

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory.

Answer any **four** out of remaining five.

Question 1

- (a) SS Ltd. is a company listed in India. The Company has appointed M/s Z & Co. as auditors. Mr. Q, a CA has recently joined the firm and has been appointed as the engagement partner for the first time. He understands that it is necessary to ensure the compliance of independence for the audit team as per standard audit practices. But he could not find as such, any policies and procedures available with the firm in documented form.

Why do you think that the firm should have policies and procedures to ensure the independence of the firm in every assignment? How does an engagement partner ensure the compliance of independence? Discuss with reference to relevant SAs. **(5 Marks)**

- (b) Mr. Bal a CA has been appointed as the auditor of Healthy Foods Pvt. Ltd. The company purchases various types of grains and converts them into flour. While obtaining an understanding of the control environment of the company, he found that entity's risk assessment procedure has some loopholes at various points in the purchases process and company is required to make certain material assertions in financial statements on the basis of fair value estimation. CA. Bal foresees a risk of material misstatement due to these fair value estimations. Suggest him as to how he should deal with such risks. Elucidate with reference to relevant SAs. **(5 Marks)**

- (c) Dreams Pvt. Ltd. is a travel management company which provides its customers with customized packages of domestic and international tours. During the period of COVID-19 and a year after that, company suffered losses due to which it went under cost cutting regime. As a part of the process, the company has adopted various courses of actions one of which is appointment of internal auditor. The internal auditor observed that the company has given a huge hall for providing a gym facility to its employees. The internal auditor observed that the gym is being used only 1-2 days week on an average basis by the employees. There is a huge balance lying in the company's bank account, but the management could not take a decision regarding investing the same, due to fluctuating market situations. The company has taken a hall on rent for the purpose of sitting cum waiting lounge for its customer. Besides, everyday there is downtime of one hour during the working hours for computers and other machines. The internal auditor of the company wants to cover these matters and report them, but Mr. X the manager of the company, is of the opinion that these matters are not related to internal audit and therefore, should not be commented upon. Express your opinion in this regard and suggest appropriate course of action. **(4 Marks)**

Answer

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

- (i) Communicate its independence requirements to its personnel and, where applicable, to others subject to them; and
- (ii) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

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

In doing so, the engagement partner shall:

- (i) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
 - (ii) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
 - (iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
- (b) According to SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", while responding to the assessed risk of material misstatements, the auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.

Based on the assessed risks of material misstatement, the auditor shall determine:

- Whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; and

- Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances.

In responding to the assessed risks of material misstatement, as required by SA 330, the auditor shall undertake one or more of the following, taking account of the nature of the accounting estimate:

- (a) Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate.
 - (b) Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether:
 - (i) The method of measurement used is appropriate in the circumstances; and
 - (ii) The assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework.
 - (c) Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures.
 - (d) Develop a point estimate or a range to evaluate management's point estimate. For this purpose:
 - (i) When the auditor uses assumptions or methods that differ from management's, the auditor shall obtain an understanding of management's assumptions or methods sufficient to establish that the auditor's point estimate or range takes into account relevant variables and to evaluate any significant differences from management's point estimate.
 - (ii) When the auditor concludes that it is appropriate to use a range, the auditor shall narrow the range, based on audit evidence available, until all outcomes within the range are considered reasonable.
- (c) **The scope of the internal auditor's work should include a review of the Utilization of Resources.**

Review of Utilization of Resources –

- The internal auditor should check whether proper operating standards and norms have been established for measuring the economical and efficient use of resources.
- They should be detailed enough to be identifiable with specific operating responsibilities and should be capable of being used by operating personnel for monitoring and evaluating their performance.

- The internal auditor should review the methods of establishing operating standards and norms. He should carefully examine the assumptions made while setting the standards to ensure that they are appropriate and necessary.
- Where there is a wide divergence between actual performance and the corresponding standards, reasons may be considered. As a part of evaluating resources utilisation, identifying the facilities which are under-utilized is an important function of the internal auditor.

