

PAPER
3

**FINAL COURSE
STUDY MATERIAL
GROUP-I**

**ADVANCED AUDITING,
ASSURANCE &
PROFESSIONAL ETHICS
MODULE 3 OF 3**



Board of Studies (Academic)
**The Institute of Chartered
Accountants of India**

(Set up by an Act of Parliament)



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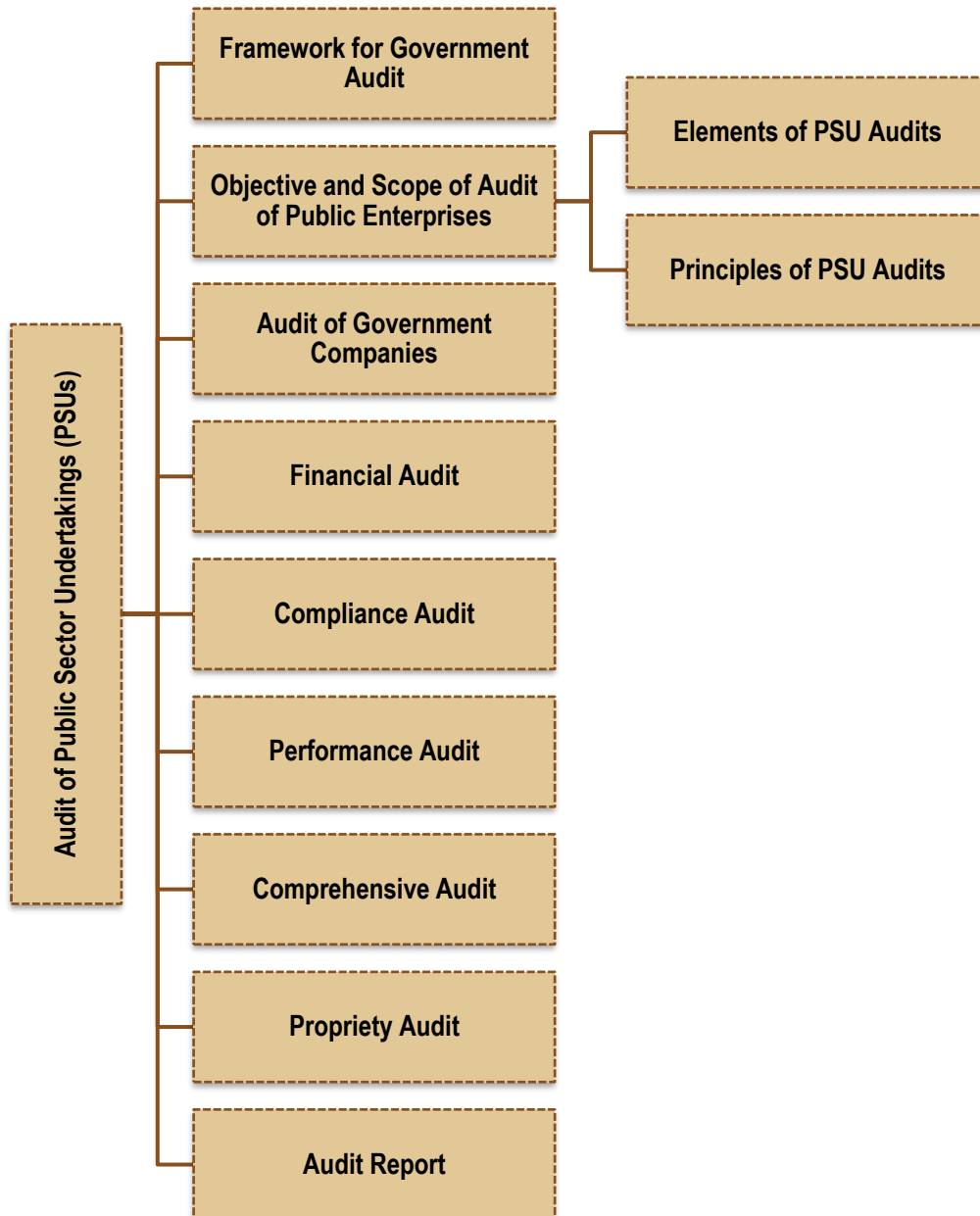
OVERVIEW OF AUDIT OF PUBLIC SECTOR UNDERTAKINGS



LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ☐ Understand the framework for government audit.
- ☐ Understand objective and scope of public enterprises audit.
- ☐ Explain the elements of PSU Audits and Principles of PSU Audits.
- ☐ Understand & explain the concept of Compliance Audit, Performance Audit, Comprehensive Audit & Propriety Audit in relation to C&AG of India.
- ☐ Comprehend about Audit report of the C&AG of India.
- ☐ Apply & analyse the above-mentioned concepts in moderately complex scenarios.

CHAPTER OVERVIEW

CA Smita had joined Indian Audit and Accounts Service after qualifying as a Chartered Accountant and cracking competitive exam thereafter. Her initial appointment was in Mumbai office. As part of audit team for conducting test audit of a PSU in insurance sector, she was verifying whether company was in compliance with regulatory norms for issuing insurance policies. It was in nature of compliance audit.

As part of audit, she found that company had issued policies to certain companies dealing in sale of mobile handsets. Such companies offered free insurance to the customers for their mobiles to cover fire, theft and similar risks. It was, however, subject to buying of their software application by customers in stipulated time. It was found by her that no actuarial valuation was done before issuing such policies and required approvals from competent authorities were not in place. As a result, she found losses on account of claim settlement due to non-compliant underwriting.

She was part of team conducting performance audit of a government owned steel company. The said company had undertaken modernization and expansion of its steel plants and the performance audit of company was carried out. Her team highlighted many deficiencies in areas ranging from project planning, tender finalisation and project execution. In each area, specific deficiencies were pointed out. Like, the team found that all material projects were delayed and not completed in time. It was also pointed that there was growth in domestic steel industry in the period covered by audit but company failed to take advantage of market conditions due to delays.

After few years, she was posted in a northern state after promotion. Her responsibility included compiling a report on financial performance of government companies and statutory corporations owned by state government. Such a report also included impact of significant comments as a result of supplementary audit of the financial statements of government companies carried out by C&AG.

One such comment related to supplementary audit already carried out by C&AG pertaining to improper determining of depreciation in financial statements of a state-owned power generating company. Its impact was highlighted in the report pointing out that said improper determination has led to overstatement of profits by ₹ 20 crore.

Such is encompassing reach of C&AG in relation to PSUs!

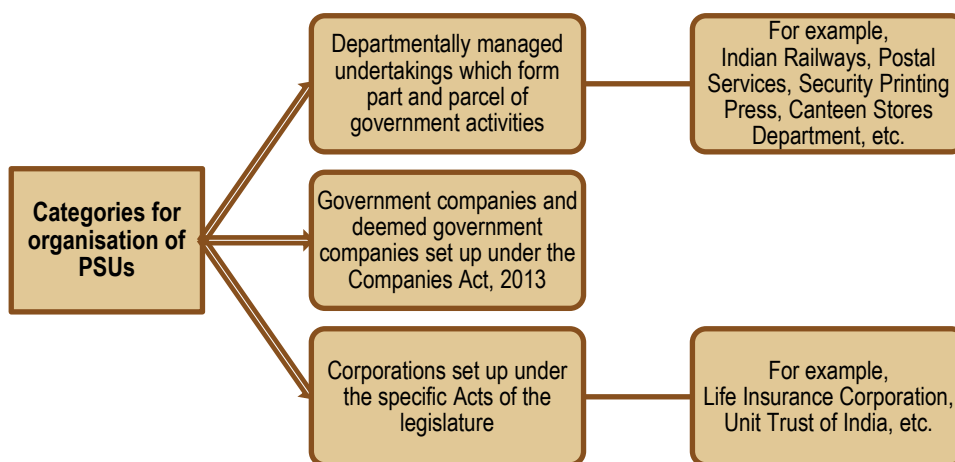


1. INTRODUCTION

Public sector undertakings in India are fundamentally owned or controlled by central government, or any state government or governments, or partly by the central government and one or more state governments. The public enterprises have been assigned a key role in the socio-economic development of the country. These enterprises are industries supplying basic inputs to industry and agriculture, such as coal, oil, steel, minerals and metals, cement, chemicals and fertilizers and heavy equipment. Public utilities like the railways, postal and telecom services, electricity generation and supply, road transport, etc. constitute another class of public enterprises. Though in the past, the public sector in India has achieved a dominant role in the national economy, the private sector is also now actively allowed in various sectors like electricity generation, telecom services, etc.



Fig.: Audit of PSUs*



Source :- newsonair.com



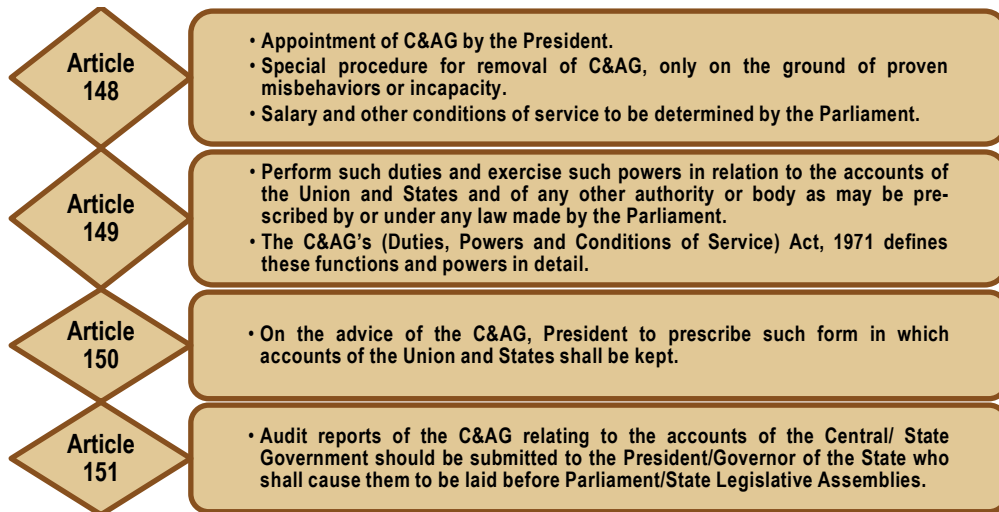
Source :- wikipedia.com



2. FRAMEWORK FOR GOVERNMENT AUDIT

In India, the Government audit is performed by an independent constitutional authority, i.e. **Comptroller and Auditor General of India (C&AG)**, through the **Indian Audit and Accounts Department**. The Constitution of India gives a special status to the C&AG and contains provisions to safeguard his independence.

Article 148 to 151 of the Constitution prescribes the role of C&AG as follows:



The **Comptroller and Auditor General's (Duties, Power and Conditions of Services) Act, 1971**, prescribes that the C&AG shall hold office for a term of six years or upto the age of 65 years, whichever is earlier. He can resign at any time through a resignation letter addressed to the President. The Act also assigns the duties regarding the audit to be followed by C&AG.

The number of organisations subject to the audit of the Comptroller and Auditor General of India is very large. This includes:



As a result of these numerous audits carried out every year, the Comptroller and Auditor General of India has been issuing a large number of audit reports.

Audit of Government Companies (Commercial Audit) – There is a special arrangement for the audit of companies where the equity participation by Government is 51 percent or more. The auditors of these companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them. He is also empowered to comment upon the audit reports of the auditors. In addition, he has a right to conduct a **supplementary audit** of such companies and cause **test audit** if considered necessary, by an order.

Audit Board Setup in Commercial Audit – A unique feature of the audit conducted by the Indian Audit and Accounts Department is the constitution of Audit Boards for conducting comprehensive audit appraisals of the working of Public Sector Enterprises engaged in diverse sectors of the economy.

These Audit Boards associate with them experts in disciplines relevant to the appraisals. They discuss their findings and conclusions with the managements of the enterprises and their controlling ministries and departments of government to ascertain their view points before finalisation.

The results of such comprehensive appraisals are incorporated by the Comptroller and Auditor General in his reports.

These Audit Boards have no separate legal entity and work under the supervision and control of the Comptroller and Auditor General.

Action on Audit Reports – The scrutiny of the Annual Accounts and the Audit Reports thereon by the Parliament as a whole would be an arduous task, considering their diverse and specialised nature, besides imposing excessive demands on the limited time available to the Parliament for discussion of issues of national importance.

Therefore, the Parliament and the State Legislatures have, for this purpose, constituted specialized Committees like the Public Accounts Committee (PAC), Estimates Committee and the Committee on Public Undertakings (COPU), to which these audit Reports and Annual Accounts automatically stand referred.

Public Accounts Committee (PAC) – It is the duty of the Public Accounts Committee to satisfy itself:

- (i) that the moneys were disbursed legally on the service or purpose to which they were applied;
- (ii) that the expenditure incurred was authorised;
- (iii) that re-appropriation has been made in accordance with the provisions made (i.e. distribution of funds).

It is also the duty of the PAC to examine the statement of accounts of autonomous and semi-autonomous bodies, the audit of which is conducted by the Comptroller & Auditor General either under the directions of the President or by a Statute of Parliament.

Estimates Committee – The Committee examines the estimates with a view to:

- (i) report what economies, improvements in organization, efficiency or administrative reform, consistent with the policy underlying the estimates may be effected;
- (ii) suggest alternative policies;
- (iii) examine whether the money is well laid out within the limit; and
- (iv) suggest the form in which the estimates shall be presented to Parliament.

The Committee does not comment upon a policy approved by Parliament, but where there is evidence that a particular policy is not leading to the desired results, or is leading to waste, it is the duty of the Committee to bring it to the notice of the House.

Committee on Public Undertakings (COPU) – The Committee on Public Undertakings exercises the same financial control on the public sector undertakings as the PAC exercises over the functioning of the Government departments. The functions of the Committee are -

- (i) to examine the reports and accounts of public undertakings.
- (ii) to examine the reports of the C&AG on public undertakings.
- (iii) to examine the autonomy and efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
- (iv) to exercise such other functions vested in the PAC and the Estimates Committee as are not covered above and as may be allotted by the Speaker from time to time.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

The objective of the Financial Committees, in doing so, is to focus not only on the individual irregularity, but also on the defects in the system which led to such irregularity, and the need for correction of such systems and procedures.

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

- (i) His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;
- (ii) He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;
- (iv) The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations.

The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature;

- (v) In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

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

TEST YOUR UNDERSTANDING 1

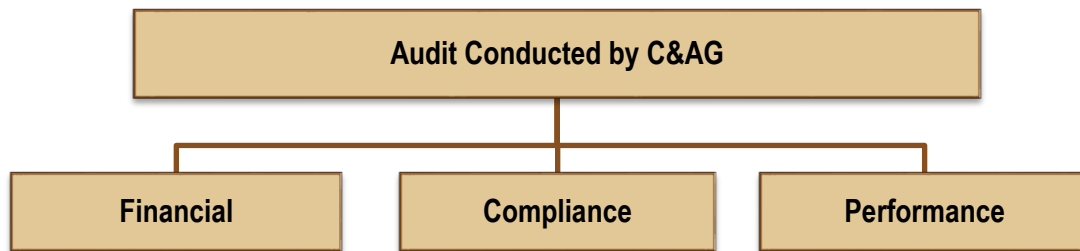
PGC & Associates are statutory auditors of BNPC Limited, a PSU in power sector. It is engaged in building large sized thermal power stations to accelerate development of power sector in the country. One of the financial committees of Parliament has decided to examine its physical and financial performance. It has also examined audit findings of C&AG in respect of which action is yet to be

taken by the said PSU. The committee also proposes to include in its report performance of the company in various operational matters.

