notified by Central Government u/s 620 A of Companies Act.
	<b>MBC (Mutual Benefit Company)</b>	i.e. Potential Nidhi co. working on lines of Nidhi co. but not so notified by Sec. 620A of Companies Act and Central Government. (Company having minimum net owned fund and preference share capital of 10 lacs. )
	<b>MNBC (Miscellaneous Non-banking co.)</b>	i.e. Chit Fund company. Where a company enters into an agreement with specified number of subscribers to subscribe a certain sum and everyone of them be entitled to a prize amount. (may be by lot).
<b>Audit Procedure</b>	<b>General Procedure</b>	1. Ascertaining the business of the Company. 2. Evaluation of I.C. System. 3. Registration with RBI which is compulsory for companies having minimum net owned funds of Rs.2 crores. Also ascertain whether it has submitted quarterly return with RBI about liquid Assets within 15 days in specified form. Moreover, it must transfer at least 20% of its net profit to reserve fund before any dividend is declared.
	<b>NBFC Public Deposit Directions</b>	<ul style="list-style-type: none"> <li>• Public deposit should be in accordance with the credit rating assigned to it.</li> <li>• Interest calculations should be proper.</li> <li>• NBFC should have accepted public deposit or renewed it only after written application is received by the depositor in a specified form.</li> <li>• Public deposits should be accepted only after advertisement or statement in lieu of advertisement has been filed with RBI.</li> <li>• Check deposit register (payment on due date).</li> <li>• Investment in approved liquid assets and it should be kept in safe custody.</li> <li>• Audited statements to be submitted within 15 days of Holding AGM to RBI.</li> <li>• Annual Return to be submitted to RBI within 6 months from close of year.</li> <li>• If it is not accepting deposits, see Board resolution in this behalf.</li> <li>• For Group holding Investment Company, see board resolution to identify the group.</li> </ul>
	<b>NBFC Prudential norms Directions</b>	(i) Compliance with income recognition and Accounting Standards, etc. (ii) Classification as Standard / Sub-standard / Doubtful / Loss Asset. (iii) Income from NPA - on realization basis. (iv) Previous year's NPA account- continue or not.
<b>Check-list for NBFC</b>	<b>Equipment Leasing Finance Company</b>	<ul style="list-style-type: none"> <li>• Check whether proposals for equipment Leasing are accepted only after proper credit appraisal.</li> <li>• The auditor should verify the adequacy of system in place for ensuring installation of assets and their periodical physical verification.</li> </ul>

		<ul style="list-style-type: none"> <li>The auditor should check the system to monitor whether Asset is adequately insured and properly maintained.</li> <li>Verify the lease agreement.</li> <li>The auditor should ensure that leasing transactions are classified and accounted as per AS-19 "Lease".</li> <li>Ensure that the provisions relating to asset classification, provisioning and income recognition are observed.</li> </ul>
	<b>Hire Purchase Finance Company</b>	<ul style="list-style-type: none"> <li>The auditor should ascertain whether there is an adequate appraisal system for extending hire-purchase finance.</li> <li>The auditor should verify the assets are property charged in the name of the NBFC.</li> <li>The auditor should examine the internal controls to ensure installation of the asset and their periodic physical verification.</li> <li>If the finance is against vehicles, the registration certificate should contain an endorsement in favour of the NBFC.</li> <li>Auditor should verify the system to ensure that hirer have not sold the assets or encumbered them.</li> <li>Whether hire-purchase installments are received regularly.</li> <li>The auditor should verify that hire purchase assets are adequately insured.</li> <li>Check the valuation of goods repossessed.</li> <li>Examine the method of accounting followed for appropriation of finance charges over the period of hire purchase contract.</li> <li>Ensure that the provisions relating to asset classification, provisioning</li> </ul>
	<b>Loan Company</b>	<ul style="list-style-type: none"> <li>Ascertain whether there is proper credit appraisal of applicant and sanction of loans.</li> <li>Verify the terms &amp; conditions of loan agreement</li> <li>Examine the adequacy of security obtained.</li> <li>Check whether adequate records are maintained as regards the bill discounting facilities.</li> <li>Check whether the loans are within the limits.</li> <li>No loans should be given on the security of own shares.</li> <li>He should examine compliance with norms for asset classification, provisioning and income recognition have been adhered to.</li> <li>The auditor should obtain balance confirmation from the borrowers as per SA 505.</li> </ul>
	<b>Investment Company</b>	<ul style="list-style-type: none"> <li>The Auditor should physically verify the investment certificate. For shares/Securities held through depository, obtain confirmation from D.P.</li> <li>Verify whether investments made by the NBFC are within limits. <ul style="list-style-type: none"> <li>Lend <math>\left[ \begin{array}{l} \leq 15\% \text{ of net owned funds to single borrower} \\ \leq 25\% \text{ of net owned fund to single group of borrowers} \end{array} \right.</math></li> </ul> </li> <li>Same is the case with investment. <ul style="list-style-type: none"> <li>Lending + Investment <math>\left[ \begin{array}{l} \leq 25\% \text{ of net owned funds to single borrower} \\ \leq 40\% \text{ of net owned fund to single group of borrowers} \end{array} \right.</math></li> </ul> </li> <li>He should ensure that income in the form of interest, dividend and capital gains is properly recognized.</li> <li>Examine the bills/contract notes received from brokers</li> <li>Verify the authorization of purchase and sale of investments.</li> <li>Check compliance with AS 13 "Accounting for Investments".</li> <li>Ascertain that investments in unquoted debentures and bonds have not been</li> </ul>

		classified as investments but as term loans.
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**Chapter#7****Audit under Fiscal Laws****16.1 INDIRECT TAX AUDIT**

<b>SCOPE OF INDIRECT TAX AUDIT</b>	<p>The indirect tax audit could cover the entire gamut of indirect taxation or be focus) on the specific areas of concern. Some of the areas of concern in indirect tax could be as under :</p> <p>a. Non availment or short / excess availment of export incentives ;</p> <p>b. Goods imported duty free or payment of duty at concessional rates, subject to the compliance with the necessary conditions ;</p> <p>c. Transfer pricing issues ;</p> <p>d. Examination of the applicability of central excise and availability of exemption on the activity and products;</p> <p>e. Valuation of goods as per applicable Rules ;</p> <p>f. Availment and utilization of CENVAT credit ;</p> <p>g. The method of production or marketing and distribution ;</p> <p>h. Procedural non compliance which could lead to demands and losing of benefits.</p>
<b>METHODOLOGY OF INDIRECT TAX AUDIT</b>	<p>a. Evaluation of internal controls as to the proper quantification and discharge of the indirect taxes ;</p> <p>b. Collection of information about the company and the industry with particular information on amount of imports, percentage of customs, amount of remove quantum of CENVAT, proportion of credit, etc.;</p> <p>c. Design the audit programme depending on the evaluation of internal controls. This would include the records to be verified, areas to be verified and the spec aspects to be checked ;</p> <p>d. The staff conducting the audit should be properly trained and should conversant of the applicable laws and procedures. The audit should be consultant in nature without compromising the independence which is required to g opinion;</p> <p>e. The report on indirect tax audit should also provide specific comments on statutory information, material matters reported by way of an executive summary and the assertion or qualification.</p>

**16.2 VAT AUDIT**

<b>MEANING</b>	<ul style="list-style-type: none"> <li>• VAT is a tax on the value added to the commodity at each stage in the production and distribution chain. VAT is an Indirect Tax on consumption.</li> <li>• It is a tax on the value at the retail point of sale which is collected at each stage sale.</li> <li>• The essence of VAT is that it provides credit set off for input tax i.e. tax paid on purchases</li> </ul>
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		against the output tax i.e. tax payable on sales. .
<b>PREPARATION FOR VAT AUDIT</b>	KNOWLEDGE OF BUSINESS	The Auditor should familiarize himself with the business of the Auditee.
	KNOWLEDGE ABOUT VAT LAW AND ALLIED LAWS	The Auditor should study the VAT Law particularly definitions, procedures to be adopted, provision regarding issues of invoices, claiming of input tax credit etc.
	PROVISIONS OF VAT	The following provisions of VAT need to understood : <ul style="list-style-type: none"> <li>• Credit for inputs / supplies (and its accounting)</li> <li>• Credit in case of capital goods.</li> <li>• Utilizing VAT credit for set off</li> <li>• Valuation of inventories / capital goods</li> <li>• Credit for goods lying in stock at inception of VAT scheme.</li> <li>• VAT on sales.</li> </ul>
	MAJOR ACCOUNTING POLICIES	The Auditor should ascertain major accounting policies with regard to sales, purchases and valuation of inventory.
	ACCOUNTING RECORDS MAINTAINED BY AUDITEE	The auditor should obtain a complete list of all the accounting records relating to sales / purchases of goods, stock, various registers, ledgers etc., maintained in which the transactions are recorded.
	EVALUATION OF INTERNAL CONTROL	The Auditor should evaluate the internal controls prevalent in the entity with respect to sales, purchases, production and accounting. He must examine the adequacy and effectiveness of the controls in order to plan the nature and timing of his audit procedures.
PROGRAMME / APPROACH TO AUDIT UNDER VAT LAW	ANALYSIS OF TURNOVER	<p>a. Sales / Purchases of Goods should be determined as per —</p> <p>(i) generally accepted accounting policies, and</p> <p>(ii) definition of Turnover in the relevant VAT Law.</p> <p>b. Differences between general accounting policies and VAT definitions should be reconciled, e.g. Price of the goods returned is deducted from the turnover / sales even if the returns are from Sales effected in the previous years, while under VAT law, the goods returned are to be deducted only if they are made within prescribed time, say 6 months from the date of sale.</p> <p>c. The sale proceeds of a fixed asset will not form a part of turnover or sales as per the generally accepted accounting policies but will form a part of turnover or sales for the purpose of VAT law.</p>

		<p>d. The Auditor should be able to get the exact quantum of the sales under-reported or over-reported duly classified for different tax rates and its impact on overall taxability.</p> <p>e. Sales as per Financial Statements may include the Sales made by all Branches, but for VAT purposes, the Sales of only those branches which are included in one Registration Certificate, will be considered.</p> <p>f. Rate-wise and Commodity-wise reconciliation statements Sales should be examined by the Auditor, and traced into the Total Sales, as reported in the Returns.</p>
	PURCHASES AND INPUT CREDIT	<p>a. The amount of purchases should be tested by applying au checks that will enable the Auditor to get the purchase eligible for grant of input tax credit segregated from of purchases.</p> <p>b. Purchases on which the input tax credit is available in full and the purchases on which it is available partially should also ascertained correctly.</p> <p>c. The Auditor should get the exact amount of the input credit available, compare the same with the credit claimed - the returns and report on the excess / short claim of credit in the returns filed.</p>
	FILING OF RETURNS	The Auditor may also be required to comment on the timely filing of the returns under the VAT law. The Auditor should out the due dates of filing of returns and find out the reasons delay in filing the returns, if any.
	COMPOSITION	The Auditor may also be required to give his report on composition scheme. He should apply suitable compliance to enable him to ascertain whether the auditee is eligible composition, and whether it has paid the requisite compo fee and complied with all the procedural formalities in relation thereto.
	CONSOLIDATION OF RETURNS	<p>a. The Auditor should check the consolidation of re filed for all the periods covered in the year under a both under State-Level VAT Law and the CST Act, These returns are to be compared with the books account and the documentary evidences available.</p> <p>b. In case of any inconsistency, a proper reconciliation book figures and the returned figures should be and also the correct quantification of tax liability is done.</p>

### 16.3 AUDIT OF PUBLIC TRUSTS

<b>INTRODUCTION</b>	<p>Public Charitable Trusts can claim exemption under Sections 11 and 12 of the Income Tax Act, 1961 by complying the following conditions :</p> <ol style="list-style-type: none"> <li>1. Application for the registration of trust shall be made within twelve months from the creation of the trust. The Commissioner of Income Tax has discretionary powers to accept delayed applications.</li> <li>2. Where the total income of the trust without giving effect to the provisions of Sections 11</li> </ol>
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	and 12 exceeds basic exemption limit in any previous year, the accounts of the trust should be audited by an accountant within the meaning of Section 288(2) of the Income Tax Act, 1961. The assessee should also furnish a report in Form 10B.	
<b>AUDIT PROGRAMME FOR THE AUDIT OF PUBLIC CHARTIABLE TRUSTS</b>	<p>An auditor should conduct routine checking during the course of audit of a public trust, in the following manner :</p> <p>(i) Check the books of account and other records having regard to the system of accounting and internal control.</p> <p>(ii) Vouch the transactions of the trust to satisfy that :</p> <ul style="list-style-type: none"> <li>➤ the transaction falls within the ambit of the trust ;</li> <li>➤ the transaction is properly authorized by the trustees or other delegated authority as may be permissible in law ;</li> <li>➤ all incomes due to the trust have been properly accounted for on the basis of the system of, accounting followed by the trust ;</li> <li>➤ all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting followed by the trust ;</li> <li>➤ amounts shown as applied towards the object of the trust are covered by the objects of trust as specified in the document governing the trust.</li> </ul> <p>(iii) Obtain trial balance on the closing date certified by the trustees' duly certified by the trustee ;</p> <p>(iv) Obtain Balance Sheet and Statement of Profit and Loss of the trust authenticated by the trustees and check the same with the trial balance with which they should agree.</p>	
	Annexure to the Audit Report	<p>a. Obtain from the trustees a certified list of persons specified in Section 13(3). These persons are :</p> <ol style="list-style-type: none"> <li>1. Author of the trust.</li> <li>2. A person who has contributed to the trust a sum in excess of ₹ 50,000 by the end of the previous year.</li> <li>3. Where the author is a HUF, a member of the family.</li> <li>4. Trustees/Manager of the trust.</li> <li>5. Any relative of the author, member, trustee or manager of the trust.</li> <li>6. Any concern in which any of the persons referred to-in clauses (1) to (5) has a substantial interest.</li> </ol> <p>b. Obtain from the trustees a statement enlisting the various items specified in Form 10B.</p> <p>c. Verify the information supplied by the trustees.</p> <p>d. Examine the need for a qualification in the report.</p>

**16.4 AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961**

<b>SECTION 44AB OF THE INCOME TAX ACT, 1961 REQUIRES THE FOLLOWING PERSONS TO GET THEIR ACCOUNTS AUDITED</b>	<ol style="list-style-type: none"> <li>1. Every person carrying on business, the total sales turnover or gross receipts which exceeds ₹2 crore in any previous year.</li> <li>2. Every person carrying on a profession whose gross receipts from profession exceeds ₹ 50 lakhs in any previous year.</li> <li>3. Every person carrying on business, income from which is determined on presumptive basis as specified under Sections 44AD or 44AE or 44AF or or 44BBA and who claims income from such business to be lower than rate specified in the sections.</li> </ol>
<b>TAX AUDITOR</b>	<p>The tax audit is to be conducted by an 'Accountant' as defined in the Explanation to Section 288(2) of the Income Tax Act, 1961. According to the section, the 'Accountant' means</p> <ol style="list-style-type: none"> <li>1. A Chartered Accountant within the meaning of the Chartered Accountant Act, 1949, and</li> <li>2. Any other person who is entitled to be appointed as an Auditor of company under Section 139 of the Companies Act, 2013.</li> </ol> <p>As per the Guidance Note on Tax Audit, a Chartered Accountant in practice Firm of Chartered Accountants cannot conduct Tax Audit under section the Income Tax Act, 1961 in the following circumstances –</p> <ol style="list-style-type: none"> <li>(i) Internal Auditor whether working with the Assessee or independently practicing Chartered Accountant or firm of Chartered Accountants a Internal Auditor of the assessee, cannot be appointed as Tax Auditor.</li> <li>(ii) A Chartered Accountant who is responsible for writing or maintenance books of account of the assessee or any partner of such Chartered Accountant the firm in which such Chartered Accountant is a partner cannot a appointment as the Tax Auditor.</li> <li>(iii) A Chartered Accountant cannot accept the Tax Audit assignment in respect of a concern in which he or his relative has substantial interest.</li> <li>(iv) A Chartered Accountant should not accept the tax audit of a person to whom he is indebted for more than ₹ 10,000.</li> </ol>
<b>AUDIT REPORT</b>	<p>The auditor is required to furnish a report on audit of the accounts of the assessee in the prescribed form and setting forth the prescribed particulars.</p> <ol style="list-style-type: none"> <li>1. Form No. 3CA : - This is the form for report in the case of a person who carries a business or profession, the accounts of which have been audited under any other law.</li> <li>2 Form No. 3CB : - This is the form for report in the case of a person who carries on a business or profession, but not being a person referred to in (1) above.</li> <li>3 Form No.3CD : - This is the form containing certain points on which the tax auditor has to provide information. These points require factual information about the assessee. The auditor should consider the following aspects while furnishing the particulars in Form No. 3CD.</li> </ol> <ol style="list-style-type: none"> <li>a) Where a particular item of income or expenditure is covered in more than one of the clauses, suitable cross-references should be given while furnishing the particulars.</li> <li>b) If there is any difference of opinion between the auditor and the assessee in respect of any information, the auditor should furnish both the views.</li> <li>c) If any particular clause is not applicable to the assessee, the auditor should state that such clause is not applicable.</li> <li>d) All particulars should be furnished in accordance with the latest applicable provisions in</li> </ol>

law and the books of account, records, documents, etc.

e) In case the auditor is given incomplete information or information is given in parts, the auditor should not withhold the entire audit report. If he thinks fit, he may qualify the report.