In the given situation, the following observations have been noted by the Internal Audit Team that:

- The company has provided a huge hall as a gym facility to employees, which is operating only 1-2 days a week. The rest of the days, it remains unutilized. Moreover, the company has taken a sitting cum waiting lounge for the customers.
- There is a huge amount lying in bank accounts on which the management is not able to make decisions regarding investing. This results in a loss of interest.
- There is a downtime of one hour for resources and computers in the company.

Moreover, Mr. X, the Manager of the company, has denied the internal auditors from reporting the said observations.

All the above-mentioned issues fall under the purview of the Internal Audit function, i.e., Review of Utilization of Resources. The auditor must highlight the weaknesses observed and give suggestions for improvement of the same. Accordingly, opinion of Mr. X, the manager of the company Dreams Pvt. Ltd. that above matters are not related to internal audit and therefore, should not be commented upon, is not tenable.

Question 2

- (a) *PQR Ltd. supplies uniforms across the country. The company has 4 warehouses at different locations throughout India and 5 warehouses at the borders. The major stocks are generally supplied from the borders.*

PQR Ltd. appointed M/s STU & Co. to conduct its audit for the financial year 2022-23. Mr. U, partner of M/s STU & Co., attended all the physical inventory counting conducted throughout India, but could not attend the same at borders due to some unavoidable reasons.

You are required to advise M/s STU & Co.,

- (i) *How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?*
- (ii) *How is an auditor supposed to deal, in case attendance at physical inventory counting is impracticable?*

(5 Marks)

- (b) CA. Pack, a qualified Chartered Accountant got the audit assignment of F(P) Ltd. for the financial year 2022-23.

He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the balance Sheet items, CA. Pack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting to ₹ 150 lakhs.

He continued as it is from the last year, on the affirmation of the management that there are no receipts and further credits during the year. CA. Pack, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by the predecessor auditor.

In your opinion, what measures need to be taken by the auditor. Also, suggest the correct audit procedure in this regard. **(5 Marks)**

- (c) Fam Associates have been appointed auditors of Home Ltd. which acquired 55% shares in Sam Ltd. on 15th October, 2022. During the audit of Home Ltd., the auditors found that the company has not prepared consolidated financial statements because, on the date of acquisition, the fair value of certain assets & liabilities has not been ascertained, which is significant and are accounted for on estimated basis only.

Help Fam Associates in framing the opinion paragraph of the audit report. **(4 Marks)**

Answer

- (a) (i) **Special Consideration with Regard to Inventory:** As per SA 501 "Audit Evidence-Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:
- (a) Attendance at physical inventory counting, unless impracticable, to:
 - (1) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
 - (2) Observe the performance of management's count procedures;
 - (3) Inspect the inventory; and
 - (4) Perform test counts; and
 - (b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
- (ii) **Attendance at Physical Inventory Counting Not Practicable:** In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support

a decision by the auditor that attendance is impracticable. Further, as explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

(b) Verification of Accounts Receivable: As per SA 510, "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether -

- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable, (like external confirmations) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 505, “External confirmations” the auditor can use external confirmation procedures to obtain audit evidence.

In addition, according to SA 580, “Written Representations”, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management’s judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

In the given case, the management of F(P) Ltd. has restrained CA. Pack, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Pack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Pack should have requested the management to provide written representation for their views and expressions and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

- (c) **Opinion Paragraph of Audit Report:** In the instant case, Home Ltd. acquired 55% shares in Sam Ltd. and the company did not prepare the consolidated financial statements because on the date of acquisition the fair value of certain assets and liabilities has not been ascertained. Therefore, accounting is done on estimate basis only which is not correct as the financial statements are materially misstated due to non-consolidation of subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. Thus, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Adverse Opinion

In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2023, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

Basis for Adverse Opinion is given below:

As explained in Note X, the Home Ltd. has not consolidated subsidiary Sam Ltd. that the Home Ltd acquired during 2022 because it has not yet been able to determine the fair

values of certain material assets and liabilities of subsidiaries at the acquisition date. This investment is therefore accounted for on an estimate basis. Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts.