Which financial committee of Parliament deals with such matters? Outline its main functions.

3. OBJECTIVE AND SCOPE OF PUBLIC ENTERPRISES AUDIT

The C&AG's (Duties, Power and Conditions of Services) Act, 1971 specifies the entities that come under audit purview of C&AG at the Union and State level. However, the scope and extent of audit is determined by the C&AG itself.



- (1) **Audit of PSUs not constrained to Financial and Compliance Audit:** Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to performance (*efficiency, economy and effectiveness with which these operate and fulfill their objectives and goals*).
- (2) **Propriety Audit:** Another aspect of audit relates to questions of propriety. This audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety.
- (3) **Comprehensive Audit:** Under comprehensive audit, the C&AG do not really cover again the field which has already been covered. He conducts an appraisal or an efficiency-cum-performance audit. He sees whether the undertakings have fulfilled the objectives for which they have been established, whether value-for-money spent has been obtained, whether the targets have been achieved, etc. He locates the areas of weakness including review of the decisions taken by the management and a comprehensive appraisal of the performance of the undertaking.

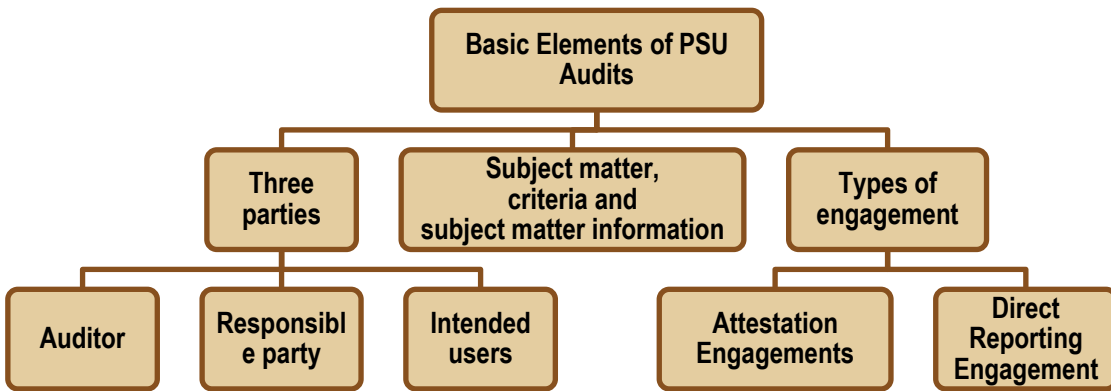
- (4) **Organisation's Decision to be taken by Competent Authority:** In examining the decisions of a management, the auditor examines that these were taken by the competent authority after examination of all aspects (economic, technological, public interest) on the basis of all the relevant information available at that time and taking into consideration the different alternatives available to management and that the decisions were consistent with the aims and objectives of the enterprise.
- (5) **Helping Government:** Audit is an instrument of accountability. But an equally important purpose of audit of public enterprises in India is to help the Government and the enterprise managements improve their efficiency and effectiveness. This is achieved by bringing out financial and operational deficiencies, inadequacies or ineffectiveness of systems, shortfalls in performance, etc. and by analysing the causes of shortfall from acceptable standards of performance.
- (6) **Highlighting Issues of Efficient and Economic Operations:** Financial performance is linked with physical performance and issues of efficient and economic operations and management of resources are highlighted. There is an increasing emphasis on audit being an instrument of improvement.
- (7) **Fiscal and Managerial Accountability:** In the broader context, Government audit encompasses **two main elements**, viz., (a) **Fiscal Accountability:** It includes audit of provisions of funds, sanctions, compliances and propriety; and (b) **Managerial Accountability:** It includes audit of efficiency, economy and effectiveness (This is often referred to as **efficiency-cum-performance audit**).

Efficiency- cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater efficiency, economy, and effectiveness.

3.1 Elements of PSU Audits

Public sector auditing augments the confidence of the intended users by providing relevant information and independent and objective assessments concerning deviations from accepted standards or principles of good governance.

Audit of all public-sector undertakings have the following basic elements:



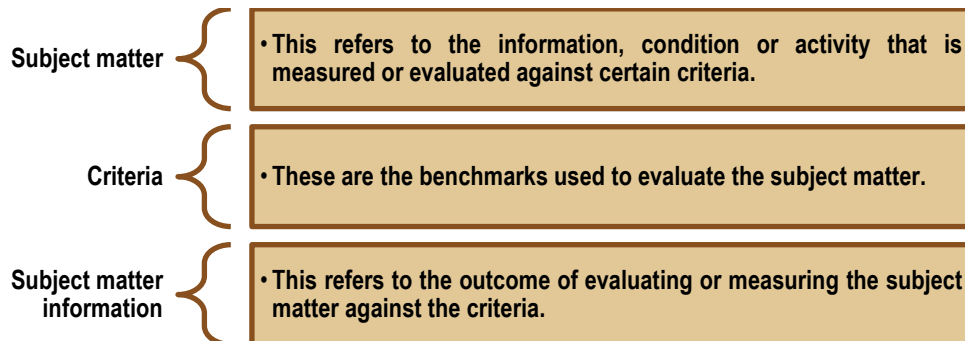
(a) **The Three parties - Auditor, Responsible Party and Intended Users.**

Auditor: The role of auditor is fulfilled by Supreme Audit Institution (SAI), India and by its personnel delegated with the duty of conducting audits. The Comptroller and Auditor General of India (C&AG) and the Indian Audit and Accounts Department (IAAD) functioning under him, constitute the Supreme Audit Institution of India. Senior functionaries of the SAI representing the C&AG in the state are called Accountants General.

Responsible Party: The relevant responsibilities are determined by constitutional or legislative arrangement. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations.

Intended Users: Intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report.

(b) **Subject matter, criteria and subject matter information.**



(c) Types of engagement - Attestation Engagements and Direct Reporting Engagement.

Attestation Engagements:

In attestation engagements, the responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.

Direct Reporting Engagement:

In direct reporting engagements, it is the auditor who measures or evaluates the subject matter against the criteria.

Financial audits are always **attestation engagements**, as they are based on financial information presented by the responsible party.

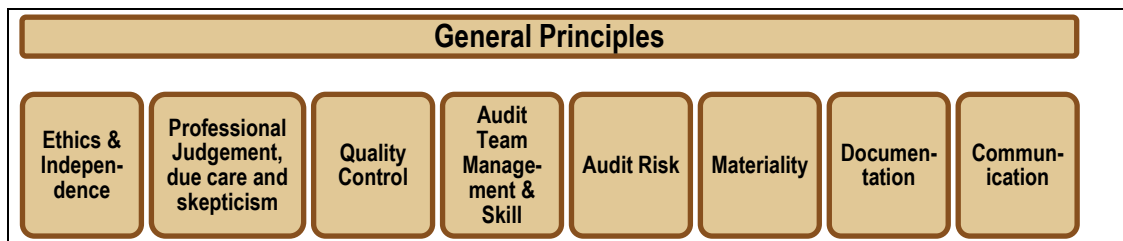
Performance audits and compliance audits are generally **direct reporting engagements**.

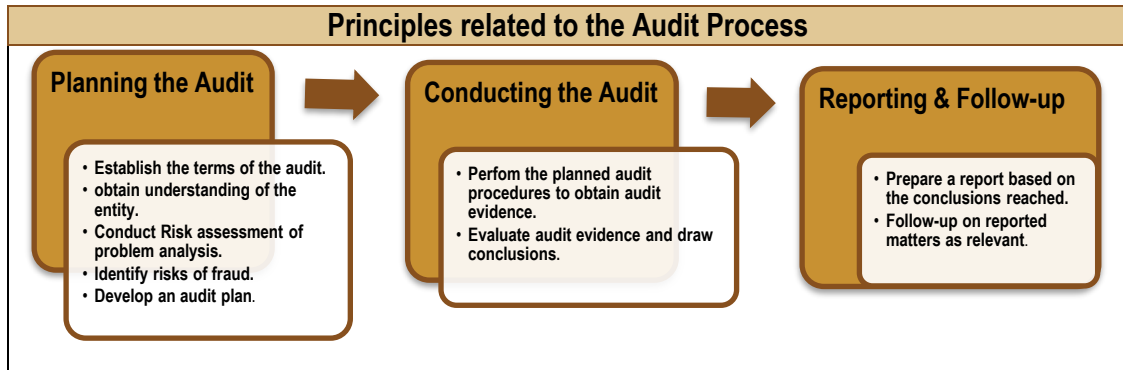
3.2 Principles of PSU Audits

The principles of PSU Audits constitute the general standards that apply to SAI India's personnel as auditors and are fundamental to the conduct of all types of PSU Audits.

The principles are categorized into two distinct groups as below:

- I. General Principles
- II. Principles related to the Audit Process





4. FINANCIAL AUDIT

Financial audit is primarily conducted to:

- ✓ express an audit opinion on the financial statements; and
- ✓ enhance the degree of confidence of intended users in the financial statements.

The C&AG shall express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In the case of financial statements prepared in accordance with a fair presentation financial reporting framework, whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

5. COMPLIANCE AUDIT

Compliance audit is the independent assessment of whether a given subject matter is in compliance with the applicable criteria.

This audit is carried out by assessing whether activities, financial transactions and information comply in all material respects, with the regulatory and other rules which govern the audited entity.



Source :- info.cgcompliance.com

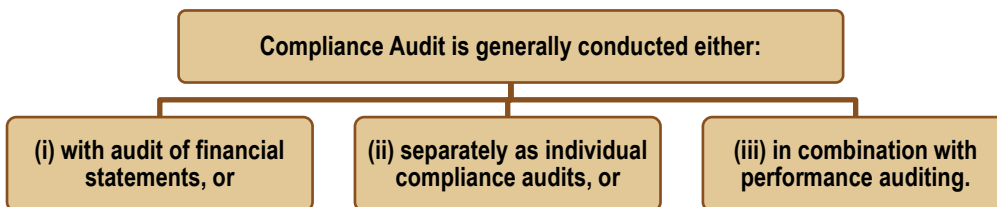
Compliance auditing is concerned with:

- (a) **Regularity**- adherence of the subject matter to the formal criteria emanating from relevant laws, regulations and agreements applicable to the entity.
- (b) **Propriety**- observance of the general principles governing sound financial management and the ethical conduct of public officials.

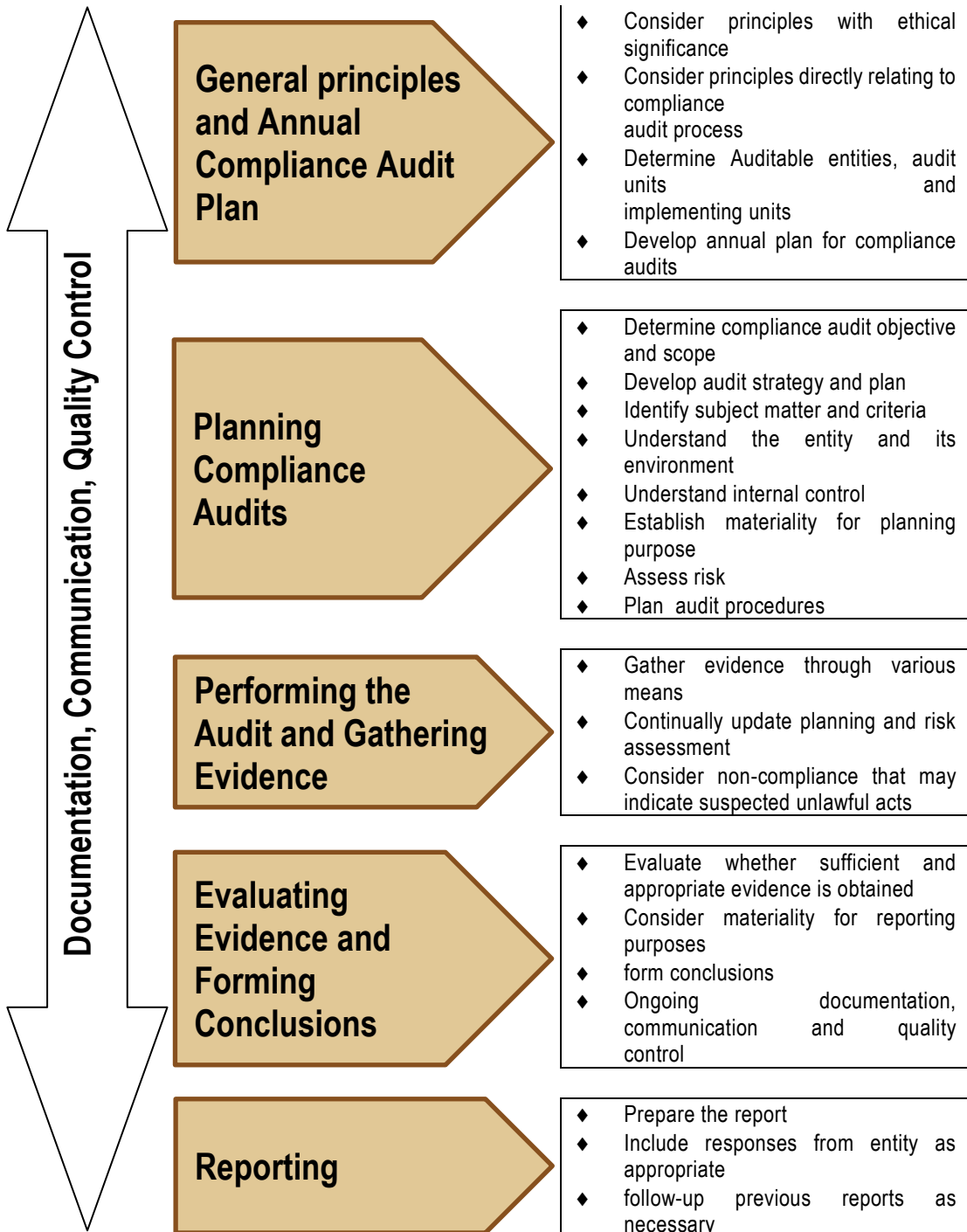
While regularity is emphasized in compliance auditing, propriety is equally pertinent in the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials.

Perspective of Compliance Auditing: Compliance Auditing is part of a combined audit that may also include other aspects. Compliance auditing is generally conducted either-

- (i) in relation with the audit of financial statements, or
- (ii) separately as individual compliance audits, or
- (iii) in combination with performance auditing.



When compliance auditing is part of a performance audit, compliance is seen as one of the aspects of economy, efficiency and effectiveness. Noncompliance may be the cause of, an explanation for, or a consequence of the state of the activities that are the subject matter of the performance audit.