## 16.5 INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

<b>INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)</b>	<p>Section 145 of the Income Tax Act, 1961 deals with the method of accounting.</p> <p>Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.</p> <p>Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assesseees or in respect of any class of income.</p> <p>Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified 10 ICDSs to be followed by all assesseees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income - tax under the head "Profit and gains of business or profession" or " Income from other sources". This notification shall come into force with effect from 1<sup>st</sup> April, 2015, and shall accordingly apply to the A.Y. 2016-17 and subsequent assessment years.</p> <p>All the notified ICDSs are applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts. In the case, of conflict between the provisions of the Income - tax Act, 1961 and the notified ICDSs, the provisions of the Act shall prevail to that extent.</p> <p>The Central Government has prescribed 10 Income Computation and Disclosure Standards (ICDSs) as under :</p> <p>A. ICDS I relating to Accounting Policies.</p> <p>B. ICDS II relating to Valuation of Inventories.</p> <p>C. ICDS III relating to Construction Contracts.</p> <p>D. ICDS IV relating to Revenue Recognition.</p> <p>E. ICDS V relating to Tangible Fixed Assets.</p> <p>F. ICDS VI relating to the Effects of Changes in Foreign Exchange Rates</p> <p>G. ICDS VII relating to Government Grants.</p> <p>H. ICDS VIII relating to Securities.</p>
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I. ICDS IX relating to Borrowing Costs.

J. ICDS X relating to Provisions, Contingent Liabilities and Contingent Assets.

The above ICDS's are to be followed by all assessee following mercantile system of accounting. Therefore, it is clear that those assessees who are following cash system of accounting need not follow the ICDS's notified above.

**Chapter#8****Cost Audit****ADVANTAGE OF COST AUDIT**

To Management	To Society	To Shareholder	To Government
<ul style="list-style-type: none"> <li>Reliable data</li> <li>Check on wastage</li> <li>Inefficiency is identified and corrective action can be taken</li> <li>It facilitates MBE (management by exception)</li> <li>Valuation of closing stock</li> <li>Detection of error and fraud</li> </ul>	<ul style="list-style-type: none"> <li>Fixation of Price</li> <li>Justification of price increase by increase in cost of production</li> </ul>	<p>It ensures that proper records are kept for material, wages etc.</p>	<ul style="list-style-type: none"> <li>Cost plus contract</li> <li>Fixation of Ceiling price</li> <li>Identification of Inefficient unit</li> <li>Protection to certain industries</li> <li>Settlement of Trade Dispute</li> <li>Promoting healthy competition among units in industry.</li> </ul>

**PROGRAMME OF COST AUDIT**

<b>1. Review of Cost Accounting Records</b>	<p>This will include:</p> <ol style="list-style-type: none"> <li>Method of costing in use- batch, process or unit.</li> <li>Method of accounting for raw materials; stores and -spares, wastages, spoilage, defectives, etc.</li> <li>System of recording wages, salaries, overtime etc.</li> <li>Basis of allocation of overheads to cost centers and of absorption by products and apportionment of service department's expenses.</li> <li>Treatment of interest, recording of royalties, research and development expenses, etc.</li> <li>Method of accounting of depreciation.</li> <li>Method of stock-taking and its valuation including inventory policies.</li> <li>System of budgetary control.</li> <li>System of internal auditing.</li> </ol>
<b>2. Verification of cost statements and other data.</b>	<ul style="list-style-type: none"> <li>Licensed, installed and utilized capacities.</li> <li>Financial ratios.</li> <li>Production data.</li> <li>Cost of raw material consumed, wages and salaries, stores, power and fuel, overheads, provision for depreciation, etc.</li> <li>Sales realization.</li> <li>Abnormal, non-recurring and special costs.</li> <li>Cost statements.</li> <li>Reconciliation with financial books.</li> </ul>

**TRUE AND FAIR COST OF PRODUCTION**

- (i) The cost auditor is required to express his opinion on true and fair cost.
- (ii) The cost is said to be true and fair if:
- Accepted Cost Accounting Principles have been applied while arriving at the cost
  - Costing principles are applied on a consistent basis.
  - Costing system appropriate to product is used.
  - All Material items are considered while arriving at the cost.

- Cost sheet is prepared in Prescribed form.
- There is elimination of prior period adjustments in cost sheet.
- Abnormal losses are ignored in determination of cost.

<p><b>For what purposes the Cost Auditor refers to financial records while conducting Cost Audit of an entity?</b> <b>Final May 2002</b></p>	<ul style="list-style-type: none"> <li>• A cost auditor expresses an opinion as to whether the company has maintained proper cost accounting records so as to give a true and fair view of cost of production, etc.</li> <li>• He is required to ascertain the cost of raw materials consumed, cost of power, cost of stock, employer costs, provision for depreciation, fuel etc.</li> <li>• Annexure to the cost audit reports require detailed information in respect of financial position including capital employed, net worth, profit, net rates, operating profit, total wages and salaries, etc.</li> <li>• Thus, cost audit cannot be done without reference to financial books.</li> <li>• Moreover, there is a statutory requirement to have a statement of reconciliation with financial accounts as part of cost audit report.</li> <li>• Further the cost statements also contain a summary of all expenditure incurred by the company.</li> <li>• Naturally this can be done only with reference to financial ledger.</li> <li>• Material discrepancy between financial records and cost records will be highlighted in the reconciliation statement requiring the cost auditor to examine deviation before reporting on the same.</li> <li>• Thus it is clear that the cost auditor needs to refer to financial records for conducting the cost audit.</li> </ul>
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## Chapter#9

## Special Audit Assignment

<p><b>For what purposes the Cost Auditor refers to financial records while conducting Cost Audit of an entity?</b> Final May 2002</p>	<ul style="list-style-type: none"> <li>• A cost auditor expresses an opinion as to whether the company has maintained proper cost accounting records so as to give a true and fair view of cost of production, etc.</li> <li>• He is required to ascertain the cost of raw materials consumed, cost of power, cost of stock, employer costs, provision for depreciation, fuel etc.</li> <li>• Annexure to the cost audit reports require detailed information in respect of financial position including capital employed, net worth, profit, net rates, operating profit, total wages and salaries, etc.</li> <li>• Thus, cost audit cannot be done without reference to financial books.</li> <li>• Moreover, there is a statutory requirement to have a statement of reconciliation with financial accounts as part of cost audit report.</li> <li>• Further the cost statements also contain a summary of all expenditure incurred by the company.</li> <li>• Naturally this can be done only with reference to financial ledger.</li> <li>• Material discrepancy between financial records and cost records will be highlighted in the reconciliation statement requiring the cost auditor to examine deviation before reporting on the same.</li> <li>• Thus it is clear that the cost auditor needs to refer to financial records for conducting the cost audit.</li> </ul>
<p><b>Write short notes own the following:</b> <b>(a) Circuit filters/Circuit breakers.</b> <b>(b) Purposes of appointing inspecting officer of a Depository.</b> 2008 – Nov</p>	<p><b>(a) Circuit Filters/Circuit Breakers:</b></p> <ol style="list-style-type: none"> <li>(i) This is the price band that set the upper and lower limit within which a stock can fluctuate on any particular day.</li> <li>(ii) A price bank for a day is a function of the previous days closing price.</li> <li>(iii) According to SEBI directions circuit filter is applied on scrips traded in rolling settlement, if their price fluctuate more than 10% of the closing price of scrip on the previous day.</li> <li>(iv) Thus circuit filters restrict extreme price movement and resist price manipulation.</li> <li>(v) This also protects investor from extreme fluctuations.</li> </ol> <p><b>(b) SEBI appoints inspecting officers to investigate or inspect the affairs of a depository for any of the following purposes:</b></p> <ol style="list-style-type: none"> <li>(1) To ensure that the books of accounts are maintained in the names specified in the regulations.</li> <li>(2) To look into the complaints received from depositor’s participant, beneficial owners or other persons.</li> <li>(3) To ascertain whether the provisions of the Act, bye-laws agreements and these regulations are being complied.</li> <li>(4) To ascertain whether the systems, procedures and safeguards are being followed in the interests and to secure the market.</li> <li>(5) To ensure that the affairs are being conducted in the interest of the Investors/Securities markets.</li> </ol>
<p><b>Contract notes in case of audit of member of Stock Exchange.</b> 2011</p>	<p><b>Contract Notes in case of Audit of Member of Stock Exchange:</b> Contract note is a document through which a contractual obligation is established between a member and a client. Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf. The contract notes should be issued to the client within 24 hours of execution of the trades. Members are also required to preserve counter-toils or duplicates of the copies of contract notes issued to clients. The member is also required to maintain written consent of</p>

	<p>clients for the contracts entered into as Principal. Contract notes should show the brokerage separately. The total brokerage charged by the member should not exceed the specified value of the-trade.</p> <p>It may be noted that the brokerage percentage is prescribed from time to time. The Contract Notes should be signed by the member or his constituted attorney. When a sole proprietor or partnership firm wishes to authorise another person to sign the contract notes, then the member is required to submit a power of attorney to the Exchange. In case of corporate membership, a board resolution is required to authorize a person including Directors to sign the contract notes. The member thereafter prepares a Contract Note in the prescribed form after adding the brokerage and sends the original Contract Note to the client. The auditor should evaluate the internal control procedures instituted by the stock broker for proper maintenance and issuance of contract notes. He should verify that the transactions done by a member are recorded in the sauda book. It should also be examined that contract notes are issued for all the business conduct on behalf of the clients. The auditor should verify the trades executed with the bills raised.</p>
<p><b>State the functions of Energy Auditor.</b> 2011- Nov</p>	<p>Functions of Energy Auditor: Energy auditing is as an activity that serves the purpose 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 can be compared with that of a financial auditor. The energy auditor is usually 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.</p> <ul style="list-style-type: none"> <li>(i) Quantity energy costs and quantities</li> <li>(ii) Correlate trends of production or activity to energy costs</li> <li>(iii) Devise energy database formats to ensure they depict the correct picture— by product, department, consumer, etc.</li> <li>(iv) Advise and check the compliance of the organisation for policy and regulation aspects.</li> <li>(v) Highlight areas that need attention for detailed investigations</li> <li>(vi) Conduct preliminary and detailed energy audits which should include the following: <ul style="list-style-type: none"> <li>(a) Data collection and analysis.</li> <li>(b) Measurements, mass and energy balances.</li> <li>(c) Reviewing energy procurement practices</li> <li>(d) Identification of energy efficiency projects and techno-economic evaluation</li> <li>(e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.</li> <li>(f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.</li> </ul> </li> </ul>
<p><b>"Margins" or Deposits with Stock Exchanges.</b> 1998- Nov</p>	<p><b>‘Margins’ or ‘Deposits’ with Stock Exchange</b></p> <p>The exchanges witness wide fluctuations in prices of securities over a period of time. in order to restrict excessive speculations and safeguard the interest of the investors, members are- required to maintain certain deposits with the exchange. The members are required to collect margins from their clients and deposit it with clearing house.</p> <p>There are three types of margins:</p> <ul style="list-style-type: none"> <li>(i) <b>Mark to market margin:</b> The objective of this margin is to cover a loss that a member may incur in case the transaction is closed out at the closing price of the trading day, which is different from the price at which the transaction has been entered into.</li> <li>(ii) <b>Volatility Margin:</b> The volatility margin is imposed to curb excessive volatility in the market</li> </ul>

	<p>and to prevent building up of excessive outstanding positions.</p> <p><b>Gross Exposure Margin:</b> Gross exposure margin is the percentage of net cumulative outstanding positions (purchases or sales) in each security that the member should keep with the exchange.</p>
<p><b>Write short notes on Rolling Settlements. 2000-May</b></p>	<p><b>Rolling Settlements:</b> A rolling settlement is one in which trades outstanding at the end of the day have to be settled (payments made for purchases or deliveries in the case of sale of securities)</p> <p>Rolling settlement was first introduced at the over the counter exchange of India (OTCEI) on a T+3 basis. The specified business days are expressed as T+No. of days from the transaction date (T= Transaction date) for example, under “T+2” Rolling settlement, a transaction entered into a Monday should be settled on immediate Wednesday, when the pay-in or payout takes place.</p> <p>Trades on each single day are settled separately from the trades done earlier or subsequent trade days. The netting of trades is done only for the day and not for multiple days. Under this scheme the pay- in and pay-out of funds are effected on same day.</p> <p>For rolling settlement to be successful three essential prerequisites are:</p> <ol style="list-style-type: none"> <li>1. Electronic trading of shares.</li> <li>2. Equity derivatives.</li> <li>3. Stock lending and borrowing schemes.</li> </ol> <p>While rolling settlement is technically possible with physical certificates the infrastructure required is not forthcoming. At the stock exchange level, rolling settlement with physical certificates would involve daily pay-in, pay-out, withdrawal, daily auction and deposits of scrips. The introduction of rolling settlement would most, probably result in the demise of the badla system.</p> <p>In case, a member fails to deliver the shares sold in rolling settlement, the stock exchange conducts an auction session on T+6, the meet the short fall created by non- delivery of shares. in this auction session, offers are invited from other members to deliver the shares sold by originally selling member since delivery has to be made to the buying member. In case no shares are received in auction, the sale transaction is closed-out at a close- out- price, determined by higher of the following:</p> <p>Higher price recorded in the scrip from the settlement in which the transaction book place upto a day prior to the auction.</p> <p>or 20% above the closing price on a day prior to the auction.</p> <p>In this case, the auction price/close-out and difference between sale price, if positive is payable by the seller. Who failed to deliver the scrips, in case, auction/ close out price is less than sale price, the difference is not given to seller but is credited to investor protection fund.</p>
<p><b>Write short notes on Hit or take orders 2002-May</b></p>	<p>Hit or take orders occur in screen-based trading in stock exchange, this is a variation of market orders. it allows for faster order execution without cluttering up the limit order book. This method converts the key strokes or mouse clicks of the broker into a limit order at the touch line price for particular scrip, without his having to place a limit order. Further all unexecuted orders of this type are automatically killed and are therefore not stored in the order book.</p> <p>A broker interested in particular scrip would ask the system to display the touch line of that scrip. He would then operate certain predefined keys or mouse clicks which would be different for buy and sell orders. The system would ask the broker to identify the client and to quantify the order. The system, would then convert his buy or sell order for the quantity specified into a limit order and attach the touch line offer price for a buy order or a touch line bid price for a sell order. This order will be matched against jobber quotes and the order book for the quantity can be executed. The unexecuted quantity if, any will be killed and removed from the system.</p>
<p><b>Types of market under NEAT (National Exchange)</b></p>	<p><b>Types of Market Under NEAT:</b></p> <p>Broadly, there are four types of market under national exchange automated trading.</p> <ol style="list-style-type: none"> <li>1. <b>Normal Market:</b> All orders which are of the regular lot size or multiples thereof are traded in Normal Market.</li> </ol>