Had Sam Ltd. been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

Question 3

- (a) *While doing Tax Audit, under section 44AB of the Income-tax Act, 1961, of the accounts of Gum Private Limited for the Assessment Year 2023-24, it was found that during the Financial Year 2022-23, Gum Private Limited had received 8,000 shares, the market value of which was ₹ 80,000 on the date of transfer, at a price of ₹ 45,000 from Paste Private Limited. The Management of Gum Private Limited maintained that the transaction was as per the terms of negotiations and there would be no cause for the Auditor to bring this matter in his Tax Audit Report.*

Discuss this aspect with relevant provisions of section 44AB of the Income-tax Act, 1961.

(5 Marks)

- (b) *DK Finance Ltd. is registered with RBI as an NBFC. Its financial statements have already been prepared and approved. A US based company is interested in investing in the equity of DK finance Ltd. but they want the company to present their financial statements under IND AS.*

What points do you think should be kept in mind while preparing the financial statements of an NBFC under IND AS?

(5 Marks)

- (c) *In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates.*

This data can be useful for preparation of Management Information System (MIS) reports and electronic dashboards that give a high-level snapshot of business performance. In view of the above facts, you are required to briefly discuss the meaning of data analytics and give examples of circumstances, when auditors can apply the concept of data analytics.

(4 Marks)

Answer

- (a) **Reporting for Receipt of Shares, the Aggregate Fair Market Value of Which Exceeds ₹ 50,000:** In this case, during the financial year 2022-23, Gum Private Ltd. received property, being shares, for ₹ 45,000 as consideration, the fair market value of which is ₹ 80,000.

A tax auditor has to furnish the details of shares received during the previous year, under clause 29B of Form 3CD, in case, the assessee has received any property, other than

immovable property, without consideration or for inadequate consideration as referred to in section 56(2)(x) of the Income-tax Act, 1961.

Section 56(2)(x) provides that where any person or persons, receives, in any previous year any property other than immovable property,

- (i) without consideration, the aggregate fair market value of which exceeds ₹ 50,000, the whole of the aggregate fair market value of such property;
- (ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding ₹ 50,000, the aggregate fair market value of such property as exceeds such consideration,

shall be chargeable to income-tax under the head "Income from other sources".

As per the facts of the case, provisions and explanations given above, the income generated by Gum Private Ltd., is ₹ 35,000 (fair market value of shares received is ₹ 80,000), is less than rupees 50,000 as per section 56(2)(x) of the Income-tax Act, 1961.

Therefore, the tax auditor of Gum Private Ltd. is not required to furnish the details of such shares received under clause 29B of Form 3CD. Thus, the contention of the management of the company, for not reporting such receipt of shares, is in order.

(b) The presentation requirements for NBFCs under IND AS are the following:

- (i) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity.
- (ii) NBFCs are required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income.
- (iii) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.
- (iv) NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of showing those only as part of the notes.
- (v) Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired.
- (vi) The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.

(c) Data Analytics: Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics. The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs.

When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following:

- preliminary analytics;
- risk assessment;
- control testing;
- non-standard journal analysis;
- evaluation of deficiencies;
- fraud risk assessment.

Question 4

- (a) CA. Honest is the statutory auditor of Wax Ltd., which is a company listed in India with a turnover of ₹ 2500 Crore as per latest financial statements. CA. Honest is the auditor of the company since last 3 years. During the year 2021-22, Company has changed its CFO. The newly appointed CFO is not much happy with CA. Honest due to his strict audit procedures as well as his harsh comments in the review reports. He always tries to avoid giving detailed information on certain important matters. During the month of October, 2022, CA. Honest decides to resign and after informing the management he finally resigned on October 12, 2022. CA. Honest has completed the limited review for the quarter ended September 2022 and has submitted his review report to the company.

Do you think CA. Honest has performed all the required duties before resigning as auditor, in accordance with Companies Act 2013 or SEBI LODR?