COMPLIANCE AUDIT PROCESS (Source:- *Compliance & Auditing Guidelines – C&AG of India*)



6. PERFORMANCE AUDIT

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

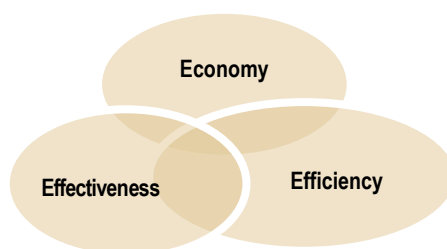
Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD).

In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

This audit promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance through an examination of whether:

- (a) decisions by the legislature or the executive are efficiently and effectively prepared and implemented; and
- (b) tax payers or citizens have received value for money.

According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:



- (i) **Economy-** It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (**e.g. human, financial and material**) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.



When conducting audits of economy, the auditor may provide answers to such questions as: (ECA Performance Audit Manual , 2017)

- Have the best prices been obtained for consultancy services?

- Is there potential for reducing the cost of sickness absences?
- Are there procedures in place to ensure that transport costs of food aid are the lowest available?
- Has there been a waste of resources in achieving an output?

(ii) **Efficiency**- It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output. When the audit objective of efficiency considers outputs, focus is usually on processes by which an organisation transforms inputs into outputs.

Auditing efficiency embraces aspects such as whether:

- sound procurement practices are followed;
- resources are properly protected and maintained;
- human, financial and other resources are efficiently used;
- optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;
- public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
- efficient operating procedures are used; and
- the objectives of public sector programmes are met cost-effectively.



In audits of efficiency, you might ask questions such as: How does the cost per job created by a training programme for the unemployed compare with similar costs per job elsewhere?

- Could project X have been implemented differently that would have resulted in improved timeliness and quality?
- Are adequate procedures and criteria for prioritising and selecting transport infrastructure projects to ensure maximum impact in place?
- Are schools maximising the use of their information technology equipment?
- When the audit objective of efficiency considers outputs, you will usually focus on processes by which an organisation transforms inputs into outputs.

(Source : ECA Performance Audit Manual , 2017)

- (iii) **Effectiveness-** It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

In auditing effectiveness, performance audit may, for instance:

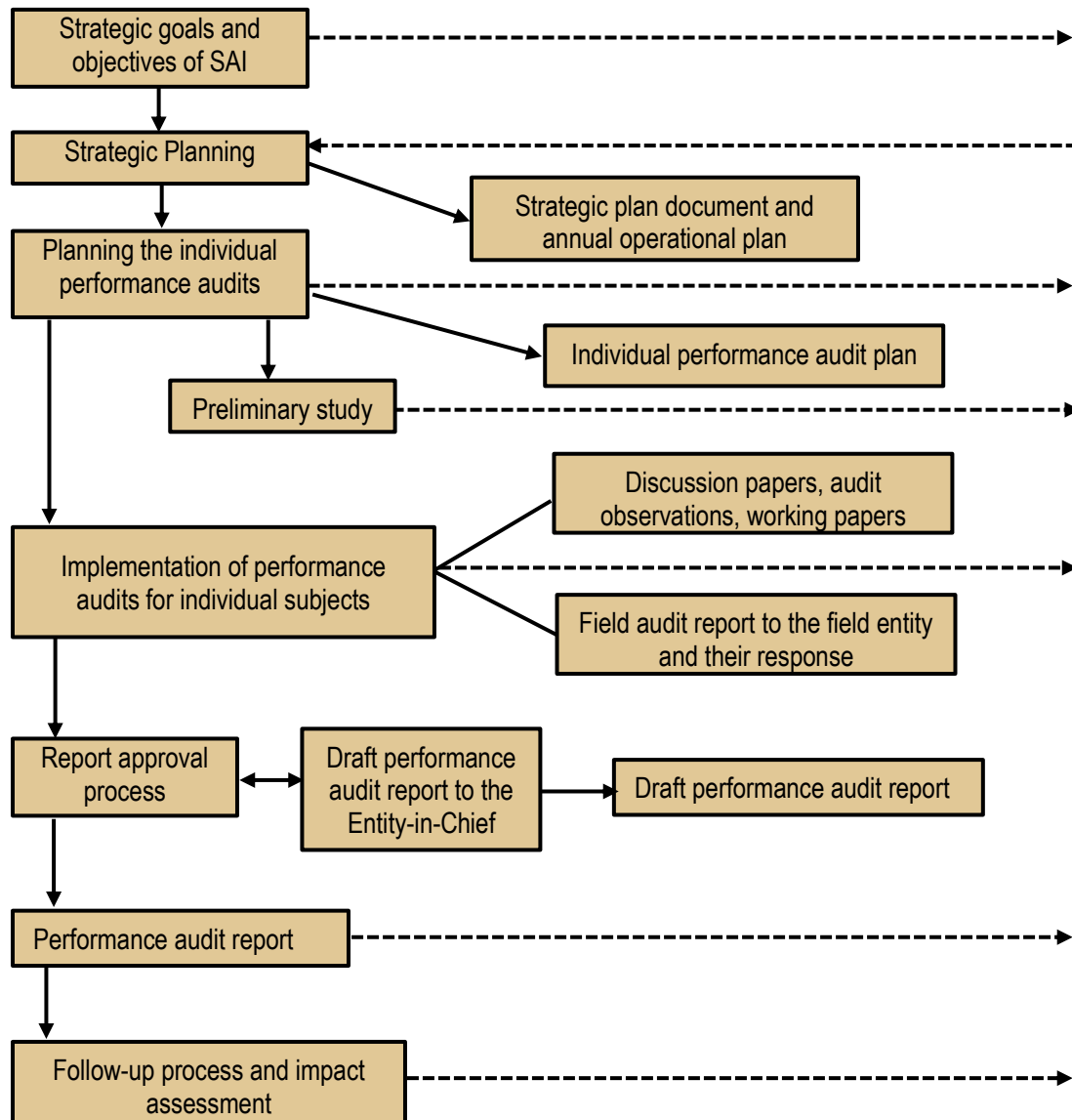
- (a) assess whether the objectives of and the means provided (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;
- (b) determine the extent to which a program achieves a desired level of program results;
- (c) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to implementation of the policy or to other causes;
- (d) identify factors inhibiting satisfactory performance or goal-fulfilment;
- (e) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes;
- (f) assess the effectiveness of the program and/or of individual program components;
- (g) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- (h) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;
- (i) assess compliance with laws and regulations applicable to the program; and
- (j) identify ways of making programmes work more effectively.



It focuses on questions such as:

- *Have infrastructure projects contributed to increased traffic flow while improving safety and reducing journey times?*
 - *Have suitable measures to monitor and mitigate the environmental impact in sector X been set up and properly implemented?*
 - *Are departments or entities achieving their objectives for all sectors of the community?*
- (Source : ECA Performance Audit Manual,2017)**

Performance Audit Cycle



6.1 Objectives of Performance Audit

The objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.



1. Performance Audit of enforcement mechanism for administering the provision of Minimum Wages Act (a social welfare legislation)

The auditors, who undertake performance audit of a program or unit, must possess knowledge of the industries or labor contracts where these provisions are applicable and also identify the population thereof before carrying out audit program. He shall evaluate the standard of living before implementation and after implementation of the Act.

Further, the auditor shall have to evaluate the evidence available as to nature of returns prescribed and obtained for taking appropriate action.

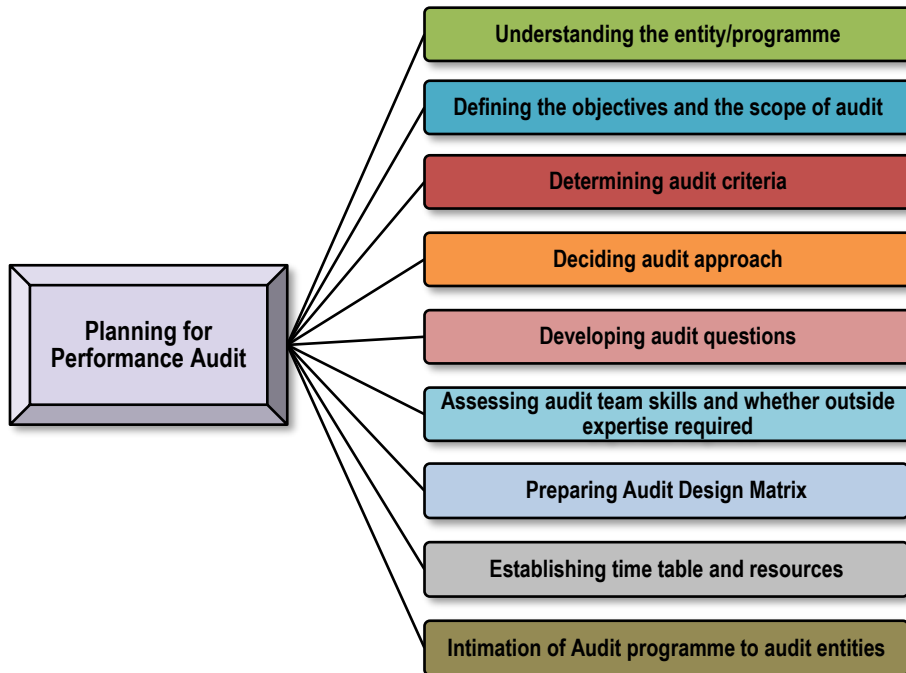
The Performance Auditor shall also have to evaluate the economy, efficiency and effectiveness in the welfare systems to be audited. He can then study the shortcomings in the coordination between different agencies like labor department, EPF and ESI organization and the control systems and point out a set of relevant problems.

The auditor shall also have to point out lacuna, if any in the existing legal frame work or enforcement mechanism to strengthen the objective of legislation. Another possible area of critical audit may be to study actual level of compensation required in each area keeping in mind the local living conditions and where the minimum wages prescribed in the statute is demonstrably different from this level he may report the same to the Government for taking appropriate action.

In this manner, the performance audit can not only examine the reasons for such vagaries but also ensures that the legislation serves the intended purpose. By reporting the same to the legislature, the corrective is made possible.

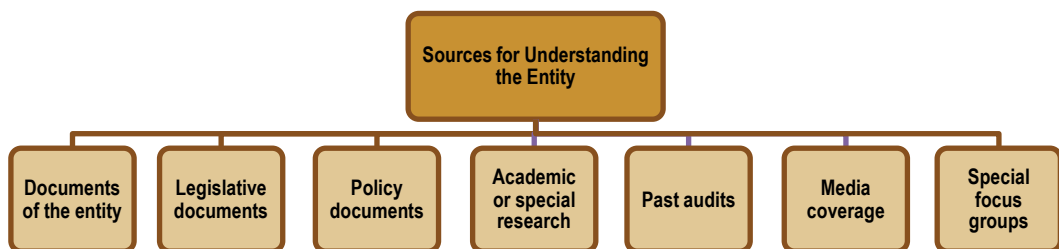
[Note: Interested students may refer to Background Material on Performance Audit of Public Sector Enterprises in India published by the CPE Committee of ICAI for further reference].

6.2 Planning for Performance Audit



The following steps are suggested to the auditors for planning while conducting the performance audit:

- (A) **Understanding the Entity/Programme** - It is the starting point for planning individual performance audit.



The auditor may use the following sources for understanding the entity:

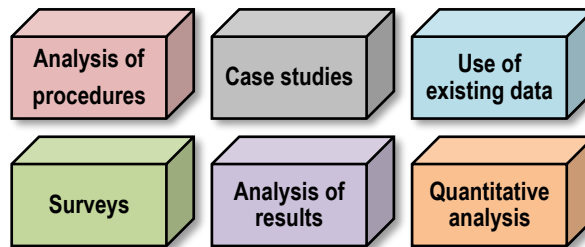
- (i) **Documents of the entity:** Documents on administration and functions of the entity, policy files, annual reports, budget documents, accounts, minutes of meetings, information on the website, internal audit reports, electronic databases and MIS reports, RTI material etc.

- (ii) **Legislative documents:** Legislation, parliamentary questions and debates, reports of the Public Accounts Committee, the Committee on Public Undertakings, the Estimates Committee and letters from Members of Parliament.
 - (iii) **Policy documents:** Documents of Planning Commission, Ministry of Finance etc.
 - (iv) **Academic or special research:** Independent evaluations on the entity, academic research and similar work done by other governments and other SAs.
 - (v) **Past audits:** Past financial and performance audits of the entity provide a major source of information and understanding.
 - (vi) **Media coverage:** Print and electronic media - their systematic documentation on regular basis in a transparent manner.
 - (vii) **Special focus groups:** Audit Advisory Committee concerns, annual and special reports of World Bank, Reserve Bank of India, reports by special interest groups, NGOs, etc.
- (B) **Defining the Objectives and the Scope of Audit** - The audit objectives should be defined in a crisp & clear manner as they will impact the nature of the audit, govern its conduct and affect audit conclusions. Setting audit objectives ensures good quality performance audits. It facilitates clarity, demonstrates consistent quality of audit and serves as a measure of quality assurance of the audit.
- Defining the scope constricts the audit to significant issues that relate to the audit objectives. It mainly focuses on the extent, timing and nature of the audit.
- (C) **Determining Audit Criteria** - Audit criteria are the standards used to determine whether a program meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit criteria are reasonable and attainable standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed.
- The audit criteria may be sought to be obtained from the following sources:
- (i) procedure manuals of the entity.
 - (ii) policies, standards, directives and guidelines.
 - (iii) criteria used by the same entity or other entities in similar activities or programmes.
 - (iv) independent expert opinion and know how.
 - (v) new or established scientific knowledge and other reliable information.

(vi) general management and subject matter literature and research papers.

- (D) **Deciding Audit Approach** - There is no uniform audit approach prescribed that can be applicable to all types of subjects of performance audits. Selection of approach also determine methods and means used for conducting the audit.

Some of the methods which could be used in conducting performance audits include:



- (i) **Analysis of procedures:** It involves review of the systems in place for planning, conducting, checking and monitoring the activity. This would consist of examination of documents such as financial reports, budgets, programme guidelines, procedure manuals, etc.
- (ii) **Case studies:** A case study is a descriptive analysis of an entity, scheme or a programme. It involves analysis of a particular issue within the context of the whole area under review.
- (iii) **Use of existing data:** The audit staff should investigate the data held by entity management and by other relevant sources. Audit conclusions based on testing of available data for correctness and completeness enhances the assurance level.
- (iv) **Surveys:** Survey is a method of collecting information from members of a population to assess the interrelation of events and conditions. Surveys on predetermined parameters can supplement the audit findings and conclusions adding value to the performance audits.
- (v) **Analysis of results:** It requires the auditor to carry out actual output-input analysis to determine the efficiency of the programme.
- (vi) **Quantitative analysis:** It involves examination of available data relating to financials like earnings, revenue, or data relating to programme implementation like details of beneficiaries etc. However, it may not be possible for the auditor to work with complete data due to its high volume. In such cases, sampling techniques are required to be used.