<b>Automated Trading)</b> <b>2002-May</b>	<ol style="list-style-type: none"> <li><b>2. Odd Lot Market:</b> An order is called, an odd lot order if the order size is less than the regular lot size, such orders have different settlement periods vis-a-vis normal orders.</li> <li><b>3. Spot Market:</b> in all respects spot orders are similar to the normal market orders except that spot orders have different settlement periods vis-a-vis normal orders.</li> <li><b>4. Auction Market:</b> Stock exchanges on behalf of their members initiate auctions to purchase from the market, the number of shares short deposited by the members. In this way, they complete the settlement process.</li> </ol>
<b>Environmental Audit.</b> <b>2002- Nov</b>	<p>Environmental Audit is an Assessment of the Nature and extent of any harm or detriment or any possible harm or detriment, which may be inflicted on any aspect of the environment by any activity process development programme, or any product chemical, or waste substance.</p> <p>Audits may be designed to:</p> <ol style="list-style-type: none"> <li>1. Verify or other wise comply with environmental requirements</li> <li>2. evaluate the effectiveness of existing environmental management systems.</li> <li>3. assess risks generally; or</li> <li>4. assist in planning for future improvements in environment protection and pollution control.</li> </ol> <p><b>The aspects to be considered while conducting an environmental audit are:</b></p> <ol style="list-style-type: none"> <li>1. Layout and design.</li> <li>2. Management of Resources.</li> <li>3. Pollution control systems.</li> <li>4. Emergent Safety system.</li> <li>5. Medical and Health care facilities.</li> <li>6. industrial hygiene.</li> <li>7. Occupational health.</li> <li>8. Information Assimilation and reporting system</li> <li>9. Compliance to the Regulatory mechanism.</li> <li>10. Concern for the Society.</li> </ol>
<b>Enumerate the main areas to be covered by the auditor in the case of environment audit of an industrial unit.</b> <b>2006 – Nov</b>	<p><b>Main Areas to be Covered in Environment Audit of industrial Unit:</b></p> <ol style="list-style-type: none"> <li><b>1. Layout and Design:</b> The layout should be designed to allow adequate provisions for installing pollution control devices. it should also accommodate up gradation of pollution control measures.</li> <li><b>2. Resource Management:</b> Resources include air, water, land, energy, raw materials and human resources etc. Use of all are interlinked and the best- use in a harmonized manner results in, the best output and minimum waste.</li> <li><b>3. Pollution Control System:</b> An effective system of pollution control should be in existence. The efficacy of the pollution control measure system should be ascertained.</li> <li><b>4. Emergency safety Arrangement:</b> Safety arrangements should remain ale 1 all the time. Staff equipped with requisite awareness and alertness should be engaged to meet contingency.</li> <li><b>5. Medical &amp; Healthcare &amp; Industrial Hygiene:</b> Adequate medical facilities should be maintained. A proper system should be established to eliminate industrial unhygienic state.</li> <li><b>6. Information Assimilation and Reporting System:</b> information System should be strengthened to generate and its reporting system should be proper. A report of compliance of all statutory environmental law should be put to Board at regular intervals.</li> <li><b>7. Regulatory Mechanism:</b> Persons who are directly working with the system are generally unaware of the latest developments and requirements for the compliance of stipulations and standards prescribed by the various regulatory authorities.</li> </ol>

	<p><b>8. Environmental Impact Assessment:</b> The system should be designed to accommodate deviations in predictions from the actual happening.</p> <p><b>9. Concern for the Society:</b> This aspect should be considered to make a balance between its own development and the society concern</p> <p><b>10. Occupational Health:</b> Safeguards against occupational Health hazards should be made available for all the workers.</p>
<p><b>Contents of Audit report of Mutual Fund. 2007 –May</b></p>	<p><b>Contents of Audit Report of Mutual Fund</b></p> <p>The auditor’s report shall comprise the following:</p> <ol style="list-style-type: none"> <li>1. Whether he has obtained all information explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit.</li> <li>2. Whether the balance sheet and revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the fund for the accounting period to which the Balance sheet or, as the case may be the Revenue account relates.</li> <li>3. Whether the statement of account has been prepared in accordance with accounting policies and the standards as specified in Ninth Schedule.</li> </ol>

## Chapter#10

## Audit of Public Sector Undertaking

## PROPERTY AUDIT

<b>Meaning</b>	<ul style="list-style-type: none"> <li>• “Propriety Audit stands for verification of transactions on the test of public interest, commonly accepted customs &amp; standards of conduct”.</li> <li>• Propriety is that which meets the tests of public interest, commonly accepted customs; and standards of conduct and particularly as applied to professional performance, requirement of law. Government regulations and professional codes” — E.L. Kohler.</li> <li>• If shifts the emphasis to substance of transaction.</li> </ul> <p><b>It requires transactions (mainly expenses) to conform to certain general principles:</b></p> <ol style="list-style-type: none"> <li>1. Expense is not prima facie more than the occasion demands and same degree of vigilance is exercised as should be exercised in respect of his own money.</li> <li>2. Authority exercises its power of sanctioning expenses to pass an order which will not accrue to its own advantage.</li> <li>3. Funds not utilized for benefit of a particular person /group.</li> <li>4. Apart from agreed remuneration, no other avenue is kept open to benefit management personnel, employees and others.</li> </ol>
<b>Problems in property audit</b>	<ul style="list-style-type: none"> <li>• It is a moral term.</li> <li>• Auditing requires verifiable propositions, establishment of which is very difficult for propriety audit.</li> <li>• It has inherent element of subjectivity.</li> <li>• However, CAG has developed norms of propriety for expenses of public funds but may not apply to transactions of private sector.</li> <li>• If management formulates norms of propriety for the entity, the element of subjectivity will get reduced.</li> <li>• For example- Travel by air (It may be judged as wasteful. However, it becomes feasible due to time saving).</li> <li>• The judgment of auditor shouldn't be subjective as far as possible.</li> </ul>
<b>Property element u/s 227 (1A)</b>	<ul style="list-style-type: none"> <li>• Whether terms on which secured loans and secured advances have been made are not prejudicial to the interests of the company or its members. Conditions like security, interest, repayment period and other business considerations.</li> <li>• Whether transactions of company which are represented merely by book entries are not prejudicial to the interest of company, i.e. effects of book-entries, unsupported by transactions, etc.</li> <li>• Whether investment of company (other than Banking/Investment company) in form of share, debenture and other securities have been sold at a price lower than its cost, i. e. to see reasonableness of decision to sell at loss.</li> <li>• Whether personal expenses have been charged to revenue.</li> </ul>
<b>Property element under cost audit report</b>	<ul style="list-style-type: none"> <li>• Matters appearing clearly wrong in principle or apparently wrong.</li> <li>• Cases where company's funds have been used in negligent/inefficient manner.</li> <li>• Factors which could have been controlled but haven't been, thus, resulting in increase in cost of production.</li> </ul>
<b>Property elements in CARO, 2003</b>	<p>Has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under Section 301 of the Act. If so, give the number of parties and amount involved in the transactions. [Paragraph 4 (iii) (a)]</p> <p>Whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima-facie prejudicial to the interest of the company. {Paragraph 4 (iii) (b)}</p> <p>Whether the receipt of the principal amount and interest are also regular. [Paragraph 4 (iii) (c)]</p>

	If overdue amount is more than one lakh, whether reasonable steps have been taken by the company for recover of the principal and interest. [Paragraph 4 (iii) (d)]
	Whether the particulars or arrangements referred to in Section 301 of the Act have been entered in the register required to be maintained under that section. [Paragraph 4 (v) (a)] Whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time. [Paragraph 4 (v) (b)] [This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in any one financial year.]
	Is the company regular in depositing undisputed statutory dues including Provident fund, Investor Education and Protection Fund, Employees' State insurance, Income-Tax, Sales-tax, VAT, Service tax, Wealth tax, Custom Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor. [Paragraph 4(ix) (a)]
	In case dues of Income Tax/ Sales Tax/ Wealth Tax/ Service Tax/ Custom Tax Excise Duty/ Cess have not been deposited on account of any dispute, the amounts involved and the forum where dispute is pending shall be mentioned. [Paragraph 4 (ix) (b)]
	Whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; if not, the deficiencies to be pointed out. [Paragraph 4 (xii)]
	Whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company [Paragraph 4(xv)]
	Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act, and if so whether the price at which shares have been issued is prejudicial to the interest of the company. [Paragraph 4 (xviii)]

<p><b>State the salient features of the directions to the auditors of Government companies issued by the Comptroller and Auditor General of India u/s 619(3) of the Companies Act, 1956 in relation to:</b></p> <p><b>(i) Assets and Investments, and</b></p> <p><b>(ii) Inventory and Contracting</b></p> <p><b>Final Nov 2006</b></p>	<p><b>(i) Assets and Investments:</b></p> <p>(i) Whether the property and assets registers are posted upto date and are reconciled with the financial books?</p> <p>(ii) Have the dates of installation and commissioning of plant and Machinery been clearly fixed by the competent authority?</p> <p>(iii) Examine whether the company has a system of monitoring the timely recovery of outstanding dues? Highlight the significant instances of failure of the system, if any.</p> <p>(iv) State whether the cash and imprest balances were physically verified during the year on a regular basis by an authorized office? Highlight the inadequacies in this regard, if any.</p> <p>(v) Indicate whether the company has laid down an investment policy? If yes, please indicate the salient features thereof.</p> <p>(vi) Whether the deposits with Banks/ financial Institutions and others have been in accordance with laws. rules, regulations etc.? Further state whether these were properly authorized by the competent authorities.</p> <p><b>(ii) Inventory and contracting:</b></p> <p>(i) Examine whether the company has prescribed the following in regard to the stores:</p> <p>a. Maximum and minimum limits of stores and spares.</p>
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	<p>b. Economic order quantity for procurement of stores.</p> <p>Examine whether the company usually makes advance payments to suppliers contractors? If so indicate whether the company has an efficient system for monitoring and adjusting such advances?</p>
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## Chapter#11

## Internal Management and Operational Audit

<p><b>General objectives of an operational audit.</b> 2011 – May</p>	<p><b>General objectives of operational audit are as follows:</b></p> <ul style="list-style-type: none"> <li>(i) Appraisal of controls: Operations and the results in which management is interested are largely a matter of control. If controls are effective in design and are faithfully adhered to the result that can be attained then they will be subject to the other limiting constraints in the organization.</li> <li>(ii) Evaluation of performance: The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise. Even when examining of appraising performance or reports of performance the operational auditor'..... is invariably fixed on control aspects.</li> <li>(iii) Appraisal of objectives and plans: In performance appraisal, the operational auditor is basically concerned with effectiveness, efficiency and economy with which operations are being carried on and not so much with how well technically the operation are going on.</li> <li>(iv) Appraisal of organizational structure: In evaluating organizational structure, the operational auditor should consider whether the structure is in conformity with the management objectives and it is drawn up on the basis of matching of responsibility and authority. He should also analyse whether line of responsibility has been fixed whether delegation of responsibility or authority is clear and there is not overlapping area.</li> </ul>
<p><b>What are the major differences between Financial and Operational Auditing?</b> 2008-May</p>	<p><b>The major differences between financial and operational auditing can be described as follows:</b></p> <ul style="list-style-type: none"> <li>(i) <b>Purpose:</b> The financial auditing is basically concerned with the opinions that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes on effectiveness and efficiency of operations for future performance.</li> <li>(ii) <b>Area:</b> Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements whereas the operational audit covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organisation.</li> <li>(iii) <b>Reporting:</b> The financial audit report is sent to all stock holders, bankers and other persons having interest in the organisation. However, the operational audit report is primarily for the management.</li> </ul> <p>The main objective of operational auditing is to verify the fulfillment of plans, and sound business requirements. Operational auditing is considered as specialized management information tool. Operational auditing is essentially a function of internal auditing staff. Operational auditing is a systematic process of evaluating an organisation's, effectiveness, efficiency and economy of operations under management control and reporting to appropriate persons, the result on the evaluation along with recommendations for improvements. Operational audit concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting or the findings but also recommends the steps for improvements in future. Operational auditing is not different from internal auditing, it is</p>



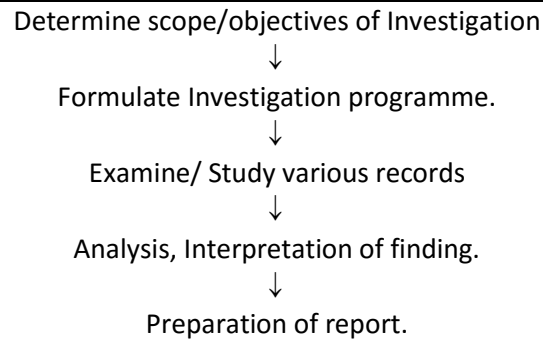
	<p>merely an extension of internal auditing into operational areas.</p> <p>While in financial auditing, the concentration is more in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are minimized or removed. In financial auditing, an auditor is called upon to review the financial statements of an enterprise to ascertain whether they reflect true and fair view of its state of affairs and of its working results. He may analyses the operations of an enterprise to appraise their cost effectiveness and also he may seek evidence to review the managerial performances.</p>
<p><b>Mention the nature and causes of behavioural problems livery to be faced by Management auditor.</b> 1998-Nov</p>	<p><b>Behavioural aspects encountered in a Management Audit</b></p> <p>Financial auditors deal mainly with figures. Management auditors deal mainly with people. There are many causes for behavioural problems arising in the review function of management audit. i Particularly, when management auditors performs comprehensive audit of operations, they cannot be as well informed about such operations as a financial auditor in a financial department. Operating processes may be unfamiliar and complex. The operating people may be speaking a language and using terms that are foreign to the auditor's experience. The nature and causes of behavioural problems that the management auditor is likely to face in the discharge of the review function that is expected of him and possible solutions to overcome these problems are discussed below:</p> <p><b>1. Staff/Line conflict:</b> Management auditors are staff people while the members of other departments are line people. Management auditors tend to discount the difficulties the line staff may face, if called on to act on the ideas of management auditors. Management auditors are specialists in their field and they may think their approach and solutions are the only answers.</p> <p><b>2. Control:</b> The management auditor is expected to evaluate the effectiveness of controls, there is an instinctive reaction from the auditee that the report of the auditor may affect them. There is a fear that the action taken based on the management audit report will affect the line people. it breeds antagonism. The causes are as under:</p> <ul style="list-style-type: none"> <li>(i) Fear of criticism stemming from adverse audit findings.</li> <li>(ii) Fear of change in day to day working habits because of changes resulting from audit recommendations.</li> <li>(iii) Punitive action by superior prompted by reported deficiencies.</li> <li>(iv) Insensitive audit practices.</li> <li>(v) Hostile audit style.</li> </ul> <p><b>Solution to behavioural problems:</b> The following steps may be taken to overcome the aforesaid problems:</p> <ul style="list-style-type: none"> <li>(i) To demonstrate that audit is part of an overall programme of review for protective and constructive benefit.</li> <li>(ii) To demonstrate the objective of review is to provide maximum service in all feasible managerial dimensions.</li> <li>(iii) To demonstrate the review will be with minimum interference with regular operation.</li> <li>(iv) The responsible officers will be involved in the process of review of the findings and recommendations before the audit report is formally released.</li> <li>(v) it is essential to create an atmosphere of trust and friendliness so that audit reports will be understood in their proper perspective.</li> </ul> <p>Finally, it needs hardly any emphasis that there should be right management culture, enlightened, auditees and auditors of the right calibre. May be to expect a combination at all times of all the three is asking for the impossible. But, a concerted effort by the management, auditors and auditees to achieve a more acceptable climate would go a long way to achieve the goal.</p>
<p><b>K Ltd., requires you</b></p>	<p><b>Organizing a Management Audit for K Ltd.:</b> The key requirement for a successful Management</p>