How can the company ensure the compliance of the requirements of LODR in case of resignation of the auditor? **(5 Marks)**

- (b) Mr. D has an expertise in navigation software used in vehicles. His customers are overseas companies. During the last financial year, Mr. D had to incur losses due to non-payment by two of his customers of different countries, one of them being insolvent and the other due to some sanctions imposed by newly appointed government of that country. Being more cautious this time, Mr. D is looking for some legal way out, through which he can ensure timely payment of his software.

Do you think there is any type of insurance cover, which can serve the purpose of Mr. D? If yes, what shall be the basic requirements of that insurance cover if Mr. D wants to go with the same? **(5 Marks)**

- (c) MNS Bank Ltd. is suffering from huge number of NPAs. During the month of April 2023, the management of the bank decided to sell some of its NPAs. Bank is doing this exercise for the first time. The management has selected following NPA accounts for sale:

Name	NPA since F.Y.	Amount (₹ In Lakh)
S store Ltd.	2018-19	27.50
V Pvt. Ltd.	2017-18	55.23
AV Fab Corp.	2020-21	34.20
MN Iron works.	2021-22	45.30
DG and Associates	2019-20	50.00

Being internal auditor of the bank, you are required to scrutinize the proposal made by the branch and help them by providing specific points to be considered. (4 Marks)

Answer

- (a) In case of resignation from the company, provisions of the Companies Act, 2013 apply. Section 140(2) of the Companies Act, 2013, requires the auditor, who has resigned from the company to file within a period of 30 days from the date of resignation, a statement with the company and the registrar, and in case of government companies, the auditor shall file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor will be liable for penal provisions.

The conditions to be complied with upon resignation of the statutory auditor of a listed entity/material subsidiary w.r.t. limited review/audit report as per SEBI LODR Regulations, includes that all listed entities/material subsidiaries while appointing/re-appointing an auditor shall ensure compliance with if the auditor resigns within 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/audit report for such quarter.

Clause A in part A of schedule III under regulation 30(2) of SEBI LODR Regulations requires detail reasons to be disclosed by the listed entities to the stock exchanges in case of resignation of the auditor of a listed entity as soon as possible but not later than 24 hours of receipt of such reasons from the auditor.

Other conditions relating to resignation shall include:

- (i) Reporting of concerns with respect to the listed entity/its material subsidiary to the Audit Committee:
 - a. In case of any concern with the management of the listed entity/material subsidiary such as non-availability of information/non-cooperation by the management which may hamper the audit process, the auditor shall approach the Chairman of the Audit Committee of the listed entity and the Audit Committee shall receive such concern directly and immediately without specifically waiting for the quarterly Audit Committee meetings.

- b. If auditor proposes to resign, all concerns with respect to the proposed resignation, along with relevant documents shall be brought to the notice of the Audit Committee.

If proposed resignation is due to non-receipt of information/explanation from the company, the auditor shall inform the Audit Committee of the details of information/explanation sought and not provided by the management, as applicable.

- c. On receipt of such information from the auditor relating to the proposal to resign as mentioned above, the Audit Committee/board of directors (In case an entity is not mandated to have an Audit Committee, then the board of directors of the entity shall ensure compliance), shall deliberate on the matter and communicate its views to the management and the auditor.
- (ii) Disclaimer in case of non-receipt of information in accordance with the Standards of Auditing as specified by ICAI/NFRA.

The Company is also required to ensure the following compliance of LODR in case of resignation of the auditor i.e.

- ☐ Format of information to be obtained from the statutory auditor upon resignation;
- ☐ Co-operation by listed entity and its material subsidiary
- ☐ Disclosure of Audit Committee's views to the Stock Exchanges.

- (b) Yes, Mr. D can opt for Trade Credit Insurance which can serve the purpose of Mr. D. As "Trade credit insurance" means insurance of suppliers against the risk of non-payment of goods or services by their buyers who may be situated in the same country as the supplier (domestic risk) or a buyer situated in another country (export risk) against non-payment as a result of insolvency of the buyer or non-payment after an agreed number of months after due-date (protracted default) or non-payment following an event outside the control of the buyer or the seller (political risk cover). Political risk cover is available only in case of buyers outside India and in countries agreed upon at the proposal stage.