- (E) **Developing Audit Questions** - Subsequent to designing of audit objectives and determination of audit criteria, the audit team is required to prepare a list of questions to which they would seek answers. The questions should be framed in comprehensive manner involving detailed hierarchy of questions.
- (F) **Assessing Audit Team Skills and whether Outside Expertise required** - It is essential that the performance auditors possess special aptitude and knowledge. The Auditing Standards of C&AG of India provide that the audit institution should develop and train the auditors to enable them to perform their tasks effectively & efficiently and should prepare manuals & other written guidance notes & instructions concerning conduct of audits.

Given the diverse range of subjects of performance auditing, the audit team needs to develop sound understanding of the programme or entity proposed to be audited.

The audit team needs to decide at the planning stage on which aspect expertise is required. Though, the Accountant General may use the work of an expert, he retains full responsibility for the expression of opinion in the auditor's report.

- (G) **Preparing Audit Design Matrix (ADM)** - Having determined the audit objective, audit criteria, audit approach, data collection etc., audit team should prepare an Audit Design Matrix. It is a structured and highly focused approach to designing a performance audit study.

The ADM highlights the data collection and analysis method as well as the type and sources of evidence required to support audit opinion/findings.

A specimen of ADM is given as under:

Audit Objective	Audit Questions	Audit Criteria	Evidence	Data Collection and Analysis Method
(1)	(2)	(3)	(4)	(5)

An ADM is prepared on the basis of information and knowledge obtained during the planning stage. A well-designed ADM leads to effective audits thus providing highest assurances to the auditing entities. It is desirable to prepare ADM for each of the audit objectives.

- (H) **Establishing Time Table and Resources** - It is significant to determine the timetable and desirable resources. Selection of appropriate audit team is the most vital component in planning an audit. Considerations for selection of an appropriate audit team should be recorded along with the proposed timelines for various activities to be undertaken as a part of audit process. The progress should also be monitored against these timelines. The Accountant General would be liable for ensuring that the performance audit is completed on

time. The variations between the required and actual time spent should be compared and approved from the competent authority.

The team should build time for translation, approval and possible delays in their own schedule in order to meet the targets.

- (I) **Intimation of Audit Programme to Audit Entities** - Audited entities must be intimated about the intention of taking up planned performance audit with the scope and extent of audit including the constitution of audit team and the tentative time schedule, well before the commencement of Audit. Acknowledgement of this may be requested and placed on record.

It may be required to refine an audit's objectives as the audit progresses for gathering the requisite information to fulfill the audit. The reasons for such changes in the objectives should also be recorded and approved from the competent authority.

The audit programme should be flexible and reviewed from time to time as it is not possible to anticipate all the contingencies at the early stage.

The Accountant General should share all significant refinements in the approach and additional tests and findings, concurrently with other audit teams when different persons conduct the audit at different locations. The system of sharing of the significant field audit experience should be documented and reviewed.

Illustration

The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:

- (i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;**
- (ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;**
- (iii) metering, billing and collection was managed efficiently and effectively;**
- (iv) monitoring and internal controls were efficient.**

What kind of audit is this? Prepare two sample observations which could be part of the audit report.

This is a performance audit. Sample observations could be:

- (i) Non replacement of defective/ burnt meters: Large number of meters, much in excess of the permitted limit of 1% of the total meters were defective and their**

replacement was not completed within the stipulated time of 1 month. This resulted in billing on average basis for a continuous period of several months. This could result in losses as well as administrative hassles and disputes with consumers.

- (ii) Under charging of meter rent: As per Schedule of Charges, the Company is required to charge meter rent of ₹30 per month for a single phase meter and ₹40 per month for three phase meter. It was observed that the Company had short charged meter rent of ₹60 lakh from 3 lakh consumers in 5 lakh bills during the period.

7. COMPREHENSIVE AUDIT

The Comptroller and Auditor General assists the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness and extravagance for managements' information.

The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. The auditors combine aspects of Financial, Compliance and Performance audits. All the audit information is used in such a way that a holistic assessment is possible. 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, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc.

Some of the issues examined in comprehensive audit are:

- (a) 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?
- (b) Have the planned production or operational outputs been achieved? Has there been under-utilisation of installed capacity or shortfall in performance and, if so, what has caused it?
- (c) Has the planned rate of return been achieved?

- (d) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
- (e) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
- (f) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?
- (g) 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?
- (h) If the enterprise has an adequate system of repairs and maintenance?
- (i) Are procedures effective and economical?
- (j) Is there any poor or insufficient or inefficient project planning?

The Bureau of Public Enterprises has issued guidelines to be followed by the public sector enterprises in respect of general management, financial management, materials management, production management, construction management, etc. and these guidelines provide another basis for appraising enterprise performance and its systems. Another source of criteria is industrial engineering and other technical studies by internal and external experts and the standards given in these. Then there are standards of financial propriety.

The starting point of a comprehensive appraisal of a public enterprise, which covers aspects of economy, efficiency and effectiveness, is the preparation of an audit programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organisation, financial and operational details available in the annual reports and accounts, capital and operational budgets, deliberations of the board of directors, material in the earlier audit inspection reports on the enterprise and other relevant available papers. These audit programmes (or guidelines) identify the areas/aspects which require further detailed audit analysis and criteria, the data required for such analysis and the sources of such data, the extent of the audit analysis including the test checks to be applied and the instructions to the audit parties assigned to the work.

TEST YOUR UNDERSTANDING 2

PS & Associates are statutory auditors of a Central government owned company for a particular year. The statutory auditors were required to examine the following areas mandatorily, provide their specific replies and also their impact on financial statements for that particular year in their audit report.

1. Whether the company has system in place to process all the accounting transactions through IT system? If yes, the implications of processing of accounting transactions outside IT system on the integrity of the accounts along with the financial implications, if any, may be stated.
2. Whether there is any restructuring of an existing loan or cases of waiver / write off of debts / loans/ interest etc. made by a lender to the company due to the company's inability to repay the loan? If yes, the financial impact may be stated. Whether such cases are properly accounted for?
3. Whether funds (grants/subsidy etc.) received / receivable for specific schemes from Central government or its agencies were properly accounted for / utilized as per its term and conditions? List the cases of deviation.

Can you gauge likely nature of such responsibility thrust upon auditors of above PSU?

 8. PROPRIETY AUDIT

Auditing, as a composite concept, looks into accounting and arithmetical accuracy, adherence to applicable rules and regulations, propriety and the "truth and fairness" of the end result. According to the varied requirements, the emphasis on each of the aforesaid factors differs between various types of audit. Propriety aspects in an audit already exists in the audits carried on by the C&AG.

8.1 Definition and Principles

Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct.

E.L. Kohler has defined the term propriety as "that which meets the tests of public interest, commonly accepted customs, and standards of conduct, and particularly as applied to professional performance, requirements of law, Government regulations and professional codes".

On an analysis, the tests boil down to tests on economy, efficiency and faithfulness. Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure.

Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company, with special regard to public interest and commonly accepted customs and standards of conduct. It is also seen whether every officer has exercised the same vigilance in respect of expenditure incurred from public money, as a person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances.

In 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. A transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned, but may still be highly wasteful.



A building may be constructed for installing a telephone exchange but may not be used for the same purpose resulting in infructuous expenditure or a school building may be constructed but used after five years of its completion is a case of avoidable expenditure .

Audit should, therefore, try to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions. These considerations have led to the evolution of audit against propriety which is now being combined by the audit authorities with their routine function of regularity audit. It is hard to frame any precise rules for regulating the course of audit against propriety. Such an objective of audit depends for its acceptance on its appeal to the common sense and straight logic of the auditors and of those whose financial transactions are subjected to propriety audit. However, some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety.

Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:

- (i) that the expenditure is not *prima facie* more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money;
- (ii) that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage;

- (iii) that funds are not utilised for the benefit of a particular person or group of persons and
- (iv) that, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

It may be stated that it is the responsibility of the executive departments to enforce economy in public expenditure. The function of audit is to bring to the notice of the proper authorities of wastefulness in public administration and cases of improper, avoidable and infructuous expenditure.

The functions of Auditor in the context of Propriety Audit may be specified as under as to :

- ◆ see that all expenditure incurred are properly planned.
- ◆ see that the size and channels of expenditure are rightful and expected to give maximum results.
- ◆ appraise whether those expenditure are likely to give optimum result.
- ◆ see that any substitute plan of action can bring about an improvement on current operation and as well as return from capital expenditure.
- ◆ examine the actions and decisions of the management to see that they are conducive to public interests and that they meet the standards of conduct.

Propriety Audit-Problems - Problems in propriety audit, however, arise mainly because of its distinct nature. The expression “propriety” is a moral term and can be understood by reference to the concept of morality accepted by the society at a given time. In any auditing, the essential test lies in formulation of auditing propositions. In the audit of financial accounts by reference to financial and legal requirements, propositions are built up about happening of events, existence, accuracy, title, ownership, compliance with law and internal regulations etc., which are all verifiable. In propriety audit the formulation of verifiable auditing propositions poses the problem.

Propriety audit has an inherent element of subjectivity because it is very difficult to establish standards of public interest, commonly accepted customs, standards for conduct which are not firm basis for audit evaluation. To take care of this situation, the C&AG has developed the norms of propriety for expenditure of public funds in our country. By laying down the standards of propriety for Government expenditure the C&AG has really tried to tackle in a practical way the complex problem of subjectivity inherent in a situation calling for propriety consideration.

The norms so developed provide the basis of verifying expenditure incurred by various Government departments. It may be appreciated that the norms of propriety applicable to governmental transactions may not *ipso facto* apply to transactions of private sector which have distinct and more

limited, objectives suited to them. Each private sector entity may have its unique objectives related, to its management philosophy and the transactions should be geared to achieve those. **For example**, a management which is operating for maximization of profits without infringing, any legal regulations may follow certain policies while another management believing in a wider measure of social justice may follow different policies. Despite these clear angularities, certain commonness can also be discerned in the policies and approaches of different managements. They include efficient operations, higher productivity and higher profit, reduction of wasteful expenditure etc. Above all, each entity has its impact on the society and building up propriety audit propositions becomes of paramount importance.

It is felt that if the management of each entity, irrespective of any legal requirements, formulates norms of propriety for the entity, taking full note of wider social repercussions inherent in its operations; a formidable hurdle in the way of wider introduction of propriety audit can be removed. The element of subjectivity in propriety evaluation will get reduced.

Propriety as a moral element should be a matter of evaluation based on objectives and prevailing circumstances. **For example**, a travel by air as such should not be considered wasteful unless it is proved that a travel by rail would have been feasible in the circumstances and would have brought the same results brought by the air travel.

The element of subjectivity has sometimes resulted in proper discharge of duty very delicate and which demands discretion, but wisdom of taking commercial decisions under dynamic environment (the economic, social and political) must be evaluated with reference to the circumstances in which these were taken (and not on hindsight) and therefore, the auditor in his field must reconstruct such circumstances. The judgment of the auditor must be objective as otherwise it would dampen the initiative of management and others in taking commercial decisions and propriety audit would prove itself to be counter-productive.

9. AUDIT REPORT OF THE COMPTROLLER AND AUDITOR GENERAL

To facilitate a proper consideration, the reports of the C&AG on the audit of PSUs are presented to the Parliament in several parts consisting of the following:

- (a) Introduction containing a general review of the working results of Government companies, deemed Government companies and corporations;
- (b) Results of comprehensive appraisals of selected undertakings conducted by the Audit Board;

- (c) Resume of the company auditors' reports submitted by them under the directions issued by the C&AG and that of comments on the accounts of the Government companies; and
- (d) Significant results of audit of the undertakings not taken up for appraisal by the Audit Board.

For certain specified states, the C&AG submits a separate audit report (commercial) to the legislature, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, and a general review of the working results of Government companies and corporations.

Integrated Case Scenario

SRM & Associates are refreshing up their knowledge on functions of various Parliamentary financial committees and on the varied functions and duties of Comptroller & Auditor General of India in relation to audit of government institutions and government companies. They feel that unless they have understood scope of duties of C&AG, they would not be in a position to do justice to audits and professional work in this area.

In the process, they have gone through various materials both offline and online. The summarized information derived from some of such materials including website of C&AG are stated below:

[A] The C&AG report for a particular year contained results of the compliance audit of Department of Revenue-Direct Taxes of the Union Government dealing with "Assessments relating to Agricultural Income". It included certain observations relating to allowing of claim for exemption of agricultural income without supporting documents, use of this area by non-agriculturists as a conduit to avoid taxes etc., in scrutiny assessments performed by the Department.

[B] The C&AG in one of its reports in respect of a state government owned industrial development corporation pointed out non-adherence of One-time settlement (OTS) guidelines of state government by the corporation resulting in acceptance of a below par OTS proposal thus foregoing recovery of loan amounting to ₹ 6.87 crores. The said corporation was providing loans to industrial units.

[C] Annual report of a listed public sector company which is a "mini-ratna" PSU was also gone through. The said company is engaged in providing diversified services to Indian Railways.

[D] A state government owned PSU was involved in setting up of a thermal power plant in the state. The C&AG, in its audit report, pointed out delay in completion of work due to failure to decide on the type of water treatment in the cooling plant on a timely basis. Besides, other reasons leading

to delay like frequent changes in lay-out and re-testing of soil by the company were pointed out.

Answer the following questions based upon above information:

1. Based on description provided at para [A] of case, which Parliamentary financial committee is likely to examine above report of C&AG and make its recommendations?

- (a) Estimates Committee.
- (b) Public Accounts Committee.
- (c) Committee on Public Undertakings.
- (d) Committee on Commerce.

2. Considering the description stated in para [B] of case, the above audit finding is likely to fall in which areas?

- (a) Compliance audit.
- (b) Performance audit.
- (c) Propriety audit.
- (d) Comprehensive audit.

3. As regards listed PSU described in para [C] of case, which of the following statements is most appropriate?

- (a) The statutory audit of above PSU is to be conducted by a firm of auditors appointed by shareholders in AGM. C&AG cannot give directions to such firm of auditors. However, its office is empowered to conduct a supplementary audit.
- (b) The statutory audit of above PSU is to be conducted by C&AG.
- (c) The statutory audit of above PSU is to be conducted by a firm of auditors appointed by C&AG. Further, C&AG can give directions to the firm of auditors.
- (d) The statutory audit of above PSU is to be conducted by a firm of auditors appointed by shareholders in AGM. However, C&AG can give directions to the firm of auditors.

4. Considering nature of audit finding described at para [D] of case concerning delay in completion of work of thermal power plant, the said audit finding is likely to fall in domain of:

- (a) Propriety audit.
- (b) Performance audit.

- (c) Financial audit.
- (d) Compliance audit.

5. PSU engagements are generally attestation engagements or direct reporting engagements. Which of the following statements is correct in this regard?

- (a) Performance audits and compliance audits are generally attestation engagements.
- (b) Performance audits and compliance audits are generally direct reporting engagements.
- (c) Performance audit is a direct reporting engagement whereas compliance audit is an attestation engagement.
- (d) Performance audit is an attestation engagement whereas compliance audit is a direct reporting engagement.