<p><b>to organize a Management audit program. Briefly ate a plan of action.</b> 2007-May</p>	<p>audit program would be the approval and support of the top management to initiate. Accordingly the following shall be the matters that should be considered while organizing the Management Audit of K. Ltd.</p> <ul style="list-style-type: none"> <li>(i) <b>Devising a statement of policy:</b> in consultation with the top Management, a policy statement on Management should be issued. The policy should ideally cover the scope, objective, the authority of the management audit function. In short the policy should be drafted to become a charter of Management Audit.</li> <li>(ii) <b>Location of audit function within the organization:</b> The hierarchical status of the Management auditor and his team should be clearly defined.</li> <li>(iii) <b>Allocation of personnel:</b> The Management audit team should comprise of personnel who have adequate experience on all the facets of the organization, ideally it should comprise of technical audit team.</li> <li>(iv) <b>Staff Training:</b> In order to maintain qualitative standards, adequate and continuous training should be offered to the Management audit team.</li> <li>(v) <b>Time and other aspects:</b> While planning management audit adequate consideration should be given to time &amp; cost involved in conducting the audit.</li> <li>(vi) <b>Frequency of audit:</b> Depending on the pace of change that happens in that industry, the frequency of the Management audit should be determined. This can be fixed in consultation with the top Management.</li> </ul>
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## Chapter#12

## Investigation

## STEPS IN INVESTIGATION



## INVESTIGATION ON BEHALF OF INCOMING PARTNER

<b>Main Purpose</b>	<ul style="list-style-type: none"> <li>• Sometimes, the incoming partner appoints the investigator to examine the affairs of the partnership firm.</li> <li>• Here the incoming partner is interested in judging whether the terms and conditions offered to him are reasonable.</li> <li>• On the basis of investigation, he wants to decide whether it is feasible and desirable for him to join the said firm.</li> </ul>
<b>Considerations by investigator</b>	<ul style="list-style-type: none"> <li>(i) First of all, he should ascertain the reasons for offer of admission to a new partner.</li> <li>(ii) Then he should study the history and growth pattern of the firm.</li> <li>(iii) He should study financial statements of previous 3-5 years to determine its profitability in past years.</li> <li>(iv) Compare the rate of return in the said firm with the common rate of return in the said field.</li> <li>(v) He should also examine assets and liability position of the firm.</li> <li>(vi) He should pay proper attention to any hidden liability or overvalued asset.</li> <li>(vii) Investigator should carefully study the provisions of the partnership deed.</li> <li>(viii) Special attention should be given to some specific points w.r.t. partnerships, such as profit sharing ratio, interest on capital etc.</li> <li>(ix) Manner of computation of goodwill on admission and retirement of a partner should be ascertained.</li> <li>(x) The reputation of the firm as well as that of partners should be properly ascertained.</li> <li>(xi) He should study the quality i.e. skill and competence of key management personnel.</li> <li>(xii) He should study the important contracts etc. For example, any lease contract.</li> </ul>

## INVESTIGATION ON BEHALF OF BANK PROPOSING TO ADVANCE LOAN TO A COMPANY

<b>1. Main Purpose</b>	<p>Whenever a prospective borrower approaches the bank for loan, the bank is primarily interested in knowing</p> <ul style="list-style-type: none"> <li>• the purpose for which a loan is required.</li> <li>• the source from which it would be repaid; and</li> <li>• the security offered by the borrower</li> </ul>
<b>2. Investigator should obtain knowledge on</b>	<ul style="list-style-type: none"> <li>• The loan proposal submitted by borrower.</li> <li>• The purpose for which the loan is required and its repayment schedule.</li> <li>• The creditworthiness and reputation of the board of directors.</li> <li>• The Memorandum or the Articles of Association of the company to assure that it is in fact empowered to borrow money.</li> </ul>

	<ul style="list-style-type: none"> <li>• The historical background and growth trend of the company during the past years.</li> <li>• Other loan obligations of the company, if any to check whether the company is regular in paying instalments thereon.</li> <li>• The growth and profit prospects of the company considering present economic scenario.</li> </ul>
<b>3. Examination of Profitability and stage of affairs.</b>	<ul style="list-style-type: none"> <li>• The investigating accountant should prepare a condensed income statement from the P&amp;L account for the previous five years so that it can be ascertained whether the company has strong past as far as profitability is concerned.</li> <li>• Moreover, he should compute profitability and financial ratios such as Debt equity and current ratios so that overall position of the company can be judged.</li> <li>• The investigator should also study the cash flow statements of the company to decide whether there has been consistent cash flow from the operating activities.</li> <li>• He should study various items of balance sheet. Assets are examined to ensure their existence, ownership and proper valuation. Special attention should be given to possibility of their overvaluation in the financial statements</li> <li>• intentionally to show strong financial position. It should also be ascertained that various assets are properly insured.</li> <li>• Liabilities should be ascertained to ensure the company's present and future obligations. It should also be examined whether all liabilities have been included by the management.</li> <li>• Moreover, he can devise projected statements so that recoverability of loan can be judged.</li> <li>• These will help the bank to decide whether to grant loan to the applicant or not.</li> </ul>

## Investigation of Frauds

<b>1. Cash Receipts</b>	<ul style="list-style-type: none"> <li>(i) First of all different sources from which income is generated, should be ascertained.</li> <li>(ii) Sometimes the management/A Employees do not account for income from some source at all. Thus, it should be ascertained whether income from all sources is accounted or not.</li> <li>(iii) Income from small or negligible source like sale of old newspaper should be carefully examined as chances of manipulation in such accounts are high.</li> <li>(iv) Copies of receipts should be carefully checked.</li> <li>(v) Receipts from customers should also be properly examined.</li> <li>(vi) Unreasonable cash discounts shown in the books should be properly enquired into.</li> <li>(vii) It should also be ensured that receipts are serially numbered and all receipts have been accounted for.</li> <li>(viii) In case of any cancelled receipt, its original copy should be properly scrutinized.</li> </ul>
<b>2. Cash Payments</b>	<ul style="list-style-type: none"> <li>(i) Internal Controls on cash payment should be carefully examined to ensure that all payments are properly authorized by competent authority.</li> <li>(ii) Acknowledgement for payment should be matched against the bill raised by the relevant party.</li> <li>(iii) Payments by bearer cheque can be manipulated, thus such payments should be carefully examined.</li> <li>(iv) Small payments such as petty cash expenditure should be thoroughly examined.</li> <li>(v) Any unusual payment such as exceptional rise in traveling expenses as compared to that of previous year should be further inquired into.</li> <li>(vi) Possibility of fake payment to dummy workmen is particularly high in some industries such as construction houses. Thus investigator should carefully examine internal controls over this area such as biometric entry.</li> <li>(vii) Alterations made in payment records should also be carefully examined.</li> </ul>

	(viii) Payments to related parties should be specially enquired as possibility of manipulations is high therein.
<b>3. Balance in Customers Ledger</b>	<ul style="list-style-type: none"> <li>(i) Trace the entries in order book with the corresponding record in sales daybook.</li> <li>(ii) Examine customer's account to ensure that they have been properly debited at appropriate amount.</li> <li>(iii) The amounts written off as bad debt should be carefully examined.</li> <li>(iv) Any unusual discounts given to them should be thoroughly enquired into and written representation should be obtained from appropriate authority in this connection.</li> <li>(v) Attention should be given to the teeming and lading frauds in such accounts.</li> <li>(vi) Balance confirmation from customers should be obtained.</li> </ul>
<b>4. Balance in Suppliers Ledger</b>	<ul style="list-style-type: none"> <li>(i) Goods inwards book should be examined w.r.t. entries made in supplier's account.</li> <li>(ii) Examine that credits have been raised in respect of actual goods received.</li> <li>(iii) Carefully examine whether rebates given by them have been appropriately adjusted or not.</li> <li>(iv) Special attention should be given to such accounts where supplier is a related party.</li> <li>(v) Balance confirmation from them should be obtained to confirm amount due to them.</li> </ul>
<b>5. Stock Defalcation</b>	<ul style="list-style-type: none"> <li>(i) Confirm whether there is strict internal controls over receipt, issue &amp; storage of stock.</li> <li>(ii) There should be stringent controls w.r.t. high value stock.</li> <li>(iii) The honesty and ethical values of persons in charge of stores should be inquired into because generally fraud in stores is possible through collusion among employees.</li> <li>(iv) Investigator should carefully go through the various records relating to inventories.</li> <li>(v) He should physically check the quantities and reconcile them with those shown in records.</li> <li>(vi) Any shortages observed therein should be further investigated.</li> <li>(vii) Small items of inventories should also be examined to rule out the possibility of pilferages.</li> </ul>

## DUE DILIGENCE

<b>1. Meaning</b>	<ul style="list-style-type: none"> <li>• This term is used in relation to corporate restructuring.</li> <li>• Corporate restructuring includes internal reconstruction, amalgamations, mergers, joint ventures, etc.</li> <li>• However, Corporate restructuring involving more than one party should be planned properly. Thus, in such cases, due diligence is conducted.</li> <li>• Thus, due diligence review is performed to check whether it is feasible and desirable to acquire/ merge the unit.</li> </ul>
<b>2. Components of D.D.</b>	<p>Discipline-wise it can be classified as follows:</p> <ul style="list-style-type: none"> <li>• <b>Commercial / Operational Due Diligence:</b> i.e. to check whether the target is commercially feasible.</li> <li>• <b>Financial Due Diligence:</b> To check the financial feasibility of the target by examining the financial statement and devising their profit trends.</li> <li>• <b>Tax Due Diligence (Direct and Indirect):</b> Whether the target is paying appropriate taxes on a regular basis. Moreover, ascertain what the tax benefits available to target are.</li> <li>• <b>Information System Due Diligence:</b> Whether information system of target is providing right information to the right management at the right time in the right quantity.</li> <li>• <b>Legal Due Diligence:</b> Whether the target is complying with all the applicable laws and regulations.</li> </ul>

- **Environmental Due Diligence:** To check the compliance of target with environmentally related rules and regulations.
- **Personnel Due Diligence:** To ascertain whether the employees of target company are competent and efficient.

## FINANCIAL DUE DILIGENCE

<b>Relation with other D.D.</b>	Sometimes, the financial due diligence is interpreted as Complete Due diligence, since it is supposed to ascertain the financial implication of all other Due Diligence. This is however not appropriate. It is less than over all Due Diligence review.	
<b>Coverage</b>	<b>Brief History of Target and Background of its Promoters</b>	<p>The auditor should begin the financial due diligence by looking into the history of the company and background of its promoters. The following points should be considered by the auditor:</p> <ul style="list-style-type: none"> <li>• How the company was set-up and who were the promoters;</li> <li>• Market share enjoyed by the target in past and change therein;</li> <li>• Any regulatory requirement in past that may have impact on the business of the target.</li> <li>• Relevant inquiry about the history of target’s business, product, expenses, suppliers, markets, etc.</li> </ul>
	<b>Accounting Policies</b>	<p>The auditor should consider the following points in relation to Accounting Policies:</p> <ul style="list-style-type: none"> <li>• What Accounting Policies are followed by the target.</li> <li>• Whether Accounting Policies followed by the target are appropriate.</li> <li>• Consider the effects of the recent changes in Accounting Policies.</li> <li>• Whether target has not changed its Accounting Policies recently with an intention to sell itself.</li> <li>• The areas in which Accounting Policies followed by the target and the acquiring enterprises are different and impact of such difference.</li> </ul>
	<b>Review of Financial Statement</b>	<p>The following points should be considered:</p> <ul style="list-style-type: none"> <li>• Whether the financial statement is prepared in accordance with relevant financial reporting framework required for preparation and presentation of financial statements.</li> <li>• Review the operating result of the target in detail, as the price of the target is largely based upon its operating results.</li> <li>• Consider the presence of any extra-ordinary item of income or expenses that might have affect the operating results.</li> <li>• Compare the actual figures with the budgeted figures.</li> <li>• Consider the basis upon which assets have been valued and liabilities have been recognized.</li> <li>• Check whether the net worth of the business has been arrived by taking into account the impact of over / under valuation of assets and liabilities.</li> <li>• Pay particular attention to the valuation of Intangible assets.</li> <li>• Look specifically for any hidden liabilities or overvalued assets.</li> </ul>
	<b>Taxation</b>	<p>He should consider the following points in relation to taxation:</p> <ul style="list-style-type: none"> <li>• Whether company is regular in paying various taxes to the Government.</li> <li>• Whether the registration of the enterprises has been made under the various tax law.</li> </ul>

		<ul style="list-style-type: none"> <li>Consider the tax effects of the merger or acquisition.</li> <li>Verify whether any tax holiday is available to the target.</li> </ul>
	<b>Cash Flow</b>	<p>He should review the cash generating abilities of the target company by considering the following points:</p> <ul style="list-style-type: none"> <li>Whether the company is able to meet its cash requirement through internal sources or it has to seek external help.</li> <li>Whether the company is able to honor its commitments with its creditors, bank, Government, Stake-holders, etc.</li> <li>If the company is able to generate cash from its debtors on a timely basis.</li> <li>Whether any fund lying idle with the company.</li> <li>Whether company is reaping more benefits out of the available funds.</li> </ul>
	<b>Financial Projections</b>	<p>The following points should be considered:</p> <ul style="list-style-type: none"> <li>The auditor should obtain the projection of next 5 years from the target company.</li> <li>Auditor should ask them to give projections on optimistic, pessimistic and most likely basis.</li> <li>Evaluate the assumptions used in preparation of financial projection.</li> <li>Mention in the report if auditor feels that the projections provided by the target are not achievable or aggressive.</li> </ul>
	<b>Management and Employees</b>	<p>In his regard, he should consider the following points:</p> <ul style="list-style-type: none"> <li>Check whether all the Employee benefits like P.F., ESI, Gratuity leave encashment, etc. have been properly paid or provided.</li> <li>The auditor should consider whether the assumption regarding increase in salaries etc. are reasonable.</li> <li>Consider whether all the eligible employees have been covered for PF, ESI, etc</li> <li>Check whether the pay packages of the key employees are appropriate or need to be revised in near future.</li> <li>Identify those key employees who will not continue after the acquisition.</li> </ul>
	<b>Statutory Compliance</b>	<p>This is the aspect that the auditor should investigate in detail:</p> <ul style="list-style-type: none"> <li>Make a list of the various laws that are applicable to the entity.</li> <li>Check whether company is liable for any Punitive charges for non-compliance of such laws.</li> </ul>

#### CONTENTS OF DUE DILIGENCE REPORT

- Summary
- History of Target
- History of Promoters
- Review of Operational D.D.
- Review of Financial D.D.
- Review of Tax D.D.
- Review of Information System D.D.
- Review of Legal D.D.
- Review of Environmental D.D.
- Review of Personnel D.D.
- SWOT Analysis.
- Suggestion.