An insurer shall offer trade credit insurance product only if all requirements mentioned below are met -

- (i) Policyholder's loss is non-receipt of trade receivable arising out of a trade of goods or services.
- (ii) Policyholder is a supplier of goods or services in consideration for a fair market value.
- (iii) Policyholder's trade receivable does not arise out of factoring or reverse factoring arrangement or any other similar arrangement.

- (iv) Policyholder has a customer (*i.e.*, Buyer) who is liable to pay a trade receivable to the policyholder in return for the goods and services received by him from the policyholder, in accordance with a policy document filed with the insurer.
- (v) Policyholder undertakes to pay premium for the entire Policy Period.
- (vi) Any other requirement that may be specified by the authority from time to time.

(c) In case of Sale of NPA by Bank, the auditor should examine that:

- the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers including non performing financial assets that may be sold, norms or such sale, valuation procedure and accounting policy.
- only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- the assets have been sold “without recourse” only *i.e.*, the entire credit risk associated with the non-performing asset should be transferred to the purchasing bank.
- subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- the NPA has been sold at cash basis only. Under no circumstances, NPA can be sold to another bank at a contingent price. The entire sale consideration has to be received on upfront basis
- the bank has not purchased an NPA which it had originally sold.
- on the sale of the NPA, the same has been removed from the books of the account of selling bank on transfer;
- If the sale is at a price below the net book value (NBV) (*i.e.*, book value less provisions held), the shortfall should be debited to the profit and loss account of that year.
- If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/ loss on account of sale of other non-performing financial assets

In the given situation, management of MNS Bank Ltd. is considering to sell following NPAs, during the month of April, 2023:

Name	NPA since F.Y.	Amount (₹ in lakh)
S Store Ltd.	2018-19	27.50
V Pvt. Ltd.	2017-18	55.23
AV Fab Corp.	2020-21	34.20

MN Iron Works	2021-22	45.30
D G Associates	2019-20	50.00

In view of above-mentioned conditions, the auditor is required to ensure that only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.

Considering the facts given in the question all the NPAs, except for MN Iron Works, are prior to April 2021 i.e., 2 years prior to April 2023. In view of above provisions, management of MNS Bank Ltd. can sell all the NPAs except for NPA of 45.30 lakh rupees of MN Iron Works as it has remained NPA in the books of the banks less than 2-year duration.

Question 5

- (a) Sonar Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Mumbai with new technology for a cost of ₹ 4,750 Crore. The project had seen delays in commencement and cost overruns. State ANY FIVE matters that a Comprehensive Audit by C & AG may cover in reporting on the performance and efficiency of this project. **(5 Marks)**

- (b) CA. T was appointed as a Technical Reviewer of M/s. ABC & Co., Chartered Accountants, for the year ending on 31st March 2023 by Quality Review Board. CA. T has completed the review of M/s. ABC & Co. within the stipulated time.

What matters shall be considered by CA. T in deciding on the type of Quality Review Report to be issued to the Quality Review Board for M/s. ABC & Co.? Mention ANY FIVE matters. **(5 Marks)**

- (c) CA. Sonu has been practising since 2008, specialising in Corporate audits and Company Law matters. Due to his good practical knowledge, he was offered editorship of a 'Company Audit' Journal, which he accepted. However, he did not take any permission from the Council regarding such editorship.

Discuss the act of CA. Sonu with reference to the Chartered Accountants Act, 1949 and the Rules made thereunder. **(4 Marks)**

Answer

- (a) The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives, and operations. However, in general, the covered areas are those of investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, the productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc.