Key Takeaways

- ◆ Public sector undertakings in India are fundamentally owned or controlled by Central Government, or any State Government or Governments, or partly by the Central Government and one or more State Governments. Such undertakings play a key role in the socio-economic development of the country.
- ◆ The accounts of selected government Companies along with the report of the statutory auditors are reviewed by C&AG by carrying out a supplementary audit.
- ◆ The scope and extent of audit carried out by C&AG in relation to PSUs may relate to compliance audit, financial audit and performance audit.
- ◆ Compliance audit is the independent assessment of whether a given subject matter is in compliance with the applicable criteria.
- ◆ Performance audit is an objective and systematic examination of evidence for providing an independent assessment of the performance of a government organization, program, activity or function in order to provide information to improve public accountability and facilitate decision making by parties with responsibilities to oversee or initiate corrective action.
- ◆ Performance audits usually address the issues of economy, efficiency and effectiveness.
- ◆ Comprehensive audit combines aspects of financial, compliance and performance audits. All the audit information is used in such a way that a holistic assessment is possible.

- ◆ In 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. A transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned, however, it may still be highly wasteful.

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG.*
2. *ABG & Co., a Chartered Accountant firm has been appointed by C & AG for performance audit of a Sugar Industry. What factors should be considered by ABG & Co., while planning a performance audit of Sugar Industry?*
3. *Sunlight Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Goa with a new technology for a cost of ₹ 5,750 crore. The project had seen delay in commencement and cost overrun. State the matters that a Comprehensive Audit by C&AG may cover in reporting on the performance and efficiency of this project.*
4. *"A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.*
5. *BT Ltd, a company wholly owned by central government was disinvested during the previous year, resulting in 40% of the shares being held by public. The shares were also listed on the BSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the BSE etc.*
Sam, the FM of the company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in

private sector under the Companies Act 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

6. *You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task?*
7. *Comptroller & Auditor General appointed Verma & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG.*
8. *The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:*
 - (i) *total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;*
 - (ii) *tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;*
 - (iii) *metering, billing and collection was managed efficiently and effectively;*
 - (iv) *monitoring and internal controls were efficient.*

What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

Answers to Test Your Understanding

1. The said matters are dealt by Committee on Public Undertakings (COPU). The functions of the Committee are -
 - (i) to examine the reports and accounts of public undertakings.
 - (ii) to examine the reports of the C&AG on public undertakings.
 - (iii) to examine the autonomy and efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
 - (iv) to exercise such other functions vested in the PAC and the Estimates Committee as are not covered above and as may be allotted by the Speaker from time to time.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

2. The above areas for which statutory auditors of PSU were required to examine, report and indicate impact of these matters in financial statements are likely to relate to directions issued by C&AG to statutory auditors under section 143(5) of Companies Act, 2013.

In terms of section 143(5), in case of a government company, the C&AG has the power to direct the auditor the manners in which accounts of company are required to be audited and auditor shall submit audit report which among other things, include the directions, if any, issued by the C&AG the action taken thereon and its impact on the accounts and financial statements of the company.

Answers to Integrated Case Scenario

- 1 (b)
- 2 (a)
- 3 (c)
- 4 (b)
- 5 (b)

Hints /Answers to Theoretical Questions

1. Refer Para 9.
2. Factors to be considered while planning the Performance Audit: Refer Para 6.2.
3. Refer Para 7
4. Refer Para 6.
5. Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them. The listing

of company's shares on a stock exchange is irrelevant for this purpose and hence Sam's opinion is not correct.

6. Refer Para 6.2.
7. In the given scenario, C&AG appointed Verma & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit.

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is not performance audit in all aspects.

8. In the given scenario, in view of the objectives discussed, performance audit is being referred. Refer Para 6.2.

INTERNAL AUDIT



LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ☐ Know the meaning and scope of Internal Audit.
- ☐ Gain the knowledge of the internal audit as per provisions of the Companies Act, 2013.
- ☐ Gain understanding of basic steps and activities involved in internal audit.
- ☐ Gain understanding of drafting of internal audit report.
- ☐ Analyse the relationship between Internal and External Auditors.
- ☐ Understand the Audit Trail.
- ☐ Acquire the knowledge of basics of the Internal Auditing Standards issued by the ICAI.

CHAPTER OVERVIEW



Meaning and
Scope of
Internal Audit

Integrity,
Objectivity and
Independence
of Internal
Auditor

Qualities of
Internal
Auditor

Steps involved
in performing
Internal Audit
Engagement

Drafting of
Internal Audit
Report

Relationship
between
Internal and
External
Auditors

Internal Audit

Try and Scale Limited, a listed company, has advertised for the post of “*Chief Internal Auditor*” in the company in few prominent pink newspapers. CA. P. is offered the position after duly vetting his credentials. The offer letter of the company states that Chief Internal Auditor is required to report to the CFO of the company. On going through contents of letter, he finds it weird. What is unusual about it and why?

Since internal audit is an independent function, the Internal Auditor has to be free from any undue influences which force him to deviate from the truth. Also, the internal auditor has to resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported- in case these deviate from set objectives. The independence of internal auditor within the company plays a large part in establishing his independence.

He immediately brought out this anomaly to the company pointing out that same is not proper. By making him report to the CFO of the company, his independence as internal auditor would lie in tatters. It was also pointed by him that to ensure independence of internal audit function, it should be positioned outside the functions which are subject to internal audit (e.g., Finance and Accounts) and his reporting should lie directly to the Audit Committee.

Besides, the offer letter also hinted at his role in “system automation” and “process re-engineering” in the company. Assuming proposed roles in above areas can also mar his independence. He was confused. “System automation” and “process re-engineering” are in nature of operational responsibilities. How he can accept responsibilities in this regard? Considering above, he thought it worthwhile to give a caveat to the company that he would not be in a position to assume accountability of these areas. It was also made clear that he

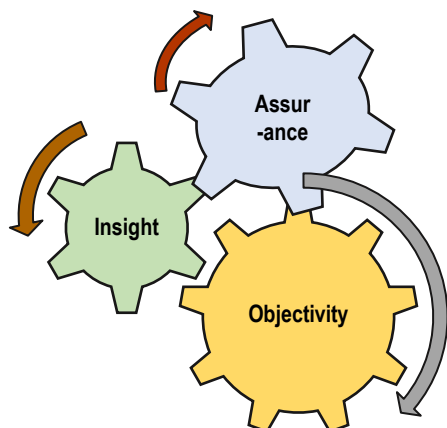
would not be able to take operational decisions in these areas which may be subject to internal audit later on. He would be able to accept only limited operational role and that too for a short duration.

The company gave a nod to both the issues flagged by him and position was accepted.

After accepting appointment, he adopted a risk-based approach for identifying important audit areas. The company's operations were myriad and diversified. It made sense to him to adopt a system and process focused approach in conducting audit procedures. Such an approach would go a long way in "error prevention." His focus remained on preventing errors at the first place. Such an approach strengthens company's internal systems leading to improvement in governance mechanisms.

1. INTERNAL AUDIT

The operation of many modern organisations have become complex with high volume of transactions carried out at multiple locations with increasing dependency on technology. This has caused further



more delegation of authorities and decentralisation of activities. Consequently, key stakeholders including Board of Directors, top management, shareholders, lenders, investors and government are concerned with the propriety of the day-to-day affairs of the organization and reliability of the various financial and non-financial information being recorded and reported to the stakeholders. Accordingly, the stakeholders get internal audit conducted to obtain report on the deficiency in internal control system and

underlying transactions for better governance of organization and take timely remedial actions wherever needed.

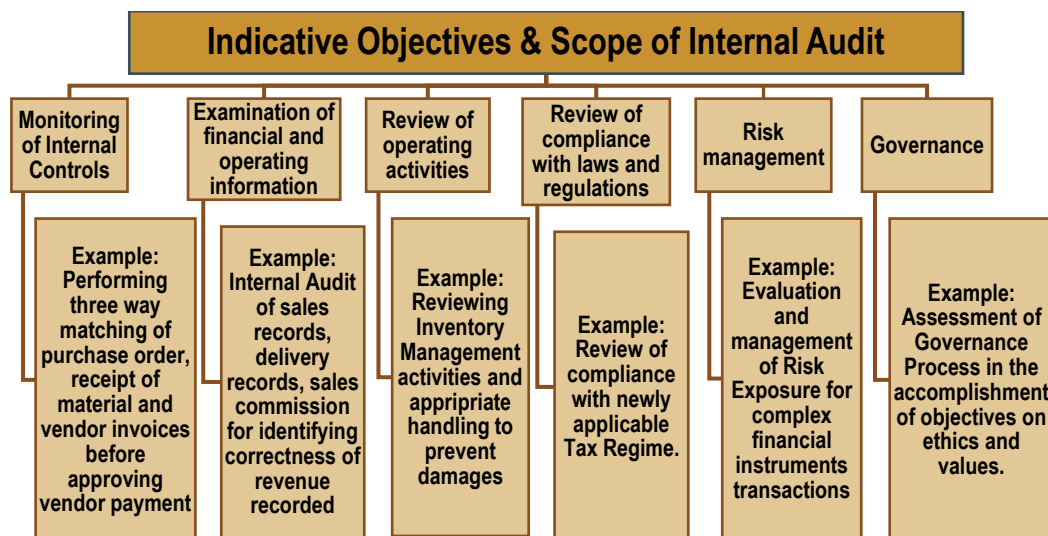
The Institute of Chartered Accountants of India constituted the Internal Audit Standards Board (IASB) as a non-standing technical board on February 5, 2004. The Internal Audit Standard Board (earlier known as the Committee on Internal Audit) is constituted with the object of formulating Standards on Internal Audit (SIAs), Guidance Notes on Internal Audit, continuously review the Standards and Guidance Notes, and to formulate and review Implementation Guides, Technical Guides, Practice Manuals, Studies and other papers, which may be issued under its own authority

for guidance of the members, as felt appropriate by the Board. Besides, the IASB also undertakes research and promote knowledge dissemination in the field of internal audit.

Definition of Internal Audit: As defined in Framework Governing Internal Audits, “Internal Audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives.”

The Framework also indicates the nature of internal audit services may go beyond assurance to include an advisory (consulting) role to help an organization achieve its objectives, provided this does not compromise the independence of the internal auditor. The internal auditing is not confined to financial transactions only and include review of operational activities, underlying internal controls, compliance to applicable laws and regulations. The objectives and scope of Internal Audit Function as per SA 610, “Using the Work of an Internal Auditor” may include:

• Monitoring of internal controls;	• Review of compliance with laws and regulations
• Examination of financial and operating information	• Risk management
• Review of operating activities	• Governance



Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate, namely-

(a)	every listed company;
(b)	every unlisted public company having- (i) paid up share capital of fifty crore rupees or more during the preceding financial year; or (ii) turnover of two hundred crore rupees or more during the preceding financial year; or (iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or (iv) outstanding deposits of twenty-five crore rupees or more at any point of time during the preceding financial year; and
c	every private company having- (i) turnover of two hundred crore rupees or more during the preceding financial year; or (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

It is provided that when an existing company gets covered under any of the above criteria shall comply with the requirements within six months of commencement of such applicability.

CASE STUDY 1

JKT Pvt. Ltd. having ₹ 40 lacs paid-up capital, ₹9.50 crores reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being ₹ 49 crores, ₹ 145 crores and ₹ 260 crores, but does not have any internal audit system. In view of the management, the internal audit system is not mandatory. Comment.

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, read with rule 13 of Companies (Audit and Auditors) Rules, 2014, every private company shall be required to appoint an internal auditor or a firm of internal auditors, having

- (i) turnover of two hundred crore rupees or more during the preceding financial year; or
- (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

Conclusion: In the instant case, JKT Pvt. Ltd. is having a turnover of ₹ 260 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the company has the statutory requirement to appoint an Internal Auditor and mandatorily conduct an internal audit.

Who can be Appointed as an Internal Auditor?

- ◆ As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.
- ◆ The internal auditor may or may not be an employee of the company.
- ◆ To be effective, the internal auditor must be regarded as a part of the management and not merely as an assistant thereto. Furthermore, he or she must have the authority to investigate every organisational activity to meet the objectives and scope of the internal audit.



1. AB Pvt. Ltd. company, having outstanding loans and borrowings from banks exceeding one hundred crore rupees, wants to appoint Mr. X, a practicing cost accountant, as an internal auditor. Is the appointment of Mr. X valid?

Provision & Conclusion: According to the provision given in section 138 of the companies Act, 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the companies. Thus, Appointment of

Conclusion: Mr. X as an internal auditor of AB Pvt. Ltd is valid.

As per Standard on Internal Audit (SIA) 210 Managing the Internal Audit Function, the Internal Audit Function performs a number of activities to achieve its objectives as outlined in its Charter (or Terms of Engagement). A few of the critical activities are as follows:

(a)	Define the overall plan, scope and methodology of the Internal Audit Function on a periodic basis.
(b)	Oversee and monitor various audit assignments, their proper planning, execution, reporting of findings and subsequent closure of reported observations.
(c)	Plan, acquire, engage and review the performance, training and development of professional staff, talent and other resources to achieve its objectives.
(d)	Identify, source, engage and manage external experts and technical solutions, if required.

- | |
|--|
| (e) Communicate and engage with all key stakeholders regarding progress and achievement of objectives. |
| (f) Develop and maintain a quality evaluation and improvement program. |

With respect to the accounting function and financial records of the organisation, the responsibilities of an Internal Auditor include:

to ascertain adequacy of system of internal control by a continuous examination of accounting procedures, receipts and disbursements, and to provide adequate safeguards against misappropriation of assets.

to operate independently of the accounting staff and must not in any way divest with any of the responsibilities placed upon him.

Not to involve in the performance of executive functions in order that the objective outlook does not get obscured by the creation of the vested interest.

to observe facts and situations and bring them to notice of authorities who would otherwise never know them; also, critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected.

to associate closely with management and keep knowledge up to date by being informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies.

At all times, the internal auditor must enjoy an independent status.

At times, the Internal Auditor is exposed to a different type of risk to independence, whereby management seeks active business support from the Internal Auditor.

Apart from providing assurance on internal controls over the operational activities of the organization, the Internal Auditor may be sometimes assigned responsibility to provide advisory inputs on governance activities such as risk management, framework of monitoring statutory compliances, automation of activities, avenues of process re-engineering with increase operational efficiency, code of ethics etc.



2. MANAGEMENT FUNCTIONS AND SCOPE OF INTERNAL AUDITING

Management is a process by which the affairs of an enterprise are conducted in such a manner that its goals and objectives are attained through optimum utilisation of all available resources, within the legal, social, economic and environmental constraints. To achieve optimum utilisation of resources management should determine the goals and objectives of the concern, quantify them to the extent possible, develop major policies and plans, implement them and exercise control over such implementation.

In the case of Companies required to appoint an Internal Auditor as per Section 138 of the Companies Act, 2013, Rule 13(2) of Companies (Accounts) Rules 2014, states: "The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity, and methodology for conducting the internal audit." Hence, in these class of companies, the Audit Committee or the Board, in conjunction with management and the Chief of Internal Audit, is expected to exercise the responsibility to formulate the objectives of internal audit. In the case of other organisations not covered under Rule 13, those who appoint the Internal Auditor (e.g., the owners, the promoters, the Board of Trustees, etc.) would generally define the objectives of internal audit.

The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.