Question:

CA Dr Mahesh Gour  
9320473019

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8879377367

Prof Khushboo Sanghavi  
8082736683

**Your client is contemplating taking over a manufacturing concern and desires that in the course of due diligence review, you should look specifically for any hidden liabilities and overvalued assets.**

**State (in brief) the major areas you would examine for the above. (8 Marks)(Final Nov 2005)**

(Final Nov 2010)

**Answer:**

Due diligence is undertaken to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements.

**Hidden liabilities**

- ❖ Product and warranty liabilities, product returns & discounts, liquidated damages, etc.
- ❖ Contingent liabilities not shown in books
- ❖ Any show cause notice, which have not matured into demands but may be material and important.
- ❖ Letters of comforts given to banks and financial institutions
- ❖ Tax liability under direct and indirect taxes.
- ❖ Long pending sales tax assessment.
- ❖ Cases of custom duty where only provisional assessment has been made and final assessment is yet to completed.
- ❖ Claims against the company including third party claims.
- ❖ Future lease liabilities.
- ❖ Agreement to buy back shares at a stated price.
- ❖ Labour claims under negotiations.
- ❖ Unfunded retirement benefit of employees.

**Overvalued assets:** The auditor shall have to specifically examine the following areas:

- ❖ Obsolete, slow and non-moving inventories and inventories valued above net realizable value, if any.
- ❖ Obsolete and unused plant and machinery and their spares.
- ❖ Investment shown at cost whose market value is much lower.
- ❖ Assets shown in books above market value due to capitalization of revenue expenditure.
- ❖ Intangibles of no value.
- ❖ Uncollectable receivables.
- ❖ Investment carrying very low rate of return.
- ❖ Assets under litigation.



**Chapter#13****Peer Review****INTRODUCTION**

- The concept of Peer review first came into existence in March 2002.
- Peer review is conducted to assure that profession is conscious of its responsibilities and strive its best to ensure that highest standards are observed by all practicing members rendering audit and attestation services to the society.
- It involves examination of the systems and procedures of the PU (Practice Unit).
- To ensure that in professional assignments, the member of ICAI,
  - (a) Comply with technical standard, and
  - (b) Have proper system to maintain quality of work.

**PEER REVIEW PROCESS**

<b>Stage I: Planning</b>	<b>Empanelment of Reviewers</b>	A panel of reviewers is maintained by the Peer Review Board. He should be: <ol style="list-style-type: none"> <li>(a) a member of ICAI;</li> <li>(b) possessing at least 10 years experience of audit; and</li> <li>(c) currently active in the practice; and</li> <li>(d) free from any obligation or conflict or interest in the reviewed firm or its partners or personnel.</li> </ol>
	<b>Selection of the Practice Unit</b>	PU's are selected for Peer Review on a random basis, as per applicability.
	<b>Intimation to the Practice Unit</b>	An Intimation in writing is sent by the Board to the practice unit informing of its selection for peer review. The following documents shall also be sent to the practice unit. <ol style="list-style-type: none"> <li>(i) A copy of the statement on Peer Review.</li> <li>(ii) A panel of three reviewers.</li> <li>(iii) A copy of the questionnaire.</li> </ol>
	<b>Initial Communications by the Practice Unit</b>	<ul style="list-style-type: none"> <li>• The practice unit is required to communicate to the Board, its choice of the reviewer within a period of 15 days from the receipt of intimation.</li> <li>• The practice unit is also required to complete and send the questionnaire to the reviewer within one month of the receipt of the intimation, along with a complete list of its attestation service engagement clients.</li> <li>• The reviewer is entitled to seek such other information also as the reviewer considers necessary.</li> </ul>
	<b>Selection of Sample Attestation Service Engagements</b>	<ul style="list-style-type: none"> <li>• The reviewer also selects a sample of attestation service engagements on random basis for review.</li> <li>• The reviewer is required to select a sample that is representative of the practice unit's client portfolio.</li> </ul>
	<b>Communication of sample selection</b>	<ul style="list-style-type: none"> <li>• The reviewer sends a written intimation to the practice unit about the sample selected by the reviewer, two weeks in advance, from the date the reviewer intends to begin the review.</li> <li>• The intimation also contains a request for ready availability of that relevant records.</li> </ul>

	<b>Confirmation of visit</b>	<ul style="list-style-type: none"> <li>The reviewer, in consultation with the practice unit, is required to fix the date(s), for on-site review.</li> <li>Date(s) are to be fixed in a manner so that the peer review process is completed within four months of the receipt of intimation by the practice unit.</li> </ul>
<b>Stage II: Execution</b>		<ul style="list-style-type: none"> <li>Such visits will be conducted at the practice unit's head office.</li> <li>The reviewer may not visit a branch (outside the city/ town limits from head office) of practice unit unless the turnover of attestation functions of that branch is more than one million rupees.</li> <li>In such a case, he may instruct the practice unit to get relevant records to the head office.</li> </ul>
	<b>Initial Meeting</b>	<ul style="list-style-type: none"> <li>An initial meeting should be held between the reviewer and the partner (designated by the practice unit for the purpose) or the sole proprietor of the practice unit.</li> <li>The purpose of the meeting is to confirm the accuracy of responses to the questionnaire.</li> <li>The reviewer should have a full understanding of the systems and procedures at the conclusion of the meeting.</li> </ul>
	<b>Compliance Review</b>	<ul style="list-style-type: none"> <li>The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration.</li> <li>The reviewer should review these general controls to gain an understanding of the working of the practice unit and specific control procedures existing at the practice unit.</li> <li>Apart from making inquiries with the personnel concerned, the reviewer may adopt other procedures to establish the fairness of the responses by the practice unit to the questions. Selection of other procedures or techniques is a matter of the reviewer's judgment.</li> </ul>
	<b>Selection of Attestation Service Engagements</b>	<ul style="list-style-type: none"> <li>The number of attestation service engagements to be reviewed depends upon the number of practicing members involved, degree of reliance to be placed on general controls and the total number of engagements undertaken by the practice unit during the period under review.</li> <li>The reviewer may modify the initial sample selected for review in consultation with the practice unit at the execution stage.</li> </ul>
	<b>Review of Records- Compliance and substantive Approach</b>	<ul style="list-style-type: none"> <li>The reviewer may adopt the compliance approach in determining the nature, timing and extent of the substantive review procedures to be applied in review.</li> <li>The reviewer should conduct adequate compliance procedures to gain an evidence that those general controls on which the reviewer intends to rely operate effectively.</li> <li>Based on the results of compliance procedures, the reviewer concludes either to rely or not to rely on the general controls.</li> <li>The compliance approach may not be warranted if the size of the firm is small or medium. In such a case, the reviewer may adopt only substantive approach for conduct of review.</li> <li>Review of working papers helps in deciding as to whether the attestation services have been undertaken in accordance with the prescribed technical standards.</li> </ul>
	<b>Obligations of the Practice Unit</b>	<ul style="list-style-type: none"> <li>The Statement requires the practice unit to produce to the reviewer or afford him access to, any record or document which contains information relevant to the</li> </ul>

		<p>peer review.</p> <ul style="list-style-type: none"> <li>• The practice unit is also expected to provide all assistance to reviewer.</li> <li>• Reviewer may take the abstracts of the documents maintained by the practice unit, but in order to ensure the confidentiality of client's file with the practice unit, the reviewer shall not carry extracts of the client's files or records acquired by him while conducting peer review, as part of his working papers.</li> </ul>
<b>Stage III: Reporting</b>	<b>Preliminary Report of Reviewer</b>	<ul style="list-style-type: none"> <li>• At the end of the on-site review, the reviewer is required to send a preliminary report to the practice unit before making any report to the Board on the areas in case systems and procedures of the practice unit reviewed have been found to be deficient or where non-compliance has been noticed by the reviewer.</li> <li>• The reviewer has to take care that the report does not contain name of any individual of the practice unit. However, no preliminary report is required in case no deficiencies or non-compliance are noticed by the reviewer.</li> <li>• The preliminary report is addressed to the practice unit.</li> <li>• If the reviewer draws a conclusion that there existed a limitation on scope of review, the fact, should also be communicated to the practice unit through the preliminary report.</li> <li>• The reviewer should prepare the report on his letterhead.</li> <li>• The report should be dated and also contain the reviewer's signature and membership number and reviewer's code number allotted by the Board.</li> </ul>
	<b>Reply to Preliminary Report</b>	<ul style="list-style-type: none"> <li>• The practice unit has to send its representations, in writing, to the reviewer, on the areas mentioned in the preliminary report.</li> <li>• The reply to the preliminary report should be sent by the practice unit within a period of 21 days from the receipt of the preliminary report from the reviewer.</li> </ul>
	<b>Qualified Report of the Reviewer</b>	<ul style="list-style-type: none"> <li>• If the reviewer is not satisfied with the reply of the practice unit, the reviewer has to submit a qualified report to the Board.</li> <li>• The report so submitted should clearly indicate that it is a "qualified report".</li> <li>• The Board may then order after twelve months for follow up review.</li> <li>• He is then required to submit the follow up report to the Board for consideration.</li> </ul>
	<b>Final report of the Reviewer</b>	<ul style="list-style-type: none"> <li>• If the reviewer is satisfied with the reply of the practice unit, the reviewer shall submit his final report to the Board.</li> <li>• The final report should incorporate the findings as discussed with the practice unit.</li> </ul>

**Chapter#14****The Sarbanes-Oxley Act 2002****INTRODUCTION**

<b>Enron scandal</b>	<ul style="list-style-type: none"> <li>• Enron was an American energy Company, mainly engaged in Production of Energy, gas and Pulp and Paper.</li> <li>• 7th Fortunes 100 best American Companies of U.S.</li> <li>• It claimed revenue of 111 Billion.</li> <li>• Assets and Profits inflated.</li> <li>• Profits and Revenue generated due to transactions with related parties.</li> <li>• Understatement of Liabilities.</li> <li>• Insider Trading.</li> <li>• Sherron Watkins (Whistle blower).</li> <li>• 'Kenneth Lay' (CEO) and 'skilling' were mainly charged for fraud.</li> <li>• Arthur Anderson (Name of firm) was their Auditor and Consultant both. They were charged for negligence in performing Professional duties.</li> <li>• Price of share of Enron dropped from \$90 to \$50. Bankrupt in late 2001.</li> <li>• Arthur Anderson facing many Civil and Criminal cases against them.</li> </ul>
<b>Worldcom scandal</b>	<ul style="list-style-type: none"> <li>• US Second largest long distance Phone Company.</li> <li>• It showed false financial growth and Profitability to raise its share price.</li> <li>• Expenditure of \$7 billion had been capitalized.</li> <li>• Its revenue was inflated by \$2 billion.</li> <li>• Assets were inflated by \$ 11 Million.</li> <li>• Security Exchange Commission started Investigation in 2002.</li> <li>• As a result, Major frauds were revealed and finally in 2004. it was declared Bankrupt.</li> </ul>
<b>Effect</b>	<ul style="list-style-type: none"> <li>• These scandals resulted in decline of public trust in accounting and reporting practices.</li> <li>• The Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting reform and Investor Protection Act of 2002 and commonly called SGX or Sarbox is a United States federal law passed in response to a number of major corporate and accounting scandals including those affecting Enron and Worldcom.</li> <li>• The Act establishes a new quasi-public authority, the Public Company Accounting Oversight Board for overseeing, regulating, inspecting and disciplining accounting firms in their roles as auditors of public companies.</li> <li>• The Act covers issues such as auditor independence, corporate governance and enhanced financial disclosure.</li> </ul>
<b>Major provisions of SOX</b>	<p>The Sarbanes-Oxley Act's major provisions include the following:</p> <ul style="list-style-type: none"> <li>• Creation of the Public Company Accounting Oversight Board (PCAOB);</li> <li>• A requirement that public companies evaluate and disclose the effectiveness of their internal controls, as they relate to financial reporting and that independent auditors for such companies "attest" to such disclosure.</li> <li>• Certification of financial reports by chief executive officers and chief financial officers;</li> <li>• Auditor Independence;</li> <li>• A requirement that companies listed on stock exchanges have fully independent audit committees;</li> <li>• Ban on most personal loans to any executive officer or director;</li> <li>• Accelerated reporting of insider trading;</li> <li>• Prohibition on insider trades during pension fund blackout periods;</li> <li>• Additional disclosure;</li> <li>• Enhanced criminal and civil penalties for violation of securities law.</li> </ul>

	<ul style="list-style-type: none"> <li>• Significantly longer maximum jail sentences and larger fines for corporate executives who knowingly and willfully misstate financial statements;</li> <li>• Employee protections allowing those corporate frauds whistle blowers who file complaints with OSHA within 90 days.</li> </ul>
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**SOX 404 REQUIREMENT**

<b>Client Management Must</b>	<ul style="list-style-type: none"> <li>• Document and test the Internal Control over financial Reporting.</li> <li>• Issue an annual assertion on the effectiveness of Internal Control over Financial Reporting.</li> </ul>
<b>External Auditor must</b>	<ul style="list-style-type: none"> <li>• Determine nature, timing and extent of testing.</li> <li>• Review work performed by Management.</li> <li>• Perform some Independent tests of control.</li> <li>• Attest and report on:             <ul style="list-style-type: none"> <li>➤ Management 404 assertion process.</li> <li>➤ Design and effectiveness of Internal Controls.</li> </ul> </li> </ul>
<b>Assertions</b>	<p>In order to make the assertion, the client must:</p> <ul style="list-style-type: none"> <li>• Document and evaluate the design of controls.</li> <li>• Evaluate the operating effectiveness of significant control.</li> <li>• Document the result of the evaluation.</li> <li>• Identify significant deficiencies or Material weakness.</li> <li>• Communicate the findings (Material Weaknesses) to Independent Auditors.</li> </ul>

**INFORMATION TECHNOLOGY AND SOX 404**

<b>Relation</b>	<ul style="list-style-type: none"> <li>• The financial reporting processes of most organizations are driven by IT systems.</li> <li>• Few companies manage their data manually and most companies rely on electronic management of data, documents and key operational processes.</li> <li>• Chief information officers are responsible for the security, accuracy and the reliability of the systems.</li> <li>• ERP (Enterprise Resource Planning) are deeply integrated in the initializing, authorizing processing and reporting of financial data.</li> </ul>
<b>COSO framework</b>	<p>The COSO framework defines five areas. The objectives of COSO Framework aim at:</p> <ol style="list-style-type: none"> <li>1. Operational Effectiveness.</li> <li>2. Financial Reporting (Better and in timely manner).</li> <li>3. Compliance with Regulatory Requirements.</li> </ol>
<b>Components of internal Control Framework as defined by COSO are as follows:</b>	
<b>Control Environment</b>	As per the Requirements of COSO framework, the control environment in the organization should be such that the top Management should assume 'its full responsibility for entire Internal Control structure.
<b>Risk Assessment</b>	The Management should undertake the Risk Assessment Procedure. It means that they should evaluate Internal and External factors that may have an Impact on the organization.
<b>Control Activities</b>	The Control Activities are specific Policies and Procedures which are undertaken to ensure correctness of some specific assertions. It helps the management to reduce the risk to an acceptably low level.
<b>Information and Communication</b>	The management should ensure that relevant information is identified and communicated in a timely manner to the Responsible Officer.