The following matters are examined and covered in reporting in the comprehensive audit:

- (1) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these, and whether there is evidence of extravagance or unnecessary expenditure?
 - (2) Have the planned production or operational outputs been achieved? Has there been under-utilization of installed capacity or shortfall in performance and, if so, what has caused it?
 - (3) Has the planned rate of return been achieved?
 - (4) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
 - (5) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
 - (6) Are the purchase policies adequate? Or have they led to the piling up of inventory resulting in redundancy in stores and spares?
 - (7) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits, and in reducing costs through technological progress?
 - (8) If the enterprise has an adequate system of repairs and maintenance?
 - (9) Are procedures effective and economical?
 - (10) Is there any poor or insufficient or inefficient project planning?
- (b)** In deciding on the type of report to be issued, a reviewer should consider the evidence obtained and should document the overall conclusions with respect to the year being reviewed with respect of the following matters:
- (1) whether the policies and procedures that constitute the reviewed firm's (AFURs) system of quality control for its attestation services have been designed to ensure quality control to provide the firm with reasonable assurance of complying with technical standards, other relevant guidance and other relevant laws and regulations.
 - (2) whether personnel of the reviewed firm (AFUR) complied with such policies and procedures in order to provide the firm with reasonable assurance of complying with technical standards, other relevant guidance, and other relevant laws and regulations.
 - (3) whether independence of AFUR is maintained in conducting audit.
 - (4) whether the AFUR has instituted adequate mechanism for training of staff.
 - (5) whether the audit firm (AFUR) ensures the availability of expertise and/or

experienced individuals for consultation.

- (6) whether the skill and competence of assistants are considered before assignment of attestation engagement.
 - (7) whether the progress of attestation service is monitored and work performed by each assistant is reviewed by the service in-charge and necessary guidance is provided to assistants.
 - (8) whether the audit firm (AFUR) has established procedure to record the audit plan, the nature, timing and extent of auditing procedures performed and the conclusions drawn from the evidences obtained.
 - (9) whether the audit firm (AFUR) maintains audit documentation as per the relevant standards.
 - (10) whether the audit firm verifies compliance with laws and regulations to the extent it has material effect on financial statement.
 - (11) whether the internal controls within the audit firm (AFUR) contribute towards maintenance of quality of reporting.
- (c) **Editorship of Professional Journal:** As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. Editorship of professional journals is covered under General Permission.

In this case, CA. Sonu, is a practicing chartered accountant having expertise in corporate audits and Company Law matters. He is being offered editorship of 'Company Audit' Journal, which he accepted without taking permission from the Council. The Company Audit journal is a professional journal and editorship of professional journals is covered under the general permission.

Conclusion: In view of above, in the given scenario, CA. Sonu will not be held liable for misconduct acceptance of editorship of professional journal 'Company Audit' under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.

Question 6

- (a) *Explain the provisions and requirements of the Companies Act, 2013 for preparation and Consolidation of Financial Statements of a company which is mandatory. Also, state in which cases the requirement related to preparation of consolidated financial statements shall not apply to a company.* **(5 Marks)**

- (b) *P Ltd has more than one subsidiary where Mr. K and Mr. X are interested. K and X are also directors in P Ltd. These concerns have numerous inter company transactions for past many years. Some of the subsidiary companies are continuously bearing losses, but are being financed by one or the other agencies in the market. One of the independent directors of a Subsidiary, reported the matter to the Central Government and requested for an investigation, as he is of the opinion that these companies are being operated to benefit certain specific persons. Mr. Q, a practicing Chartered Accountant has been appointed by the Central Government as inspector to investigate the matter.*

You are required to guide Mr. Q regarding the type of investigation to be conducted and matters to be considered in such investigation. **(5 Marks)**

- (c) *Mr. R has been appointed as the statutory auditor of Famous Ltd. which is a listed company. As per the terms of acceptance of audit, the whole audit fee shall be payable in four installments of ₹ 3 lakh each, and shall be paid after every limited review done on quarterly basis and conclusion of audit committee meeting of every quarter. Full and final payment shall be done after the yearly financial statements and Audit Reports are released. The firm received first two payments on time while third payment which was supposed to be received in the month of January was received on March 25th, 2023 along with the remaining part of the Audit Fee.*

Discuss the validity of above fee structure and terms of payment in the light of applicable provisions given by ICAI.