Internal audit plan should be developed in such a manner that all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle. Also, ensuring that appropriate consideration is made and adequate balance is ensured to the following:

- ◆ Risk underlying the business process
- ◆ Value that the internal audit can provide to the organization
- ◆ Effort involved in conducting the internal audit for a particular business process
- ◆ Risk Appetite of the organization
- ◆ Coverage of all auditable areas within the defined time range

In addition, each of the managerial functions should be reviewed by the internal auditor. The scope of internal auditor's work should also include a review of-

- ◆ Internal Control System & Procedures
- ◆ Custodianship & Safeguarding of Assets
- ◆ Compliance with Policies, Plans, Procedures & Regulations
- ◆ Relevance & Reliability of Information
- ◆ Organisational Structure
- ◆ Utilisation of Resources
- ◆ Accomplishment of Goals & Objectives

On the basis of such review, the internal auditor should in his report, highlight the weaknesses observed and give suggestions for improvement. We may now have a brief description of each of the above areas of review:

(i) Review of Internal Control System and Procedures -

- (a) The review of internal control system and procedures involves assessing the design and operational efficiency and effectiveness of the internal control system to strengthen the overall internal control environment of the entity. The objective to review is to minimise the overall residual risk by suggesting the appropriate controls to reduce the inherent risk.



2. Review of three-way matching internal control involves matching of Purchase Orders, Goods Receipt Notes and Invoice to ensure all the ordered quantity of the intended goods have been received and invoiced accordingly. The failure of this internal control may involve over-invoicing, over-payment, non-receipt, or under-receipt of goods.

As far as possible, controls should be in-built in the operating functions for prevention or timely detection of the fraud and errors and minimize the cost of control.



3. The establishment of a separate credit control department would not be justified if the objective of reducing credit risk and minimising debt recovery period could be met through controls in-built in the accounting and sales systems, especially in smaller and medium-sized concerns.

- (b) Internal Control System should be reviewed considering the limitations of internal controls, i.e., cost-benefit comparison, human errors, collusion, and abuse by process owners.



4. Collusion of payment authorizer and payment maker to over pay a related party; those charged with governance themselves overriding the internal controls with malafide intention, etc.

It should also be seen whether the internal controls were in use throughout the period of intended reliance. A break-down in internal controls for a specific portion of intended reliance would need special attention.

(ii) Review of Custodianship and Safeguarding of Assets -

- This involves verifying the existence of the assets.
- The internal auditor should review the segregation of duties is in place.
- The internal auditor should review the control systems to ensure that all assets are accounted for fully. He should review the means used for safeguarding assets against losses **e.g. fire, improper or negligent activity, theft and illegal acts, etc.**
- He should review the control systems for intangible assets e.g. the procedures relating to credit control. Where an enterprise uses electronic data processing equipment, the physical and systems control on processing facilities as well as on data storage should be examined and tested.



5. The existence of intangible assets could be only an annual subscription in the name of an entity, for example, an annual ERP subscription.

(iii) Review of Compliance with Policies, Plans, Procedures and Regulations - It is essential that the various functional segments of an enterprise comply with the relevant policies, plans, procedures, laws and regulations so that the operations are carried out in a coordinated manner. He should examine the system of periodical review of existing policies particularly when there is a change in the method and nature of operations of the enterprise. By combining the results of his review of the adequacy of the systems with the result of his compliance tests, the internal auditor should be able to evaluate the effectiveness of the former. He should point out specific weaknesses and suggest remedial action.

(iv) Review of Relevance and Reliability of Information - The internal auditor should review the information systems to evaluate the reliability and integrity of financial and operating information given to management and to external agencies such as governmental bodies, investors, trade organisations, labour unions, etc. He should examine the accuracy and

reliability of financial and operational records. The usefulness of the reports as well as of the records should be evaluated with reference to their costs. The internal auditor should examine whether the reporting is by exception i.e. the reports highlight the significant and distinctive features. In case of automated management information system, where relevant information used for critical decision making is generated from the computer system, then adequacy of the controls build in the system should be reviewed to ensure data integrity and reliability of such information.

(v) Review of the Organisation Structure - The internal auditor should conduct an appraisal of the organisation structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith. For this purpose:

- He should review the manner in which the activities of the enterprise are grouped for managerial control. It is also important to review whether responsibility and authority are in harmony with the grouping pattern.
- The internal auditor should examine the organisation chart to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others.
- He should particularly see that the responsibilities of managerial staff at headquarters do not overlap with those of chief executives at operating units. He should examine whether there is a satisfactory balance between the authority and responsibility of important executives.
- The internal auditor should examine the reasonableness of the span of control of each executive (the number of subordinates that an executive controls). He should examine whether there is a unity of command i.e., whether each person reports only to one superior.
- Where dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed. This must be made known to all concerned.
- He should review adequate segregation of duties is considered while defining the organization structure.
- Finally, he should evaluate the process of managerial development in the enterprise.

(vi) Review of Utilisation 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.



6. For example, it may consist of under-utilized machines, unoccupied storage space, huge cash or bank balances, idle manpower, etc. While commenting on staffing, the internal auditor should pay special attention to non-productive work being performed. This would require an inquiry into the job descriptions of employees combined with an intelligent observation of the work being done.

- (vii) **Review of Accomplishment of Goals and Objectives** - The internal auditor should review the overall objectives of the enterprise to evaluate whether they are clearly stated and are attainable. The internal auditor should examine whether, to the extent possible, objectives are expressed in precise quantifiable terms (both monetary and non-monetary) to facilitate detailed planning to be made for achieving them. Budgeting forms an important part of such planning. This will ensure that plans anticipate the problem areas. There should also be sufficient flexibility in the plans to permit such improvements in their implementation, as would benefit the enterprises as a whole.



3. INTEGRITY, OBJECTIVITY AND INDEPENDENCE OF INTERNAL AUDITOR

There is a set of core principles fundamental to the internal audit function and activities. These basic principles of internal audit are critical to achieving the desired objectives as set out in the Definition of Internal Audit. The Basic Principles of Internal Audit are a set of core principles fundamental to the function and activity of internal audit.

1. The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

The independence of the internal audit function as a whole, and the Internal Auditor within the organisation, plays a large part in establishing the independence of the Internal Auditor. The overall organisation structure of key personnel, the position and reporting of the Chief Internal Auditor within this structure, along with the powers and authority which is derived from superiors further establishes the independence of the Internal Auditor.

2. The Internal Auditor shall be honest, truthful and be a person of high integrity. He shall operate in a highly professional manner and seen to be fair in all his dealings. He shall avoid all conflicts of interest and not seek to derive any undue personal benefit or advantage from his position.
3. The Internal Auditor shall conduct his work in a highly objective manner, especially in gathering and evaluation of facts and evidence. He shall not allow prejudice or bias to override his objectivity, especially in arriving at conclusions or reporting his opinion.



7. For example, to avoid any conflict of interest, the internal auditor should not review an activity for which he was previously responsible. It is also expected from the management to take steps necessary for providing an environment conducive to enable the internal auditor to discharge his responsibilities independently and also report his findings without any management interference.



8. For example, in the case of a listed company, the internal auditor may be required to report directly to those charged with governance, such as the Audit Committee instead of the Chief Executive Officer or the Chief Financial Officer. The internal auditor should immediately bring any actual or apparent conflict of interest to the attention of the appropriate level of management so that necessary corrective action may be taken.

TEST YOUR UNDERSTANDING 1

After an illustrious career in Indian Audit & Accounts Service for about 25 years, Parteek, a post graduate in law, has taken voluntary retirement from government service. Being in fine spirits, he wants to take responsibilities in corporate sector as Chief internal auditor. On looking at attractive

compensation packages, he applied for such position in a leading listed company engaged in oil refining business. The Board of company is keen on him due to his impressive credentials.

Can he be appointed in this leading position of said company?

TEST YOUR UNDERSTANDING 2

CA Deva is internal auditor of a listed company. The company wants to make sure that it is in compliance with SEBI requirements at all times and it is never on the wrong side of law. It asks its internal auditor to manage its compliance tracking system including directly corresponding with regulator in this regard. The profile and scope of internal audit agreed at time of appointment included *“compliance with laws and regulations.”*

Can he perform such type of activities in capacity of internal auditor of company?



4. QUALITIES OF INTERNAL AUDITOR

Internal auditor is required to objectively review overall governance and operational functions of the organization and, is required to internal with various stakeholders and other employees of the organisation. To perform his duties effectively, he is required to possess good knowledge of the subject matter, underlying information system and good soft skills.

Some of the specialised knowledge and expertise that Internal Auditor should obtain are:

1. The internal auditor should have the special expertise necessary for evaluating management control systems, especially financial and accounting controls.
2. Accounting and finance functions provide basic data for management control of an enterprise. Therefore, the internal auditor must have accounting and financial expertise to be able to discharge his duties.
3. The internal auditor is also expected to evaluate both financial and operational controls. This requires a good knowledge of the operations of the organization, technology and commercial practices of the enterprise.
4. He should also have a good knowledge of commerce, laws, taxation, cost accounting, economics, quantitative methods and EDP systems.

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|--|
| 5. An understanding of the accounting software, ERP system and other applications being used by the organization along with the knowledge of the basic controls related to Information Technology. |
| 6. An understanding of management principles and techniques is another essential qualification of an internal auditor as also the ability to deal with people. |
| 7. By his conduct the internal auditor should provide an assurance to the management that the confidentiality of such information would be maintained |



5. PERFORMING INTERNAL AUDIT ENGAGEMENT

Typical internal audit engagement comprises of following five steps:

Step 1 – Obtain knowledge of the Business and its Environment

Step 2 – Perform Audit Planning

Step 3 – Gather required information

Step 4 – Perform audit checks

Step 5 – Reporting of Internal Audit Issues

All of these steps are required to be performed while performing any Internal Audit engagement in the same sequence. Let us see some of the major activities to be performed under each of these steps:

Step 1 – Obtain knowledge of the Business and its Environment

Internal Auditor must conduct meetings with key stakeholders, Board of Directors and Key management personals to obtain understanding of the organization's business environment, its operations, organization's vision, mission and top management's expectations from the audit functions.

Internal auditor must obtain understanding of various business documents – Standard Operating Procedures and Financial Statement Etc.

Internal auditor must also obtain understanding of the underlying Information Technology landscape, various applications and ERP systems of the organization and Management Information System of the organization.

Internal auditor must also obtain understanding of the regulatory landscape and various laws and regulations that are applicable to the organization.

Step 2 – Perform Audit Planning

Internal Auditor must plan the audit engagement as per the Standard on Internal Audit (SIA) 310, Planning the Internal Audit Assignment. Audit scope must be approved by Audit Committee and Board of Directors.

Once approved, Internal Auditor must share detailed Audit Plan with the key managerial personals and plan in advance the detailed schedule of the Internal Audit to be conducted.

Internal Auditor must conduct the opening meeting with key stakeholders before start of audit engagement and share details of Information and System Access required to perform the audit.

Detailed work plan must be prepared by the audit managers and approved with Head of Internal Audit / Chief Internal Auditor. The work plan must be prepared after performing the evaluation of all major underlying risks in the process being reviewed and the audit checks to be performed to assess the adequacy of the control environment to mitigate such risks.

Step 3 – Gather required information

Internal Auditor must obtain the required information and perform checks to ensure correctness and integrity of information received. To the extent possible, Internal Auditor must obtain the information directly from the source.

Adequate planning should be done and advance intimation should be made for any interim information needed for performing audit checks.

Step 4 – Perform audit checks

Internal Auditor should collate all data and perform analytical procedures to identify key trends and outliers. Analytical procedures should be performed in accordance with the Standard on Internal Audit (SIA) 6, Analytical Procedures. To the extent possible, relevant analytical tools may be used to perform review of the complete data for the audit period.

Wherever needed, Internal Auditor must select the sample in accordance with Standard on Internal Audit (SIA) 5, Sampling.

Detailed audit testing must be performed as per the audit work plan. Internal Auditor must ensure adequate evidences must be collected and stores in accordance to Standard on Internal Audit (SIA) 320, Internal Audit Evidence

Internal Auditor must prepare detailed listed of the Identified audit issues and controls gaps. Interim reports may be issued after proper review of the work performed as per the Standard on Internal Audit (SIA) 350, Review and Supervision of Audit Assignments.

Adequate document of the internal audit work papers needs to be ensured as per Standard on Internal Audit (SIA) 330, Internal Audit Documentation

Step 5 – Reporting of Internal Audit Issues

Internal Auditor must prepare a draft report of Internal Audit issues comprising of the business process/ function reviewed as per scope, detailed audit coverage and exclusions, if any, audit period covered during the audit, summary along with detailed issues over the gaps noted along with implication of the business and recommendation to mitigate the identified gaps.

Management Action Plan should be agreed along with responsibility of action and timelines for actions. Internal Auditor must also review the status of actions taken by the management against the actions agreed during previous audits and report the status of such follow up in the audit report.

Internal Auditor should thereafter circulate Final Report and presentation his findings to the Audit Committee. Internal auditor must adhere to Standard on Internal Audit (SIA) 360, Communication with Management and Standard on Internal Audit (SIA) 370, Reporting Results while sharing the result of internal audit with the stakeholders.

6. INTERNAL AUDIT REPORT

The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action. However, in case the internal auditor comes across any actual or suspected fraud or any other misappropriation of assets, it would be more appropriate for him to bring the same immediately to the attention of the management.

As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

At the end of a particular audit assignment, an “Internal Audit Report” covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.

On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

This Standard on Internal Audit (SIA) deals with the internal auditor’s responsibility to issue only the first type of reports, the Internal Audit Report pertaining to specific audit assignments and not to the periodic (e.g. Quarterly) reporting for the whole entity as per the Annual/Quarterly audit plan.

On the basis of the internal audit work completed, the Internal Auditor shall issue a clear, well documented Internal Audit Report which includes the following key elements:

(a) An overview of the objectives, scope and approach of the audit assignments;

(b) The fact that an internal audit has been conducted in accordance the Standards of Internal Audit;

(c) An executive summary of key observations covering all important aspects, and specific to the scope of the assignment;

(d) A summary of the corrective actions required (or agreed by management) for each observation; and

(e) Nature of assurance, if any, which can be derived from the observations.

The content and form of the Internal Audit Report are to be established by the Internal Auditor based on his best professional judgement, in consultation with the auditee and, if necessary, with inputs from other key stakeholders. No internal audit report shall be issued in final form unless a written draft of the report has previously been shared with the auditee.

The internal audit report shall be issued within a reasonable time frame from the completion of the internal audit work.

1. Basis of Internal Audit Report: Each internal audit report is prepared on the basis of the audit procedures conducted and the analysis of the audit evidence gathered. Conclusions reached shall be based on all the findings rather than on a few deviations or issues noted. Controls operating effectively have their own importance and should be acknowledged, while the risk and significance of observations noted have a role to play in prioritising the matters to be reported.

2. Conducted in Accordance with SIAs: Where the internal audit is conducted in compliance with the Standards of Internal Audit, (within the Framework governing Internal Audits), and the internal auditor can substantiate the same with supporting evidence and documentation, the internal audit report shall include a statement confirming that “the internal audit was conducted in accordance with the Standards of Internal Audit issued by the Institute of Chartered Accountants of India”.