	<b>Monitoring</b>	Monitoring refers to the process undertaken by Management to determine whether I.C. System is adequate or not.
<b>Information Technology &amp; SOX 404 → SUMMARY</b>	<p>Section 404: Requirement</p> <ol style="list-style-type: none"> <li>1. I.C. Report by Management.</li> </ol> <p style="text-align: center;">↓</p> <p style="text-align: center;">Attested by Auditor</p> <p style="text-align: center;">↓</p> <p style="text-align: center;">Filed in SEC</p> <ol style="list-style-type: none"> <li>2. Now-a-days most of the Companies maintain their accounts in CIS.</li> <li>3. Those Internal Controls are different from those in Manual System.</li> <li>4. I.C. → General I.C. Application I.C.</li> <li>5. Thus management should evaluate whether their I.C. relating to financial Reporting in CIS are adequate.</li> <li>6. In CIS → 5 factor as per COSO framework to be ensured.</li> </ol>	

## IMPLEMENTATION OF DISCLOSURE CONTROLS AND PROCEDURES

- Disclosure Controls and Procedures are meant to ensure that all the information required by law to be included in the periodic reports filed with the SEC is made available to those responsible for preparing them in a complete and timely fashion.
- The Disclosure Controls and Procedures should be crafted in such a way that they are easy to follow and practical to implement.
- They should be in writing and should be customized to reflect the operations of the company and its particular risk profile.
- A list of suggestions is given below:

<b>Disclosure Committee</b>	A disclosure committee may be established charged with assisting the CEO and CFO in developing, writing and overseeing Disclosure Controls and Procedures.
<b>Inventory of Current Procedures</b>	To take an inventory of the company's existing practices and weaknesses with regard to: <ul style="list-style-type: none"> <li>• preparing annual reports;</li> <li>• the handling of whistle blowers complaints with respect to the company's disclosure;</li> <li>• the review of any matters raised by the company's independent auditors ,and</li> <li>• the retention of relevant documents.</li> </ul>
<b>Identification of Personnel</b>	The disclosure committee should identify persons both inside and outside the company whose input is critical to the disclosure process.
<b>Preparation of Controls and Procedures Timetable and Check list</b>	The disclosure committee should disseminate internally a Control and Procedures check list which fills in any gaps and fixes any weaknesses discovered by the inventory.
<b>Backup certifications</b>	Companies may wish to consider obtaining "backup" support certifications from certain officers that confirm the certifications of the CEO and CFO.

## CA FINAL - ADVANCED AUDITING & PROFESSIONAL ETHICS

### AMENDMENTS APPLICABLE FOR MAY 2017 EXAMS

#### 1. SA 610 (REVISED) "USING THE WORK OF INTERNAL AUDITORS" (W.E.F. 31.04.2016)

Scope of this SA	<p>1. This SA deals with the external auditor's responsibilities if using the work of internal auditors. This includes</p> <p>(a) using the work of the internal audit function in obtaining audit evidence and</p> <p>(b) using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.</p> <p>2. This SA does not apply if the entity does not have an internal audit function.</p> <p>3. In some cases, the external auditor may be prohibited, or restricted to some extent, by law or regulation from using the work of the internal audit function or using internal auditors to provide direct assistance. The SAs do not override laws or regulations that govern an audit of F.S. Such prohibitions or restrictions will therefore not prevent the external auditor from complying with the SAs.</p>		
The External Auditor's Responsibility for the Audit	<ul style="list-style-type: none"> <li>▪ The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement.</li> <li>▪ Although they may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with SA 200.</li> <li>▪ This SA, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors.</li> </ul>		
	Activities Relating to Internal Control	Evaluation of internal control	Internal audit function may be assigned specific internal control responsibility for reviewing controls, evaluating their operation and recommending improvements thereto.
		Examination of financial and operating information	Internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
		Review of operating activities	The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.
		Review of compliance with laws and regulations	Internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Objectives of Auditor	<p>(a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent ;</p> <p>(b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit ; and</p> <p>(c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.</p>	
Definitions	Internal audit function	A function of an entity that performs assurance & consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.
	Direct Assistance	The use of internal auditors to perform audit procedures under the direction, supervision and review of external auditor.

**REQUIREMENTS OF SA 610 (REVISED)**

Determining Evaluating the Whether, in Which Areas and to What Extent the Work of the Internal Audit Function Can Be Used	Evaluating the Internal Audit Function	<p>The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following :</p> <p>(a) Objectivity of the internal auditors ;</p> <p>(b) Level of competence; and</p> <p>(c) Application of Systematic and disciplined approach.</p> <p>The external auditor shall not use the work of the internal audit function if the external auditor determines that :</p> <p>(a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors ;</p> <p>(b) The function lacks sufficient competence ; or</p> <p>(c) The function does not apply a systematic and disciplined approach.</p>
	Factors affecting Objectivity, Competency and Approach	
	Objectivity of Internal Auditor	<p>Objectivity. refers to 'the ability to perform without allowing bias to override professional judgments. Factors that may affect the external auditor's evaluation include the following :</p> <ol style="list-style-type: none"> <li>1. Organizational status of the internal audit function;</li> <li>2. Conflicting responsibilities.</li> <li>3. Oversight functions of TCWG w.r.t. employment decisions related to the internal audit function.</li> </ol>



			4. Constraints or restrictions placed on the internal audit function by management or TCWG.
		Level of Competency	<p>Competence of the internal audit function refers to the attainment of knowledge and skills to enable assigned tasks to be performed diligently. Factors that may affect the external auditor's determination include the following :</p> <ol style="list-style-type: none"> <li>1. Policies for hiring, training and assigning internal auditors to internal audit engagements.</li> <li>2. Adequate of technical training and auditing of internal auditors.</li> <li>3. Knowledge of internal auditors w.r.t. entity's financial reporting and the applicable FRF.</li> <li>4. Membership of relevant professional bodies that oblige internal auditors to comply with the relevant professional standards.</li> </ol>
		Systematic and Disciplined Approach	<p>Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following :</p> <ul style="list-style-type: none"> <li>▪ Existence, adequacy and use of documented internal audit procedures.</li> <li>▪ Existence of appropriate quality control policies and procedures for internal audit function.</li> </ul>
	Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used		<ul style="list-style-type: none"> <li>▪ The external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan.</li> <li>▪ The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly.</li> <li>▪ The external auditor shall also evaluate whether, in aggregate, using the work of the internal audit function to the extent planned would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.</li> <li>▪ The external auditor shall, in communicating with TCWG an overview of the planned scope and timing of the audit in accordance with SA 260, communicate how the external auditor has</li> </ul>

		planned to use the work of the internal audit function.
Using the Work of the Internal Audit Function	<p>1. If the external auditor plans to use the work of the internal audit function. the external auditor shall discuss the planned use of its work.</p> <p>2. The external auditor shall read the reports of the internal audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.</p> <p>3. The external auditor shall perform sufficient audit procedures on the work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether :</p> <p>a. The work of the function had been properly planned, performed, supervised, reviewed and documented ;</p> <p>b. Sufficient appropriate evidence had been obtained to enable the function to draw reasonable conclusions; and</p> <p>c. Conclusions reached are appropriate in the circumstances and the reports prepared by the function are consistent with the results of the work performed.</p> <p>4. The nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of :</p> <p>a. The amount of judgment involved ;</p> <p>b. The assessed risk of material misstatement ;</p> <p>c. The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors ; and</p> <p>d. The level of competence of the function; and shall include re-performance of some of the work.</p> <p>5. The external auditor shall also evaluate whether the external auditor's conclusions regarding the internal audit function and the determination of the nature and extent of use of the work of the function for purposes of the audit remain appropriate.</p>	
Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance	Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit	<p>1. The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors.</p> <p>2. 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.</p> <p>3. The external auditor shall not use an internal auditor to provide direct assistance if :</p> <p>(a) There are significant threats to the objectivity of the internal auditor;</p> <p style="text-align: center;">or</p> <p>(b) The internal auditor lacks sufficient competence to perform the</p>

		<p>proposed work.</p> <p>1. In determining the nature and extent of work that may be assigned to internal auditors and the NTE of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider :</p> <p>(a) The amount of judgment involved in Planning and performing relevant audit procedures; and Evaluating the audit evidence gathered ;</p> <p>(b) The assessed risk of material, misstatement ; and</p> <p>(c) The external auditor's evaluation of the existence and significance of threats to tie objectivity and level of competence of the internal auditors who will he providing such assistance.</p> <p>2. The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:</p> <p>(a) Involve making significant judgments in the audit ;</p> <p>(b) Relate to higher assessed risks of material misstatement ;</p> <p>(c) Relate to work with which the internal auditors have been involved; or</p> <p>(d) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.</p> <p>3. Having appropriately evaluated whether and, if so, to what extent internal auditors can be used to provide direct assistance on the audit. the external auditor shall, in communicating with TCWG an overview of the planned scope and timing of the audit in accordance with SA 260, communicate the nature and extent of the planned use of internal auditors to provide direct assistance so as to reach a mutual understanding that such use is not excessive in the circumstances of the engagement.</p>
Using Internal Auditors to Provide Direct Assistance		<p>1. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall :</p> <p>(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</p> <p>(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.</p>

	<p>2. The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with SA 220.</p> <p>3. The direction, supervision and review by the external auditor of the work performed by the internal auditors shall be sufficient in order for the external auditor to be satisfied that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work.</p>
Documentation	<p>w.r.t. Use of work of Internal Audit Function by external Auditor</p> <p>(i) Whether the function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors;</p> <p>(ii) The level of competence of the function; and</p> <p>(iii) Whether the function applies a systematic and disciplined approach, including quality control ;</p> <p>(b) The nature and extent of the work used and the basis for that decision; and</p> <p>(c) The audit procedures performed by the external auditor to evaluate the adequacy of the work used.</p>
	<p>W.r.t. Direct Assistance of internal auditor used by external auditor</p> <p>(a) The evaluation of the existence and significance of threats to objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;</p> <p>(b) The basis for the decision regarding the nature and extent of the work performed by the internal auditors;</p> <p>(c) Who reviewed the work performed and the date and extent of that review in accordance with SA 230 ;</p> <p>(d) The written agreements obtained from an authorized representative of the entity and the internal auditors; and</p> <p>(e) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.</p>

## 2. SAE 3420 "ASSURANCE ENGAGEMENTS TO-REPORT ON THE CUMPIATION OF PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS (W.E.F. 01.04.2016)

### POINTS COVERED

- What do you mean by Pro forma- Financial Information?
- What factors should be considered before accepting such Assignments?
- How to Plan and perform such assurance engagement?
- Consideration while forming opinion

- How to prepare Assurance Report?
- When the Issues/ Raises capital by way of IPO/ FPO they prepare a document called “prospectus”
- These may contain “ Proforma Financial Statements”
- How to examine & report of “Proforma Financial statement” – SA 3420

**EXAMPLE**

- A Ltd Acquires B Ltd on 1<sup>st</sup> April 2017 and later on it is planning IPO on 1<sup>st</sup> July 2017 for which financial statements of the F.Y 16- 17 were to be presented in the Prospectus.



Particulars	A Ltd audited unadjusted	B Ltd. audited Unadjusted	Proforma Adjustments Interco	Proforma Resulting Financials
Sales	10,000	5000	500	14500

Purpose of Pro Forma Financial Information Included in a Prospectus	The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. This is achieved by applying pro forma adjustments to the unadjusted financial information.
Compilation of Pro Forma Financial information	The compilation of pro forma financial information involves the responsible party gathering, classifying, summarizing and presenting financial information That illustrates the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at the selected date. Steps involved are : 1. Identifying the source of the unadjusted financial information to be used in compiling the pro forma financial information, and extracting the unadjusted financial information from that source;

	<p>2. Making pro forma adjustments to the unadjusted financial information for the purpose for which the pro forma financial information is presented; and</p> <p>3. Presenting the resulting pro forma financial information with accompanying disclosures.</p>	
Effective Date	This SAE is effective for assurance reports dated on or after 1 <sup>st</sup> April 2016.	
Objective	<p>The objectives of the practitioner are:</p> <p>(a) To obtain reasonable assurance about whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria; and</p> <p>(b) To report in accordance with the practitioner's findings.</p>	
Definitions	Applicable criteria	<ul style="list-style-type: none"> <li>▪ The criteria used by the responsible party when compiling the pro forma financial information. Criteria may be established by all authorized or recognized standard-setting organization or by law or regulation.</li> <li>▪ Where established criteria do not exist, they will be developed by the responsible party.</li> </ul>
	Pro forma adjustments	<p>In relation to unadjusted financial information these include :</p> <p>i) Adjustment's to unadjusted financial information that illustrate the impact of a significant event or transaction as if the event had occurred for the transaction had been undertaken at an earlier date selected for purpose of the illustration ; and</p> <p>ii) Adjustments to unadjusted financial information that are necessary for the pro forma financial to be compiled on a basis consistent with the applicable FRF of the reporting entity and its accounting policies under that framework .</p>

## Factors to be considered before accepting such Assignments

### KEY TO REMEMBER

- **Competence and capabilities**
- **Suitability of criteria/ is it misleading**
- **Audit / Review to Acquiring CO.**
- **Audit / review of Subsidiary Co.**
- **Modified report of the Acquiring Co.**
- **Wordings of opinion prescribed by criteria.**
- **Agreement regarding**
  - ✓ Their responsibility to prepare Proforma financial statements
  - ✓ Follow criteria
  - ✓ Disclosure criteria if not available publicly
  - ✓ Access to information available
  - ✓ Preparation of additional information
  - ✓ Access to information of Acquiring co and Acquiree Co.

### **REQUIREMENTS OF SAE 3420**

**CA Dr Mahesh Gour**  
9320473019

**CA Vidhi Chedda**  
8879377367

**Prof Khushboo Sanghavi**  
8082736683

Engagement Acceptance	<p>Before agreeing to accept an engagement, the practitioner shall :</p> <p>(a) Determine that the practitioner has the capabilities and competence to perform the engagement;</p> <p>(b) 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 ;</p> <p>(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 ;</p> <p>(d) Where the sources from which the unadjusted 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 EOM 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 EOM paragraph with respect to such sources;</p> <p>(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 ;</p> <p>(f) Obtain the agreement of the responsible party that it acknowledges and understands its responsibility for:</p> <ol style="list-style-type: none"> <li>i. Adequately disclosing and describing the applicable criteria to the intended users ;</li> <li>ii. Compiling the pro forma financial information on the basis of the applicable criteria to the intended users</li> <li>iii. Providing the practitioner with: <ol style="list-style-type: none"> <li>a. Access to all information such as records, documentation and other relevant material.</li> <li>b. Additional information that the practitioner may request from the responsible party for the purpose of the engagement ;</li> <li>c. Access to those within the entity and the entity's advisors from whom the practitioner determines it necessary to obtain evidence.</li> </ol> </li> </ol>
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### How to PLAN AND PERFORM ?