CA. P has been representing M/s VS and Associates before Income-tax Appellate Tribunal for a case of income escaping assessment for F.Y. 2016-17. There were unidentified credits in the books of accounts. CA. P was the statutory auditor of the company that time and did not mention any thing about such credit in his audit report. Later, it was found that he had sufficient evidences to believe that these credits were liable to be taxed. In order to make his case stronger, he produces false documents and made witness present false statements.

What do you think are provisions against CA. P under different Acts? **(4 Marks)**

Answer

- (a) **Preparation of Consolidated Financial Statements:** According to section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Further, section 129(4) of the said Act, provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to its the consolidated financial statements.

The consolidated financial statements shall also be approved by the Board of Directors before they are signed on behalf of the Board, along with its standalone financial statements and shall also be laid before the annual general meeting of the company along with the laying of its standalone financial statement.

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary(ies) in Form AOC-1.

According to the Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act.

However, the requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:

- (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
- (ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
- (iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made there under, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity. However, as per paragraph 33 of Ind AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment

entity subsidiary, unless the parent itself is an investment entity.

Thus, the companies having subsidiaries, which have previously never prepared the consolidated financial statements, must prepare their consolidated financial statements in adherence with this mandatory requirement. This will provide the holding companies' stakeholders more transparency about the companies' businesses.

- (b) As per section 216 of the Companies Act, 2013, where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons,
- (i) who are or have been financially interested in the success or failure, whether real or apparent, of the company; or
 - (ii) who are or have been able to control or to materially influence the policy of the company; or
 - (iii) who have or had beneficial interest in shares of a company or who are or have been beneficial owners or significant beneficial owner of a company.

While appointing an inspector, the Central Government may define the scope of the investigation as respects the matters or the period to which it is to extend.

Scope and extent of investigation - When a chartered accountant is appointed to carry out an investigation under any of the aforementioned provisions, the extent of enquiry, the objective of the investigation and the various matters referred to for investigation are specified in the order of investigation issued by the appointing authority.

On a consideration thereof, the investigating accountant should determine the areas of accounts which require investigation and the extent to which the enquiry is to be made as well as his general approach to the enquiry.

In case of a company having subsidiaries or where one or more directors are interested in one or more concerns, all the dealings with these concerns should be examined for these may have been entered into with the intention of transferring profit. Generally, all sales and purchases of goods and assets from directors and their associated concerns should be scrutinized since these also can be a vehicle of illicit transferring of profits.

Any breach of duty or abdication of responsibility for purposes of investigation would be material only if it has resulted in a loss to the company. In such a case, the factors responsible for the loss or losses, besides the amount thereof, shall have to be investigated. Negligence would be culpable only if it was in relation to a duty cast by the Act, Articles of Association or by a resolution of the shareholders or that of the Board of Directors.

Any negligence in the discharge of duty of a director or any other managerial personnel must be construed very broadly, for apart from being the agents of the company, they are trustees of its property. As such, it is their duty to safeguard the property of the company and protect the interest of the shareholders. It must be remembered, however, that it is not the duty of a director to attend to the business of a company continuously and, therefore, so long as the decisions of the Board at which the director was present were taken on a proper consideration of the evidence available and in the best interest of the company, he would not be responsible for any losses suffered by the company.

It may be necessary for an investigator to interrogate directors, officers, agents, and others concerned with matters under his enquiry. Before drawing up his brief in this regard as well as for framing his conclusions, he should, if necessary, take legal assistance. If the investigating accountant is required to report on the efficiency of the management, he should be discreet in expressing his opinion. Usually, it is sufficient if he merely indicates the general limitations of the management. The inspector must ensure that the persons who figure in the investigation get the fullest opportunity to explain their action and conduct. However, the inspector cannot hold out any assurance to anybody except the assurance of fairness implicit in the job.

In view of above, CA. Q shall determine the areas of accounts which required investigation and the extent to which the inquiry is to be made and the approach to be adopted.