3. Content and Format of Internal Audit Report: The manner in which the internal audit report is drafted and presented is a matter of professional judgment and choice and could be influenced by the preferences of the recipients. The SIA does not mandate any particular format or list of contents since the Internal Auditor is expected to exercise his best professional judgement on matters regarding how and what to report. Where some level of assurance is being provided, the form and content of the report shall be as per SIA 380, “Issuing Assurance Reports”. A typical internal audit report should include the following:

- ◆ Audit Scope performed
- ◆ Audit period Covered
- ◆ Executive Summary
- ◆ Summary of the critical findings
- ◆ Detailed audit findings with elaboration on business impact and root cause of such issues
- ◆ Rating of the highlighted issues (E.g High / Medium / Low) in accordance to the rating criteria approved by Audit Committee
- ◆ Audit recommendation to improve control environment and address the highlighted finding
- ◆ Response received from the responsible functional authority containing action plan and target timelines for action

4. Documentation: To confirm compliance of audit procedures with this SIA, the list of documents required is as follows:

(a) Copies of draft and final internal audit reports to be maintained, appropriately cross referenced to specific observations.

(b) If appropriate, management action plans may be counter signed by respective management personnel.

6.1 Follow-up

As per SIA 390 Monitoring and Reporting of Prior Audit Issues, the Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance. The responsibility to implement the action plans remains with the management.

In monitoring and reporting of prior audit issues, the responsibility of the Internal Auditor is usually in the form of an “Action Taken Report (ATR) of previous audits”.

The term “Monitoring and Reporting” used in this Standard refers to the periodic tracking of issues raised during prior audits and evaluation of the corrective actions undertaken by the auditee to resolve them and to report any open and pending matters to the management and those charged with governance (e.g. the Audit Committee).

The internal auditor should review whether follow-up action is taken by the management on the basis of his report. If no action is taken within a reasonable time he should draw the management's attention to it. Where the management has not acted upon his suggestions or not implemented his recommendations, the internal auditor should ascertain the reasons thereof.

Where the management has accepted his recommendations and initiated the necessary action, the internal auditor should periodically review the manner and the extent of implementation of the recommendations and report to the management highlighting the recommendations which have not been implemented fully or partly.



7. RELATIONSHIP BETWEEN INTERNAL AND EXTERNAL AUDITORS

- ◆ The scope and objective of internal audit are dependent upon the size and structure of the entity and the requirements of its management. As stated earlier the internal auditor operates in various areas such as review of the accounting system and internal control; examination of financial and operating information for the benefit of management, the examination of the economy, efficiency and effectiveness of operations including non-financial controls of various tangible assets of the entity. While operating in these areas, there is a lot of overlap between the work of internal auditors and external auditors.
- ◆ The work done by the internal auditor has an important bearing on the work performed by the statutory auditor as evaluation done by the internal auditor in respect of internal controls, reliability of financial information, verification of assets, etc. is also required to be done by the external auditor. The function of an internal auditor is an integral part of the system of internal control.
- ◆ It is a statutory requirement too as per section 138 of the Companies Act, 2013 where the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.
- ◆ However, it is obligatory for a statutory auditor to examine the scope and effectiveness of the work carried out by the internal auditor. For the purpose, he should examine the Internal Audit Department of the organisation, the strength of the internal audit staff, their qualification and their powers.
- ◆ The extent of independence exhibited by the internal auditor in the discharge of his duties and his status in the organisation are important factors for determining the effectiveness of his audit. But so far, the practice of audit being conducted jointly by the internal auditors is of great assistance to statutory auditors.
- ◆ The external auditor should, as part of his audit, evaluate the internal audit function to the extent he considers that it will be relevant in determining the nature, timing and extent of his compliance and substantive procedures. Depending upon such evaluation, the external auditor may be able to adopt less extensive procedures than would otherwise be required.

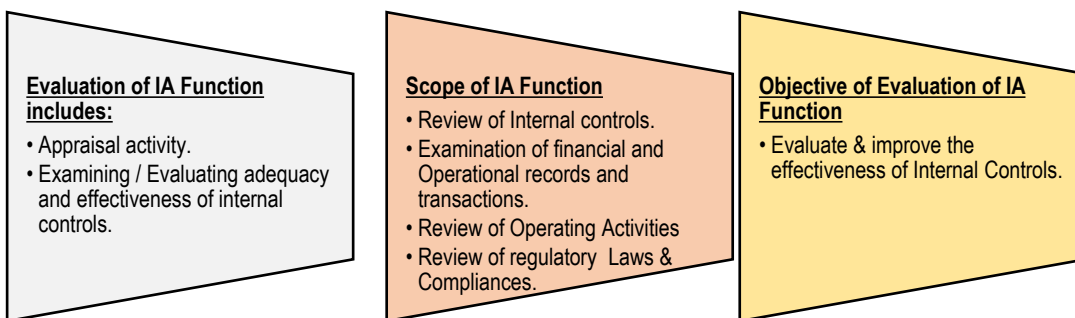
Difference Between Internal & External Auditors

BASIS FOR COMPARISON	INTERNAL AUDIT	EXTERNAL AUDIT
1. Performed by	Internal audit is performed by an independent internal auditing function within the organisation or by external body.	It is an audit function performed by the independent body which is not a part of the organization.
2. Examination	The Internal auditor examines the adequacy of operational controls of the organisation.	The External auditor examines the Accuracy and Validity of Financial Statements.
3. Appointment	The Internal auditor is appointed by the Audit Committee or Board of Directors.	The External auditor is appointed by the Members.
4. Users of Report	Generally, internal audit report is used by top Management and referred by statutory auditor.	The user of external audit report is Stakeholders.
6. Reporting	Internal Audit Report provides weakness in internal controls and effectiveness of the operational activities.	The opinion is provided on the truthfulness and fairness of the financial statement of the company.
7. Status of Auditor	The Internal auditor could be an employee of the company.	The External auditor is mandatorily not an employee of the company.

SA 610 “Using the work of an Internal Auditor” deals with certain aspects of relationship between internal and external auditors.

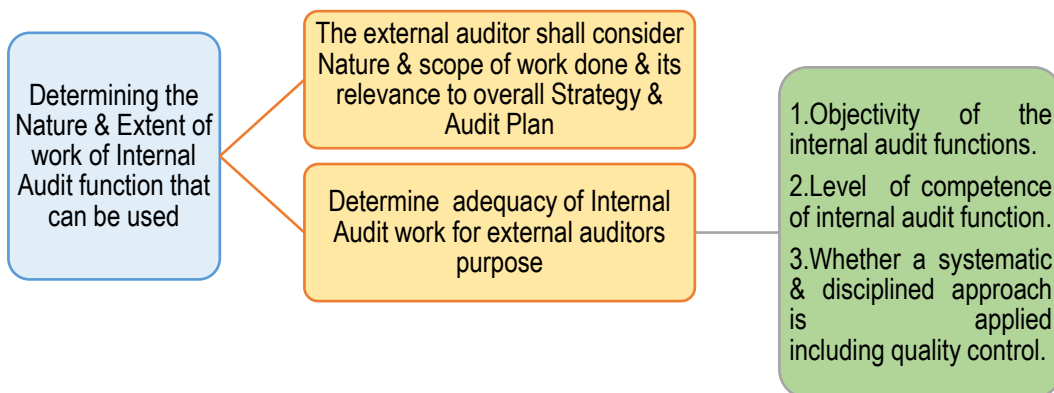
7.1 Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used

Evaluating the Internal Audit Function:

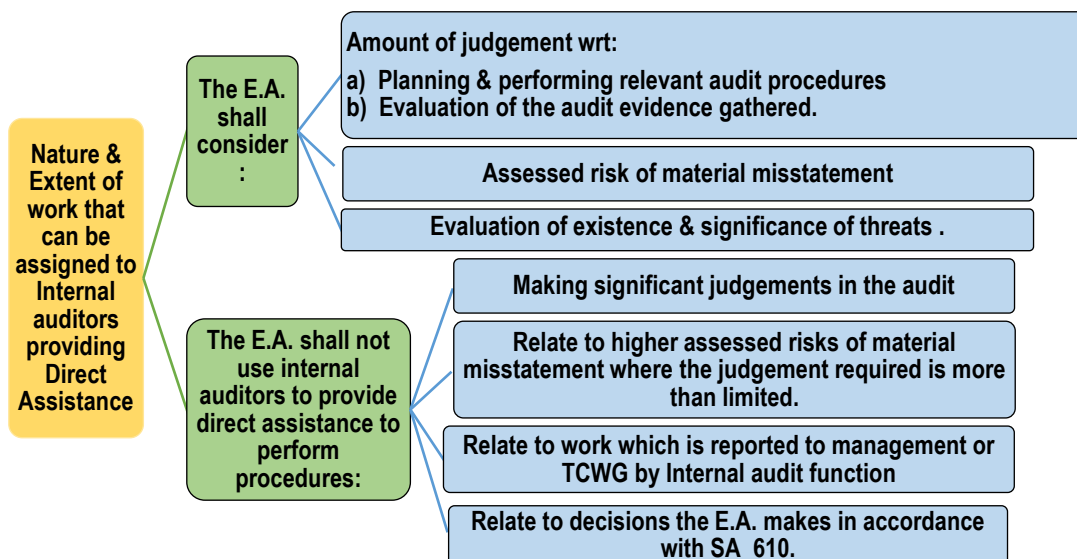


7.2 Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used

The external auditor shall not use the work of the internal audit function if the external auditor determines that the function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors; the function lacks sufficient competence or the function does not apply a systematic and disciplined approach, including quality control.



7.3 Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance



(A brief overview of using Direct Assistance from Internal Auditors by External Auditors)

The external auditor shall evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with the planned use of the work of the internal audit function, 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.

7.4 If the External Auditor uses Internal Auditors to Provide Direct Assistance on the Audit, the External Auditor shall include in the Audit Documentation

- (a) The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;
- (b) The basis for the decision regarding the nature and extent of the work performed by the internal auditors;
- (c) Who reviewed the work performed and the date and extent of that review in accordance with SA 230 Audit Documentation;
- (d) The written agreements obtained from an authorized representative of the entity and the internal auditors; and
- (e) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

Finally, in India, even the statute has now recognised that internal audit is necessary for the efficient running of companies. Thus, a review of the internal audit function in specified companies has become a statutory responsibility for the statutory auditor.

[Note: Student are advised to refer SA 610 Using the work of Internal Auditor for more details, SA 610 is reproduced in Auditing Pronouncements.]

Illustration 2

The Managing Director of X Ltd is concerned about high employee attrition rate in his company. As the internal auditor of the company he requests you to analyze the causes for the same. What factors would you consider in such analysis?

Solution

The factors responsible for high employee attrition rate are as under:

- (i) Job Stress & work life imbalance;

- (ii) Wrong policies of the Management;
- (iii) Unbearable behaviour of Senior Staff;
- (iv) Safety factors;
- (v) Limited opportunities for promotion;
- (vi) Low monetary benefits;
- (vii) Lack of labour welfare schemes;
- (viii) Whether the organization has properly qualified and experienced personnel for the various levels of works?
- (ix) Is the number of people employed at various work centres excessive or inadequate?
- (x) Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?



8. INTERNAL AUDIT AS A MANAGEMENT FUNCTION

Management is a process by which the affairs of an enterprise are conducted in such a manner that its goals and objectives are attained through optimum utilisation of all available resources, within the legal, social, economic and environmental constraints. At the most fundamental level, management functioning is a set of five general functions: planning, organizing, staffing, directing and controlling. While the first five functions of planning, organizing, staffing and leading are critical attributes to create and grow stakeholder's wealth whilst controlling is the critical function that is key to preserve stakeholder's wealth.

As per the revised definition of the term 'Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, "Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives". Accordingly Internal Auditor is expected to critically evaluate the management activities and advise them on the areas of improving internal controls and manage business and operational risks effectively by recommending appropriate mitigating controls.

Internal Audit is an important element of management controlling function, it helps management to set up appropriate systems and processes in place to mitigate risk while remaining independent to the operations. Internal Auditor is expected to report on the identified gaps and areas of weak

internal control, further he is expected to identify the root cause of the problems and suggest appropriate mitigating steps and strengthen the internal controls environment of the organization.

Accordingly, Internal Audit is seen as an important function that helps management to achieve organization goals and perform its function in an orderly manner.



9. AUDIT TRAIL

Audit Trail (or Edit Log) is a visible trail of evidence enabling one to trace information contained in statements or reports back to the original input source. Audit trails are a chronological record of the changes that have been made to the data. Any change to data including creating new data, updating or deleting data that must be recorded.

Records maintained as audit trail may include the following information:

- ◆ when changes were made i.e., date and time (timestamp)
- ◆ who made the change i.e., User Id
- ◆ what data was changed i.e., data/transaction reference; success/failure

Audit trails may be enabled at the accounting software level depending on the features available in such software or same may be captured directly in the database underlying such accounting software.

In order to demonstrate that the audit trail feature was functional, operated and was not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors, as appropriate. An illustrative list of internal controls which may be required to be implemented and operated are given below:

- ◆ Controls to ensure that the audit trail feature has not been disabled or deactivated.
- ◆ Controls to ensure that User IDs are assigned to each individual and that User IDs are not shared.
- ◆ Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.
- ◆ Controls to ensure that access to the audit trail (and backups) is disabled or restricted and access logs, whenever the audit trails have been accessed, are maintained.

- ◆ Controls to ensure that periodic backups of the audit trails are taken and archived as per the statutory period specified under the provisions of the Act.

TEST YOUR UNDERSTANDING 3

Up Down Limited is in doldrums since last two years. The demand for its products has declined drastically. The statutory auditor is of the view that situation has put into question going concern assumption of the company. Its internal auditor has helped management in devising a strategy to deal with such risks and come out of the situation. The plan includes venturing into different product lines using same plant with minor modifications. Further, internal auditor has also prepared estimates of revenue generation along with cash flows.

Can statutory auditor place total reliance on work performed by internal auditor in this regard?

Key Takeaways

- ◆ Internal Audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives.
- ◆ It is mandatory for all listed companies, unlisted public companies/private companies fulfilling certain criteria to appoint internal auditor in accordance with provisions of Section 138 of Companies Act, 2013 and relevant rules.
- ◆ The internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company in terms of section 138 of Companies Act, 2013. He may or may not be employee of the company.
- ◆ In such companies specified in section 138 of the Companies Act, 2013, the Audit Committee or the Board, in conjunction with management and the Chief of Internal Audit, is expected to exercise the responsibility to formulate the objectives of internal audit.
- ◆ Basic principles governing an internal audit include independence, integrity and objectivity.
- ◆ Each internal audit report is prepared on the basis of the audit procedures conducted and the analysis of the audit evidence gathered. Conclusions reached shall be based on all the findings rather than on a few deviations or issues noted.
- ◆ Reporting of internal audit results is generally undertaken in two stages- At the end of a particular audit assignment, an *"Internal Audit Report"* covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from

those assignments. Further, on a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee.