#### KEY TO REMEMBER

1. Assessing the Suitability of the Applicable criteria.
2. Materiality
3. Obtaining an understanding of how the responsible party has compiled the Proforma Financial Information and other Engagement circumstances.
4. Obtaining Evidence about the appropriateness of the source from which the Unadjusted financial information has been extracted.
5. Obtaining Evidence about the appropriateness of the Proforma Adjustments
6. Modified Audit opinion or Review conclusions, or EOM paragraph, with respect to the source from which the unadjusted financial information has been extracted.
7. Inappropriate source or Proforma adjustments
8. Obtaining evidence about the calculations within the proforma financial information

9. Evaluating the presentation of the pro forma financial information.		
Planning and Performing an Engagement	Assessing the Suitability of the Applicable Criteria	The practitioner shall assess whether the applicable criteria are suitable, as required by the Framework for Assurance Engagements, and in particular shall determine that they include, at a minimum, that : (a) The unadjusted financial information be extracted from an appropriate source; (b) The pro forma adjustments be: (i) Directly attributable to the event or transaction ; (ii) Factually supportable; and (iii) Consistent with the entity's applicable FRF and its accounting policies under that framework ; and (c) Appropriate presentation be made and disclosures be provided to enable the intended users to understand the information conveyed.
	Materiality	The practitioner shall consider materiality with respect to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.
	Obtaining an Understanding of how the Responsible Party has Compiled the Pro Forma Financial Information and Other Engagement Circumstances	The practitioner shall obtain an understanding of : (a) The event or transaction in respect of which the pro forma financial information is being compiled; (b) How the responsible party has compiled the pro forma financial information; (c) The nature of the entity, including: (i) Their operations; (ii) Their assets and liabilities ; and (iii) The way they are structured and how they are financed ; (d) Relevant industry, legal and regulatory, and other external factors pertaining to the entity. (e) The applicable FRF and the accounting and financial reporting practices of the entity, including their selection and application of accounting policies.
	Obtaining Evidence about the appropriateness of the Source from Which the Unadjusted Financial Information Has Been Extracted	(i) The practitioner shall determine whether the responsible party has extracted the unadjusted financial information from an appropriate source. (ii) 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. (iii)The practitioner shall determine whether the responsible party has appropriately extracted the unadjusted financial information from the source.
	Obtaining Evidence about the Appropriateness of the Pro Forma Adjustments	i. In evaluating whether the pro forma adjustments are appropriate, the practitioner shall determine whether the responsible party has identified the pro forma adjustments necessary to illustrate the impact of the event or transaction at the date or for the period of the illustration.  ii. In determining whether the pro forma adjustments are in accordance with the applicable criteria, the practitioner shall determine whether



		<p>they are :</p> <p>(a) Directly attributable to the event or transaction ;</p> <p>(b) Factually supportable.</p> <p>(c) Consistent with the entity's applicable financial reporting framework and its accounting policies under that framework.</p>
	<p>Modified Audit Opinion or Review Conclusion, or EOM Paragraph, with Respect to the Source from Which the Unadjusted Financial Information Has Been Extracted</p>	<p>A modified audit opinion or review conclusion May have been expressed with respect to either the source from which the unadjusted financial information has been extracted or a report containing an EOM paragraph may have been issued with respect to such source. In such circumstances, if the relevant law or regulation does not prohibit the use of such a source, the practitioner shall evaluate :</p> <p>(a) The potential consequence on whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria ;</p> <p>(b) What further appropriate action to take; and</p> <p>(c) Whether there is any effect on the practitioner's ability to report in accordance with the terms of the engagement, including any effect on the practitioner's report.</p>
	<p>Inappropriate Source or Pro Forma Adjustments' -</p>	<p>If, on the basis of the procedures performed, the practitioner identifies that the responsible party has :</p> <p>(a) Used an inappropriate source from which to extract the unadjusted financial information, or</p> <p>(b) Omitted a pro forma adjustment, that should be included, applied a pro forma adjustment that is not in accordance with the applicable criteria or otherwise inappropriately applied a pro forma adjustment, the practitioner shall discuss the matter with the responsible party.</p> <p>If the practitioner is unable to agree with the responsible party as to how the matter should be resolved, the practitioner shall evaluate what further action to take.</p>
	<p>Obtaining Evidence about the Calculations within the Pro Forma Financial Information</p>	<p>The practitioner shall determine whether the calculations within the pro forma financial information are arithmetically accurate.</p>
	<p>Evaluating the Presentation of the Pro Forma Financial Information</p>	<p>The practitioner shall evaluate the presentation of the pro forma financial information. This shall include consideration of :</p> <p>(a) The overall presentation and structure of the pro forma financial information, including whether it is clearly labeled to distinguish it from historical or other financial information ;</p> <p>(b) Whether the pro forma financial information and related explanatory notes illustrate the impact of the event or transaction in a manner that is not misleading ;</p> <p>(c) Whether appropriate disclosures are provided with the pro forma financial information to enable the intended users to understand the information conveyed ; and</p> <p>(d) Whether the practitioner has become aware of any significant events</p>

		<p>subsequent to the date of the soul cc from which the unadjusted financial information has been extracted that may require reference to, or disclosure in, the pro forma financial information.</p> <p>(e) The practitioner shall read the other information included in the prospectus containing the pro forma financial information to identify material inconsistencies, if any, with the pro forma financial information.. if, on reading the other information, the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact in that other information, the practitioner shall discuss the matter with the responsible party.</p> <p>It correction of the matter is necessary and the responsible party refuses to do so, the practitioner shall take further appropriate action.</p>
Written Representations		<p>The practitioner shall request written representations from the responsible party that :</p> <p>(a) In compiling the pro forma financial information, the responsible party has identified all appropriate pro forma adjustments necessary to illustrate the impact of the event or transaction at the date or for the period of the illustration; and</p> <p>(b) The pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.</p>
Forming the Opinion		<ul style="list-style-type: none"> <li>• The practitioner shall form an opinion on whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.</li> <li>• In order to form that opinion, the practitioner shall conclude whether the practitioner has obtained sufficient appropriate evidence about whether the compilation of the pro forma financial information is free from material omissions, or inappropriate use or application of a pro forma adjustment.</li> <li>• That conclusion shall include an evaluation of whether the responsible party has adequately disclosed and described the applicable criteria to the extent that these are not publicly available. The practitioner shall express an unmodified opinion when the practitioner concludes that the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.</li> </ul>
Form of Opinion	Unmodified Opinion	The practitioner shall express an unmodified opinion when the practitioner concludes that the pro forma financial information has been compiled, in all material respects by the responsible party on the basis of the applicable criteria
	Modified Opinion	<ul style="list-style-type: none"> <li>• Where the relevant law or regulation precludes publication of a prospectus that contains a modified opinion with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and the practitioner concludes that a modified opinion is nevertheless appropriate in accordance with the Framework for Assurance Engagements, the practitioner shall discuss the matter with the responsible party. If the responsible party does not agree to make the necessary changes, the practitioner shall.</li> </ul>

		<p>(a) Withdraw from the engagement ; or (b) Consider seeking legal advice.</p> <ul style="list-style-type: none"> <li>Where the relevant law or regulation may not preclude publication of a prospectus that contains a modified opinion with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and the practitioner determines that a modified opinion is appropriate in accordance with the Framework for Assurance Engagements, the practitioner shall apply the requirements in the Framework for Assurance Engagements regarding modified opinions.</li> </ul>
	Emphasis of Matter Paragraph	<ul style="list-style-type: none"> <li>In some circumstances, the practitioner may consider it necessary to draw users( attention to a matter presented or disclosed in the pro forma financial information or the accompanying explanatory notes.</li> <li>This would be the case when, in the practitioner's opinion, the matter is of such importance that it is fundamental to users' understanding of whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria. In such circumstances, the practitioner shall include an Emphasis of Matter paragraph in the practitioner's report provided that the practitioner has obtained sufficient appropriate evidence that the matter does not affect whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.</li> <li>Such a paragraph shall refer only to information presented or disclosed in the pro forma financial information or the accompanying explanatory notes.</li> </ul>
Preparing the Assurance Report		<p>The practitioner's report shall include the following basic elements :</p> <p>(a) A title that clearly indicates that the report is an independent assurance report ;</p> <p>(b) An addressee(s), as agreed in the terms of engagement ;</p> <p>(c) Introductory paragraphs that identify :</p> <p>(i) The pro forma financial information ;</p> <p>(ii) The source from which the unadjusted financial information has been extracted;</p> <p>(iii) The period covered by, or the date of, the pro forma financial information ;</p> <p>and</p> <p>(iv) A reference to the applicable criteria on the basis of which the responsible party has performed the compilation of the pro forma financial information, and the source of the criteria;</p> <p>(d) A statement that the responsible party is responsible for compiling the pro forma financial information on the basis of the applicable criteria ;</p> <p>(e) A description of the practitioner's responsibilities, including statements that</p> <p>(i) The practitioner's responsibility is to express an opinion about whether the</p>

pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria ;

(ii) For purposes of this engagement, the practitioner is not responsible for updating or reissuing any reports or opinions on any historical financial information used in compiling the pro forma financial information, nor has the practitioner, in the course of this engagement, performed an audit or review of the financial information used in compiling the pro forma financial information; and

(iii) The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration.

(f) A statement that the engagement was performed in accordance with SAE 3420, 'Assurance Engagements to Report on the Compilation of Pro Forma Financial information Included in a Prospectus', which requires that the practitioner comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about whether the responsible party has compiled, in all material respects, the pro forma financial information on the basis of the applicable criteria ;

(g) Statements that :

(i) A reasonable assurance engagement to report on whether the pro forma financial information has been compiled, in all material' respects, on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by the responsible party in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether :

- The related pro forma adjustments give appropriate effect to those criteria; and
- The pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information ;

(ii) The procedures selected depend on the practitioner's judgment, having regard to the practitioner's understanding of the nature of the entity, the event or transaction in respect of which the pro forma financial information has been compiled, and other relevant engagement circumstances; and

(iii) The engagement also involves evaluating the overall presentation of the pro forma financial information;

(h) Unless otherwise required by law or regulation, the practitioner's opinion using one of the following phrases, which are regarded as being equivalent :

(i) The pro forma financial information has been compiled, in all material respects, on the basis of the (applicable criteria) ; or

(ii) The pro forma financial information has been properly compiled on the basis stated;

(i) The practitioner's signature;

(j) The date of the report; and

(k) The place of signature.

**3 .Company Auditor (Chapter 8)**

Third Proviso to Sec. 139(2)	"Provided also that every company, existing on or before the commencement of this Act which is required to comply with the provisions of this sub-section, shall comply with requirements of this sub-section within a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act."	
Directions for change of auditors - Sec. 140(5)	Who may issue directions	Tribunal
	When directions may be issued	(i) suo mow by Tribunal or (ii) on an application made to Tribunal by the C.G. or by any person concerned.
	Circumstances in which directions may be issued	If Tribunal is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to. the company or its directors or officers, it may, by order, direct the company to change its auditors.
	Appointment of Auditor by C.G. - proviso to Sec. 140(5)	If the application is made by the C.G. and the Tribunal is satisfied that any change of the auditor is required, <ul style="list-style-type: none"> <li>it shall within 15 days of receipt of such application. make an order that he shall not function as an auditor</li> </ul> <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> <li>the C.G. may appoint another auditor in his place.</li> </ul>
	Disqualifying the auditor for further appointment	<ul style="list-style-type: none"> <li>An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of 5 years from the date of passing of the order</li> </ul> <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> <li>the auditor shall also be liable for action under section 447.</li> </ul>

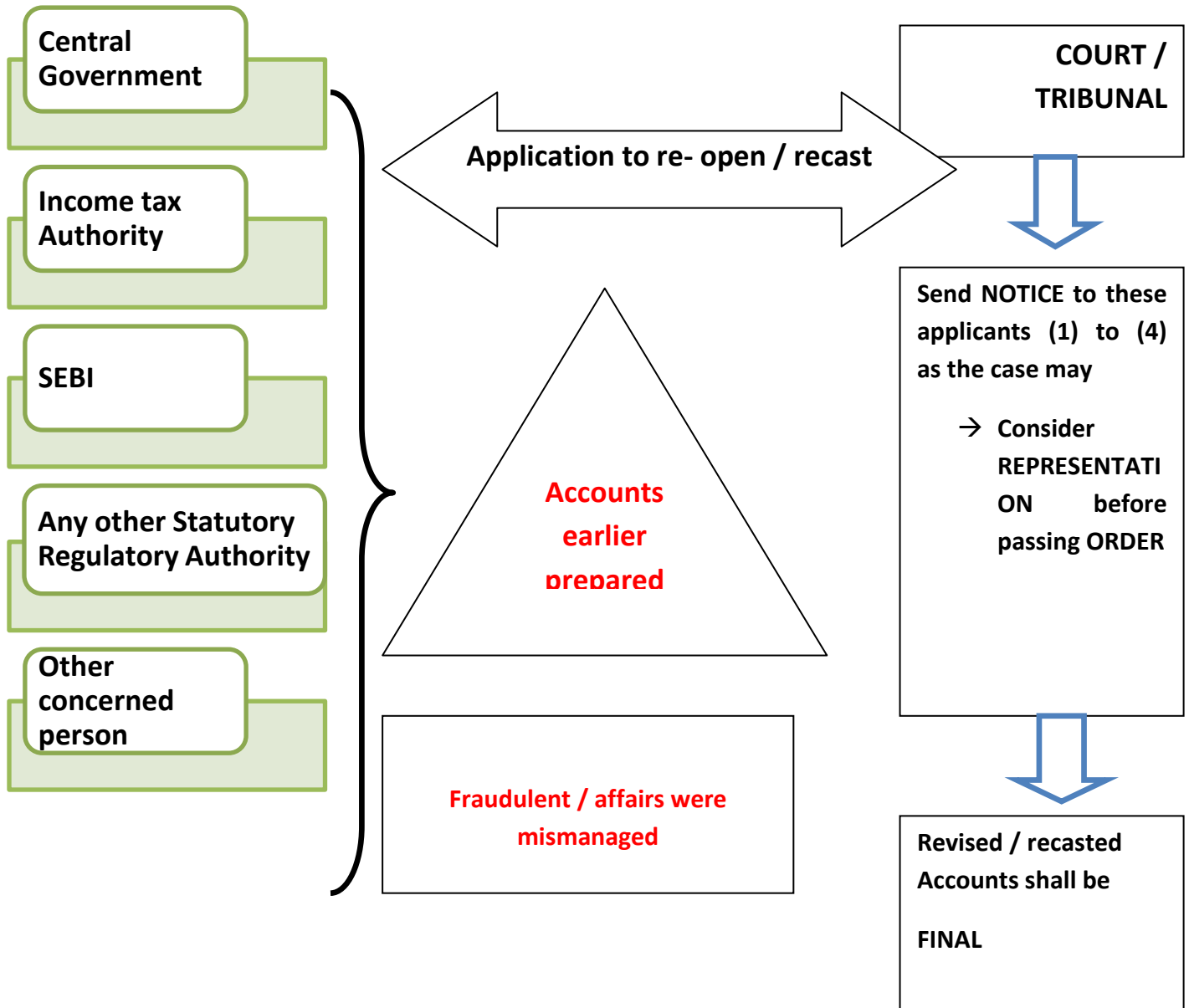
**4. COMPANY-AUDIT - SPECIAL CONSIDERATIONS (CHAPTER 9)**

Second Proviso to Rule 6 of Companies (Accounts) Rules, 2014 -Manner of consolidation of accounts - as amended on 27.07.2016	Nothing in this rule shall apply in respect of preparation of consolidated F.S. by a company if it meets the following conditions :- <ol style="list-style-type: none"> <li>it is a wholly-owned or 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 F.S.;</li> <li>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</li> <li>its ultimate or any intermediate holding company files consolidated F.S. with the Registrar which are in compliance with the applicable ASs."</li> </ol>
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**SECTION 129 CONSOLIDATION**

- Sec 129 (3) deals with the consolidated F.s
- Rule 6 of companies( Accounts) Rules, 2014 deals with manner of consolidation, this rule provides for exemption from consolidation.
- Old provision:
- Provided further that nothing in this rule shall apply in respect of preparation of consolidated F.S by an intermediate wholly owned subsidiary, other than wholly owned subsidiary whose immediate parent co is incorporated outside India”