- (c) **Audit Fees:** As per Chapter X of Council General Guidelines, 2008 a member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ₹ 1,00,000/-.

Under section 141(3) of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014, a person shall be disqualified to be appointed as auditor if he or his relative or his partner is indebted in excess of rupees five lakh to the company or its subsidiary or its holding company or its associate company or a subsidiary of such holding company.

However, the Research Committee of the ICAI has expressed the opinion that where in accordance with the terms of engagement of auditor by a client, the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company at any stage.

Conclusion: In the instant case, Mr. R is appointed to conduct statutory audit of Famous Ltd., a listed entity and it was decided in the terms of acceptance of audit, that the whole audit fee shall be payable in four installments of rupees 3 lakh each and shall be paid after every limited review done on quarterly basis and conclusion of audit committee meeting every quarter. He has received the audit fees of ₹ 3,00,000 in respect of two quarters, but for third and fourth quarter the payment of fess was received on March 25th, 2023, for the year ended 31.3.2023 which is on progressive basis.

Therefore, Mr. R will not be held guilty for misconduct.

OR

- (c) **Applicable provisions as per the Income-tax Act, 1961:** In connection with proceedings under the Income-tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income-tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income-tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income-tax Act 1961.

Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

As per section 271J of the Income-tax Act, 1961 if an accountant or a merchant banker or a registered valuer, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of ten thousand rupees for each such report or certificate by way of penalty.

Applicable provisions as per the Chartered Accountants Act, 1949: As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional capacity.

Further, as per Clause (6) of Part I of Second Schedule, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity.

In the instant case, CA. P, a chartered accountant was appointed as representative by M/s VS Associates to appear before Income-tax Appellate Tribunal in the matter of its Income-tax proceedings of income escaping assessment for the year 2016-17.

As per given facts of the case, it is very much clear that there were unidentified credits in its books of accounts, but CA. P did not mention about that in his audit report whereas he was having sufficient evidence that those credits were liable to be taxed. Also, he produced false documents and made witness present false statements which squarely falls as an offence within section 278 of the Income-tax Act, 1961. In view of above, CA. P would be liable under section 278 of the Income-tax Act, 1961 and will be held liable for professional misconduct under clause 5 and clause 6 of Part I of Second Schedule of the Chartered Accountants Act, 1949.

Alternative Solution

Applicable provisions as per the Income-tax Act, 1961: In connection with proceedings under the Income-tax Act, 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income-tax Authority or the appellate tribunal.

As per section 277A of the Income-tax Act, 1961 if any person (hereafter in this section referred to as the first person) wilfully and with intent to enable any other person (hereafter in this section referred to as the second person) to evade any tax or interest or penalty chargeable and imposable under this Act, makes or causes to be made any entry or statement which is false and which the first person either knows to be false or does not believe to be true, in any books of account or other document relevant to or useful in any proceedings against the first person or the second person, under this Act, the first person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to three years and with fine.

Further, as per section 271J of the Income-tax Act, 1961 if an accountant, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of ten thousand rupees for each such report or certificate by way of penalty.

Applicable provisions as per the Chartered Accountants Act, 1949: As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional capacity.

Further, as per Clause (6) of Part I of Second Schedule, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity.

Conclusion: In the instant case, CA. P, a chartered accountant was appointed as representative by M/s VS Associates to appear before Income-tax Appellate Tribunal in the matter of its Income-tax proceedings of income escaping assessment for the year 2016-17.

As per given facts of the case, it is very much clear that there were unidentified credits in its books of accounts, but CA. P did not mention about that in his audit report whereas he was having sufficient evidence that those credits were liable to be taxed. Also, he wilfully made or causes to be made any entry or statement which is false in any books of account or other document relevant to or useful in any proceedings against the M/s VS Associates, under this Act, CA. P shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to three years and with fine.

In view of the above, CA. P would be liable under section 277A of the Income-tax Act, 1961 and will be held liable for professional misconduct under clause 5 and clause 6 of Part I of Second Schedule of the Chartered Accountants Act, 1949.