**SECTION 130(1)** Reopening of accounts on Court’s or Tribunal order

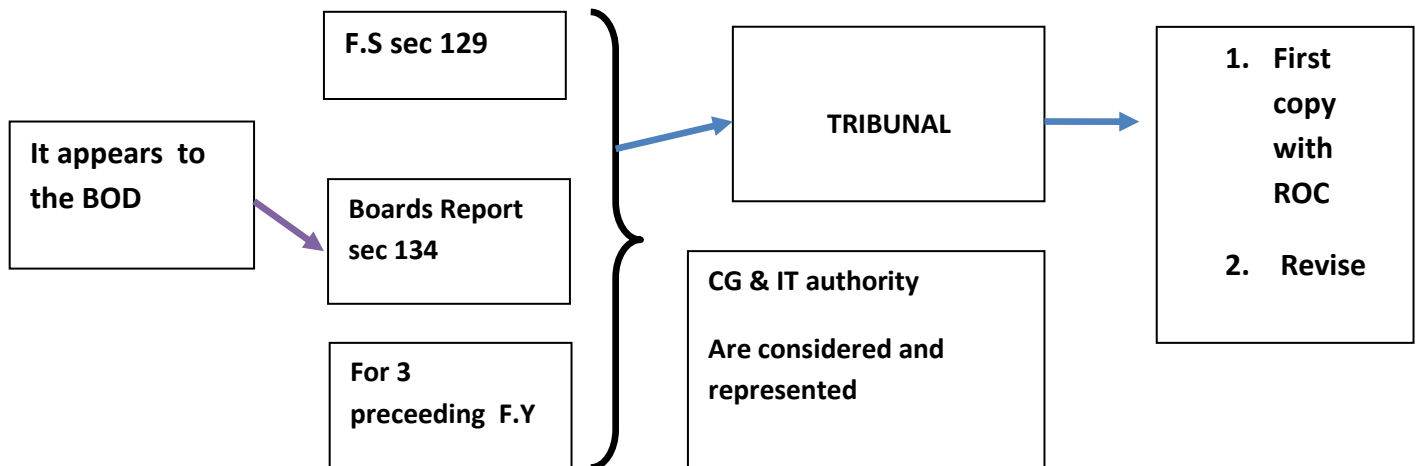


Reopening Of Accounts On Court's Or .Tribunal	Order by Court or Tribunal - Sec. 130(1)	A company shall not re-open its books of ac omit AND not recast its financial statements, unless
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Order - Section 130		<ul style="list-style-type: none"> <li>an application in this regard is made by the C.G., the Income-tax authorities, the SEBI, any other statutory regulatory body or authority or any person concerned AND</li> <li>an order is made by a court of competent jurisdiction or the Tribunal</li> </ul>
	Nature of order made by Court or Tribunal - Sec. 130(1)	Order is made by a court of competent jurisdiction or the Tribunal to the effect that— (i) the relevant earlier accounts were prepared in a fraudulent manner; Or (ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements
	Requirement before passing the order - Proviso to Sec. 130(1)	<ul style="list-style-type: none"> <li>The court or the Tribunal, as the case may be, shall give notice to the C.G., the Income-tax authorities, the SEBI or any other statutory regulatory body or authority concerned AND</li> <li>shall take into consideration the representations, if any, made by that Government or the authorities, SEBI or the body or authority concerned before passing any order under this section.</li> </ul>
	Status of Revised account - Sec. 130(2)	The accounts so revised or re-cast u/s 130(1) shall be final.

**SECTION 131**

**VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD' REPORT**



Such revision is allowed only once in a year

Detailed reasons for the revision of such F.S or report shall be disclosed in the Board's report in the relevant F.Y in which such revision is being made

Voluntary revision of financial statements or Board's report - Sec. 131	Circumstances in which F.S. or Board's Report may be revised and Conditions - Sec. 131(1)	<ul style="list-style-type: none"> <li>If it appears to the directors of a company that—               <ol style="list-style-type: none"> <li>the financial statement of the company ; or</li> <li>the report of the Board,</li> </ol> </li> <li>do not comply with the provisions of section 129 or section 134</li> <li>they may prepare revised financial statement or a revised report</li> <li>in respect of any of the three preceding financial years</li> <li>after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and</li> <li>a copy of the order passed by the Tribunal shall be filed with the Registrar:</li> </ul>
	Requirement before passing order - 1s' Proviso	Tribunal shall <ul style="list-style-type: none"> <li>give notice to the Central Government and the Income tax authorities and</li> <li>shall take into consideration the representations if any, made by that C.G. or the authorities before passing any order under this section.</li> </ul>
	Limit on number of revisions - 2nd Proviso	<ul style="list-style-type: none"> <li>Such revised F.S. or report shall not be prepared or filed more than once in a financial year.</li> </ul>
	Disclosure of Reasons for deviation - 3rd proviso	The detailed reasons for revision of such F.S. or report shall also be disclosed in the Board's report in the relevant FY year in which such revision is being made.
	Scope of Revision - Sec. 131(2)	Where copies of the previous F.S. or report – <ul style="list-style-type: none"> <li>have been sent out to members</li> <li>or</li> <li>delivered to the Registrar</li> <li>or</li> <li>laid before the company in general meeting, the revisions must be confined to—             <ol style="list-style-type: none"> <li>the correction in respect of which the previous F.S. or report do not comply with the provisions of Sec. 129 or Sec. 134;</li> </ol> <p style="text-align: center;">AND</p> <ol style="list-style-type: none"> <li>the making of any necessary consequential alternation.</li> </ol> </li> </ul>
	Powers of C.G. to frame Rules - Sec. 131(3)	The C.G. may make rules as to the application of the provisions of this Act in relation to revised financial statement or a revised director's report and such rules may, in particular— <ol style="list-style-type: none"> <li>make different provisions according to which             <ul style="list-style-type: none"> <li>the previous F.S. or report are replaced</li> <li>or</li> </ul> </li> </ol>



		<ul style="list-style-type: none"> <li>are supplemented by a document indicating the corrections to be made;</li> </ul> <p>(b) make provisions with respect to the functions of the company's auditor in relation to the revised F.S. or report ;</p> <p>(c) require the directors to take such steps as may be prescribed.</p>
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## 5. AUDIT OF DIVIDEND (CHAPTER 12)

Unpaid Dividend Account Sec.124 Companies Of Special account Act, 2013	Transfer unpaid of Account dividend to Special account	Where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration, the company shall, within 7 days & on- the date of expiry of the said period of 30 days, transfer the total amount of unpaid or unclaimed dividend to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.
	Placing details unpaid dividend on website	The company shall, within a period of 90 days of making any transfer of unpaid/unclaimed dividend to special account, prepare a statement containing the names, address and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the C.G. for this purpose, in such form, manner and other particulars as may be prescribed.
	interest payable by company in case of default	<ul style="list-style-type: none"> <li>If any default is made in transferring the unpaid/unclaimed dividend to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of 12% p.a. and</li> <li>the interest accruing on such amount shall enure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.</li> </ul>
	Right of the member	Any person claiming to be entitled to any money transferred to unpaid dividend Member account may apply to the company for payment of the money claimed.
	Transfer to IEPF	<ul style="list-style-type: none"> <li>Money transferred to Unpaid Dividend Account which remains unpaid or unclaimed for a period of 7 years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established u/s 125</li> </ul> <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> <li>The company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.</li> </ul>
	Transfer of Shares	<ul style="list-style-type: none"> <li>All shares in respect of which unpaid or unclaimed dividend</li> </ul>

		<p>has been transferred to IEPF shall also be transferred by the company in the name of IEPF along with a statement containing such details as may be prescribed.</p> <ul style="list-style-type: none"> <li>Any claimant of shares transferred to IEPF shall be entitled to claim the transfer of shares from IEPF in accordance with such procedure and on submission of such documents as may be prescribed.</li> </ul> <p>Explanation—For the removal of doubts, it is hereby clarified that in case any dividend is paid or claimed for any year during the said period of seven consecutive years, the share shall not be transferred to Investor Education and Protection Fund.</p>
	Penalty for Non – compliance	If a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than ` 5 Lacs but which may extend to ` 25 Lacs and every officer of the company who is in default shall be punishable with fine which shall not be less than ` 11 Lac but which may extend to ` 5 Lacs.
Investor Education and Protection Fund - Sec. 125	Establishment of Fund	The Central Government shall establish a Fund to be called the Investor Education and Protection Fund
	Amount to be transferred to Fund	<p>(a) Amount given by the C.C. by way of grants after due appropriation made by Parliament by law in this behalf ;</p> <p>(b) Donations given to the Fund by the C.G., State Governments, companies or any other institution;</p> <p>(c) Amount in the Unpaid Dividend.. Account of companies ;</p> <p>(d) Amount in the general revenue account of the C.G. which had been transferred to that account u/s 205A(5) of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act ;</p> <p>(e) the amount lying in the investor Education and Protection Fund u/s 205C of the Companies Act, 1956; the</p> <p>(f) interest or other income received out of investments made from the Fund;</p> <p>(g) the amount received under sub-section (4) of section 38;</p> <p>(h) the application money received by companies for allotment of any securities and due for refund ;</p> <p>(i) matured deposits with companies other than banking companies;</p> <p>(j) matured debentures with companies ;</p> <p>(k) interest accrued on the amounts referred to in clauses (h) to (j) ;</p> <p>(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years ;</p> <p>(m) redemption amount of preference shares remaining unpaid or</p>

		<p>unclaimed for seven or more years; and</p> <p>(n) such other amount as may be prescribed:</p> <p>(o) Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.</p>
	Utilization of Fund	<p>The Fund shall be utilized for —</p> <p>(a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon ;</p> <p>(b) promotion of investors' education, awareness and protection ;</p> <p>(c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement ;</p> <p>(d) reimbursement of legal expenses incurred in pursuing class action suits u/s 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal ; and</p> <p>(e) any other purpose incidental thereto, in accordance with such rules as may be prescribed:</p> <p>Explanation.—The disgorged amount refers to the amount received through disgorgement or disposal of securities.</p>

### 6. Corporate Governance (Chapter 13)

<p>Issues involved in Corporate Governance Chapter IV of SEBI (LODR) Regulations, 2015</p>	<p>a) Board of Director including its composition, independent director, non executive director etc.;</p> <p>b) Provisions regarding composition and functioning of Audit Committee (Regulation 18).</p> <p>c) Provisions regarding setting up and role of Nomination and Remuneration Committee.</p> <p>d) Provisions regarding setting up and role of Stakeholder Relationship Committee</p> <p>e) Provisions regarding setting up and role of Risk Management Committee</p> <p>f) Vigil mechanism</p> <p>g) Related party Transaction</p> <p>h) Management of Subsidiaries</p> <p>i) Obligations w.r.t. Independent Directors</p> <p>j) Obligations w.r.t. directors and senior management</p> <p>k) Others as specified in Part E of schedule II (Discretionary).</p> <p><b>Note:-</b> Detail of these clauses is similar to provisions as covered in earlier Listing agreement.</p>
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### COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

AS AMENDED BY

COMPANIES (COST RECORDS AND AUDIT) AMENDMENT RULES, 2016

DATED 14/07/2016

## 7. COMPANIES (COST RECORDS AND AUDIT) RULES, 2014 - AS AMENDED BY COMPANIES (COST RECORDS AND AUDIT) AMENDMENT RULES, 2016 dated 14.07.2016

Application of Cost records – Rule 3	No change	
Application of Cost records -Rule 3 Applicability for Cost Audit - Rule 4	Exemption	The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3; and (i) whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue ; or (ii) which is operating from a special economic zone or (iii) which is engaged in generation of electricity for captive consumption through captive consumption plant.
Cost Audit -Rule 6	Appointment of Cost Auditor	<ul style="list-style-type: none"> <li>Companies required to get the cost records audited, shall within 180 Days of the commencement of every financial year, appoint a cost auditor.</li> <li>Before such appointment is made, the written consent of cost auditor to such appointment and a certificate from him or it shall be obtained.</li> </ul>
	Content of the Certificate	<p>The Cost Auditor appointed shall submit certificate that –</p> <p>(a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959 and the Rules or regulations made there under.</p> <p>(b) the individual or the firm, as the case may be, satisfies the criteria provided in Sec. 141, so far as may be applicable.</p> <p>(c) the proposed amendment is within the limits laid down by or under the authority of the Act.</p> <p>(d) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.</p>
	Intimation to Cost auditor and Central Govt.	<ul style="list-style-type: none"> <li>Company shall inform the cost auditor of his or its appointment as such and</li> <li>file a notice of such appointment with the Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier,</li> <li>through electronic mode, in Form CRA-2, along with the specified fee.</li> </ul>
	Tenure of Cost Auditor	Every cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.
	Removal before expiry of tenure	<ul style="list-style-type: none"> <li>Cost Auditor appointed under these rules may be removed from his office before the expiry of his term, through a Board Resolution after giving a reasonable opportunity of being heard to the Cost Auditor and recording the reasons for such removal in writing.</li> <li>Form CRA-2 to be filed with the C.G. for intimating appointment of</li> </ul>

		another cost auditor shall disclose the relevant Board Resolution to the effect.
	Filling of Casual Vacancy	<ul style="list-style-type: none"> <li>Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the BOD within 30 days of occurrence of such vacancy and</li> <li>the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.</li> </ul>
	Approval of Cost Statements	The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the BOD before they are signed on behalf of the Board by any of the director authorized by the Board, for submission to the cost auditor to report thereon.
	Submission of Cost Audit report	<ul style="list-style-type: none"> <li>Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in Form CRA-3.</li> <li>Every cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.</li> <li>Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in XBRL format in specified manner along with specified fees.</li> </ul>

### 8. TAX AUDIT U/S. 44 AB

Applicability	<p>Sec 44AB is applicable to the following classes of assesses :</p> <p>(a) Assessee carrying on business where total sales or turnover or gross receipts exceeds Rs. 100 lakhs in any previous year ; or</p> <p>(b) Assessee carrying on profession where gross receipts exceeds Rs. 50 Lakhs in any previous year; or</p> <p>(c) Assessee carrying on the business referred to u/s 44AE/44BB (Exploration of Mineral Oil) /44BBB (Foreign companies engaged in Civil Construction) and declaring lower income than prescribed under those sections in any previous year; or</p> <p>(d) Assessee carrying on profession covered u/s 44ADA and declaring lower income than deemed u/s 44ADA and his income exceeds the maximum exempted amount.</p> <p>(e) Assessee carrying cm the business covered u/s 44AD and shall not be eligible to claim the benefit of provisions of Sec. 44AD and his income exceeds the maximum exempted amount.</p> <p>Note: Where the assessee is proprietor of more than one concern, aggregate .of all the businesses to be taken into consideration for the purposes of compliance with the provisions of sec. 44AB.</p>
Form 3CD -Clause 13(d)	Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)
Form 3CD -Clause 13(e)	If answer to (d) above is in the affirmative, give details of such adjustments :

		Increase in profit (Rs.)	Decrease in profit (Rs.)	Net effect (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			
	TOTAL			
Form 3CD -Clause 13(f)	Disclosure as per ICDS :			
	i.	ICDS I Accounting Policies		
	ii.	ICDS II Valuation of Inventories		
	iii.	ICDS III Construction Contracts		
	iv.	ICDS IV Revenue Recognition		
	v.	ICDS V Tangible Fixed Assets		

	vi.	ICDS VII Governments Grants
	vii.	ICDS IX Borrowing Costs
	viii.	ICDS X Provisions, Contingent Liabilities and Contingent Assets

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CA Mahesh Gour is an associate member of ICAI. He is been awarded with the degree of PhD for his research in the area of “Management in Taxation”. He is also a LLB and MBA (finance). He is an eminent and nation famous faculty of Indirect Taxation & Auditing. He has been teaching Tax laws at various levels for past Eight Years . More than 14000 students of CA, CMA & CA have benefitted from his extraordinary teaching skills. Student have always appreciated his insights and teaching methods and have regarded him as a great motivator. Currently he is visiting faculty at various Institutes in Mumbai. He is also a visiting faculty of WIRC of ICAI. In 2008, Dr. Mahesh Gour was honoured with the title of “Master Mind & Memory Guru” for his outstanding skills of memorizing. He is the first and only professor in the field who uses his unique methods of mnemonics and memory techniques while teaching. Also this is exemplary , when he made a 10th standard student memorise CA Final book with page numbers in mere 4 days. He is founder and director of Aaditya Foundation and Partner of Mahesh Gour & Co.



CA Vidhi Chheda is a passionate faculty teaching audit since last 8 years. The faculty uses lucid teaching techniques and memory techniques to make sure students take back home what is taught in the class, unique notes with pictures and diagrams helps the students to memorize the concepts. She is teaching at various coaching institutes. She assures that students scores maximum marks with her guidance. She is an active faculty with ICAI.



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