- ◆ The internal auditor should review whether follow-up action is taken by the management on the basis of his report. If no action is taken within a reasonable time he should draw the management's attention to it. Where the management has not acted upon his suggestions or not implemented his recommendations, the internal auditor should ascertain the reasons thereof.
- ◆ The work done by the internal auditor has an important bearing on the work performed by the statutory auditor as evaluation done by the internal auditor in respect of internal controls, reliability of financial information, verification of assets, etc. is also required to be done by the external auditor.
- ◆ It is obligatory for a statutory auditor to examine the scope and effectiveness of the work carried out by the internal auditor. For the purpose, he should examine the Internal Audit Department of the organisation, the strength of the internal audit staff, their qualification and their powers.
- ◆ The extent of independence exhibited by the internal auditor in the discharge of his duties and his status in the organisation are important factors for determining the effectiveness of his audit.
- ◆ The external auditor should, as part of his audit, evaluate the internal audit function to the extent he considers that it will be relevant in determining the nature, timing and extent of his compliance and substantive procedures.
- ◆ The external auditor shall not use the work of the internal audit function if the external auditor determines that the function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors; the function lacks sufficient competence or the function does not apply a systematic and disciplined approach, including quality control.
- ◆ Standards on Internal audit are recommendatory in nature.

APPENDIX

The following Standards on Internal Audit are recommendatory in nature. The Standards shall become mandatory from such date as notified by the council:

Section I: Preface

Preface to the Framework and Standards on Internal Audit

Section II: Framework

Framework Governing Internal Audits

Section III: Basic Principles

Basic Principles of Internal Audit

Section IV: Standards on Key Concepts (100 Series)

SIA 110: Nature of Assurance

SIA 120: Internal Controls

Section V: Standards on Internal Audit Management (200 Series)

SIA 210: Managing the Internal Audit Function

SIA 220: Conducting Overall Internal Audit Planning

SIA 230: Objectives of Internal Audit

SIA 240: Using the Work of an Expert

Section VI: Standards on the Conduct of Audit Assignments (300 - 400 Series)

SIA 310: Planning the Internal Audit Assignment

SIA 320: Internal Audit Evidence

SIA 330: Internal Audit Documentation

SIA 350: Review and Supervision of Audit Assignments

SIA 360: Communication with Management

SIA 370: Reporting Results

SIA 390: Monitoring and Reporting of Prior Audit Issues

Section VII: Standards on Internal Audit (As on July 1, 2013)

SIA 5: Sampling

SIA 6: Analytical Procedures

SIA 7: Quality Assurance in Internal Audit

SIA 11: Consideration of Fraud in an Internal Audit

SIA 13: Enterprise Risk Management

SIA 14: Internal Audit in An Information Technology Environment

SIA 17: Consideration of Laws and Regulations in an Internal Audit

SIA 18: Related Parties

TEST YOUR KNOWLEDGE

Theoretical Questions

1. Write a short note on Internal Audit Report.
2. State the important aspects to be considered by the External auditor in the evaluation of the Internal Audit Function.
3. AB Pvt. Ltd. company has outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint an internal auditor. Please guide him for the applicability of the same and who can be appointed as an internal auditor and what work would be reviewed by him.
4. Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.
5. Mr. A is appointed as a statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct

assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

- (a) Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.
 - (b) Will your answer be different if Mr. A asks direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?
6. The XYZ Ltd has to appoint Mr. A as Chief Internal Auditor to lead the internal audit function for the Company. The Managing Director of the Company has asked the HR head to define the reporting structure of the Chief Internal Auditor, so that he can discharge his duties objectively? Suggest the ideal reporting structure of the Chief Internal Auditor that HR head may propose to the Managing Director?
7. The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their Internal Audit plan for next financial year? What approach would Mr. A follow to prepare the internal audit plan for next year?
8. The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. to perform detailed analysis of their expenses in previous year and report all risks and underlying gaps? What audit approach should Internal Auditor follow to identify such gaps?
9. The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. to present detailed report on their finding and areas where immediate action is needed to mitigate critical risks? What should be the content of internal audit report to address this requirement of the Audit Committee?
10. The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their analysis on the implementation of recommendation of previous audit report and highlight critical areas which need immediate attention of Audit Committee? What should be the steps followed by internal auditor to address this requirement of Audit Committee?

Answers to Test Your Understanding

1. As per section 138 of Companies Act, 2013 the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

The Board can appoint any professional as may be decided by it. The applicant in question is a law post graduate and he has spent 25 years of his career in Indian Audit & Accounts Service. Therefore, he has got the necessary experience and skills required for the said vacancy. The Board would be in a position to appoint such a competent and experienced person in the field of auditing as its Chief Internal auditor.

2. The Internal Auditor does not assume any responsibility to manage or operate the compliance framework or to take compliance related decisions. It is not responsibility of the Internal Auditor to execute or resolve compliance related risks (e.g., engaging directly with regulators, etc.).

Although internal audit function provides independent assurance to enhance governance (which includes compliance with laws and regulations), it does not assume operational responsibility of its compliance framework. It is the responsibility of the management. He is responsible for auditing the compliance framework and not managing it. Similarly, he does not accept compliance related risks like directly engaging with regulator.

3. The greater the judgment needed to be exercised in planning and performing the audit procedures and evaluating the audit evidence, the external auditor will need to perform more procedures directly because using the work of the internal audit function alone will not provide the external auditor with sufficient appropriate audit evidence.

The appropriate use of going concern assumption requires significant judgment on part of statutory auditor.

Therefore, statutory auditor cannot place total reliance on internal auditor's work in this regard and he should perform more procedures directly.

Hints /Answers to Theoretical Questions

1. **Refer para 6.**
2. **Evaluation of Internal Audit Functions by External Auditor:** The external auditor's general evaluation of the internal audit function will assist him in determining the extent to which he

can place reliance upon the work of the internal auditor. The external auditor should document his evaluation and conclusions in this respect. The important aspects to be considered in this context are:

- (a) **Organisational Status** - Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself, the internal auditor reports to the management. In an ideal situation, his reports to the highest level of management and are free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.
- (b) **Scope of Function** - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate, acts upon internal audit recommendations.
- (c) **Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.
- (d) **Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.

3. **Applicability of Internal Audit:** Section 138 of the Companies Act, 2013 states that every private limited company is required to conduct internal audit if its outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In view of above provisions, AB Pvt. Ltd. is under compulsion to conduct internal audit as its loans or borrowings are falling under the prescribed limit.

Who can be appointed as Internal Auditor- The internal auditor shall either be a chartered accountant or a cost accountant, whether engaged in practice or not, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.

The internal auditor may or may not be an employee of the company.

Work to be reviewed by Internal Auditor- Refer Para 2.

4. Refer Para 7.3

5. (a) **Direct Assistance from Internal Auditor:** As per SA 610 “Using the Work of Internal Auditor”, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

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

Significant judgments include the following:

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

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

- (b) **Direct Assistance from Internal Auditor in case of External Confirmation Procedures:** SA 610 “Using the Work of Internal Auditor”, provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned.

Further, in accordance with SA 505, “External Confirmation” the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

6. HR Head need to evaluate multiple options and identify most suitable option in light of the relevant provisions, guidance and overall governance of the organization. HR head also need to evaluate different option for his administrative reporting and various options for functional reporting of Chief Internal Auditor. The possible options to be considered and evaluated

include Board of Directors, Audit Committee, Managing Director of the Company, Chief Executive Officer or Chief Financial Officer.

As per section 138 of the Companies Act 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

As per the revised definition of the term 'Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, "Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives".

Refer para 3.1, The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

As per the requirement of the above stated provision, Chief Internal Auditor need to be independent of the operational activities and report of Audit Committee / Board of Directors to enjoy his true status of independent auditor. He may administratively report to CEO or Managing Director for his administrative reporting purpose or any other similar authority till the time it is approved by Board of Directors and it does not impact his independence to be able to perform his duties and report to audit committee / Board of Director independently.

7. Refer para 2.0.

The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.

Internal audit plan should be developed in such a manner that all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle. Also, ensuring that appropriate consideration is made and adequate balance is ensured to the following:

- Risk underlying the business process
- Value that the internal audit can provide to the organization
- Effort involved in conducting the internal audit for a particular business process

- Risk Appetite of the organization
 - Coverage of all auditable areas within the defined time range
8. Refer para 5.0
9. Refer para 6.0

As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

- **At the end of a particular audit assignment**, an “Internal Audit Report” covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.
- **On a periodic basis, at the close of a plan period**, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

Accordingly, a typical internal audit report should include the following:

- Audit Scope performed;
- Audit period Covered;
- Executive Summary;
- Summary of the critical findings;
- Detailed audit findings with elaboration on business impact and root cause of such issues;
- Rating of the highlighted issues (E.g High / Medium / Low) in accordance to the rating criteria approved by Audit Committee;

- Audit recommendation to improve control environment and address the highlighted finding;
- Response received from the responsible functional authority containing action plan and target timelines for action.

10. Refer para 6.1

As per SIA 390 Monitoring and Reporting of Prior Audit Issues, the Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance. The responsibility to implement the action plans remains with the management.

In monitoring and reporting of prior audit issues, the responsibility of the Internal Auditor is usually in the form of an "Action Taken Report (ATR) of previous audits".

To address the requirement of Audit Committee in the given situation, Internal Auditor should assess the action taken against the previous audit findings and report a summary of the action taken by the management. Typical Action Taken Report may include the following:

- Reference to the previous audit reporting containing the reported issues
- Implementation Action agreed by the management along with target implementation date
- Status of action taken by management. The same may be classified under Implemented / Not Implemented
- Residual risk and rating for any unimplemented action
- Audit findings not implemented for long period of time
- Any critical audit finding that require immediate action for action or implementation

DUE DILIGENCE, INVESTIGATION & FORENSIC ACCOUNTING



LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ☐ Know the concept of Due Diligence, Investigation and Forensic Accounting.
- ☐ Differentiate between Audit and Investigation.
- ☐ Know the steps to be taken at the time of Investigation.
- ☐ Understand the purpose of Due diligence and content of its report.
- ☐ Gain knowledge of FAIS, Forensic Accounting Investigation Report.

CHAPTER OVERVIEW



Due Diligence	Investigation	Forensic Accounting
• Purpose • Classification • Work Approach to Due Diligence • Content of Due Diligence Report	• Steps in Investigation • Special Issues in Investigations • Audit V/s. Investigation	• Meaning • Fraud and Procedures • FAIS • Forensic Accounting Investigation Report

K, a CA final student, had an inkling of “*Due Diligence*”, “*Investigation*” and “*forensic accounting*”. The terms sounded familiar to him but he lacked knowledge about fine distinctions among these. “*Due Diligence*” broadly means taking care before entering into agreement or transaction with a party which a reasonable person ought to take. Can it be performed by anyone? Of course. It is not an exclusive activity bracketed for Chartered Accountants.

“*Investigation*” is aimed at establishing a fact or a happening or assessing a situation. Reasons for investigation are varied. Like, a Chartered accountant may be engaged to discover whether a fraud has occurred or to conduct an investigation where an entity proposes to buy a business. Its purpose is specific. It is not in nature of general prudence and care.

“*Forensic accounting*” relates to use of professional accounting skills in matters involving the possibility of a fraud in order to collect relevant evidence and facts which could help support an expert view for *potential or actual civil or criminal litigation*. *The evidence should be suitable for use in court of law or before a regulatory body.*

He was reading a report about a Surat based company whose forensic accounting was conducted by an IBA (Indian Banks’ Association) empanelled firm. The facts of the company made interesting reading. It was engaged in importing raw diamonds and exporting diamonds after finishing besides catering to domestic market. The said company was availing credit facilities consisting of ₹250 crore from a consortium of bankers consisting of 5 banks. The credit facilities consisted of cash credit limit, packing credit limit, Bills purchased limit, LCs issued and term loans. The account was declared NPA due to failure to meet repayment obligations, devolved LCs and overdrawn accounts. The company had also trade transactions with its sister concerns.

How should Forensic Professional have proceeded with? The approach in a forensic accounting is on gathering facts and evidence and a critical examination of all the evidence with respect to violations. It includes review of data over period of time to identify red flags and use of computer assisted techniques to find digital evidence stored in the system. Review of documentation and gathering market intelligence is next crucial step. Interviews with identified employees can be of great help.

It would also include answer to the questions like whether funding availed by the company from banks was required. It may turn out that credit requirements of the borrower were not assessed properly, and company was provided credit facilities disproportionate to its requirements. It would require analysis of PCL and bills purchased facilities to understand the purpose. There may be forex transactions not in accordance with imports and exports. Transactions with sister concerns would require to be analysed for probable fund diversion and siphoning off. It would help in digging out trail for end use of funds.

He was surprised to learn that Standards exist in this field too. Forensic Accounting and Investigation Standards (FAIS) enhance quality of forensic accounting and investigation services rendered by Chartered Accountants.

1. DUE DILIGENCE REVIEW

Due Diligence is used to investigate and evaluate a business opportunity, verify Agreements, encumbrances on the assets, Assets – their title and ownership, intellectual Property, Health, Safety and Environment Laws, etc. It implies a general duty to exercise care in any transaction. Most legal definition of due diligence describes it as a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depends on the relative facts of the special case.

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.

Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

Due Diligence may also be required to be performed in cases of corporate restructuring, venture capital financing, lending, leveraged buyouts, public offerings, disinvestment, corporatisation, etc. Sometimes, in a restructuring exercise, while the unit may remain within a group, it may pass from under the charge of one management team to that of another team. This situation also gives rise to the need for a due diligence review.

One such emerging area is around mandatory human rights and environmental due diligence. The OECD Due Diligence Guidance for Responsible Business Conduct (RBC) set out the expectation that how an enterprises can carry out risk-based due diligence. Under OECD RBC due diligence standards, enterprises are expected to carry out risk-based due diligence to identify, prevent, mitigate and account for how they address actual and potential adverse impacts to people, society and the planet.

DIFFERENCE BETWEEN DUE DILIGENCE AND AUDIT

It needs be underlined that due diligence is different from audit. Audit is an independent examination and evaluation of the financial statements on an organization with a view to express an opinion thereon. Whereas due diligence refers to an examination of a potential investment to confirms all material facts of the prospective business opportunity. It involves review of financial and non-financial records as deemed relevant and material. Simply put, due diligence aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party.

2. IMPORTANCE OF DUE DILIGENCE

When a business opportunity first arises, it continues throughout the talks, initial data collection and evaluation commence. Thorough detailed due diligence is typically conducted after the parties involved in a proposed transaction have agreed in principle that a deal should be pursued and after a preliminary understanding has been reached, but prior to the signing of a binding contract.

The purpose of due diligence is to assist the purchaser or the investor in finding out all the care that a reasonable person can, about the business he is acquiring or investing in prior to completion of the transaction including its critical success factors as well as its strength and weaknesses.

In addition, it may expose problems or potential problems that can be addressed in the price negotiations or by dealing suitable clauses in the contractual documentation, in particular, warranty and or indemnity provisions.

There are many reasons for carrying out due diligence including:

To confirm that the business is what it appears to be;

To identify potential 'deal killer' defects in the target company and avoid a bad business transaction;

To gain information that will be useful for valuing assets, defining representations and warranties, and/or negotiating price concessions; and

To verify that the transaction complies with investment or acquisition criteria.

**3. CLASSIFICATION OF DUE-DILIGENCE**

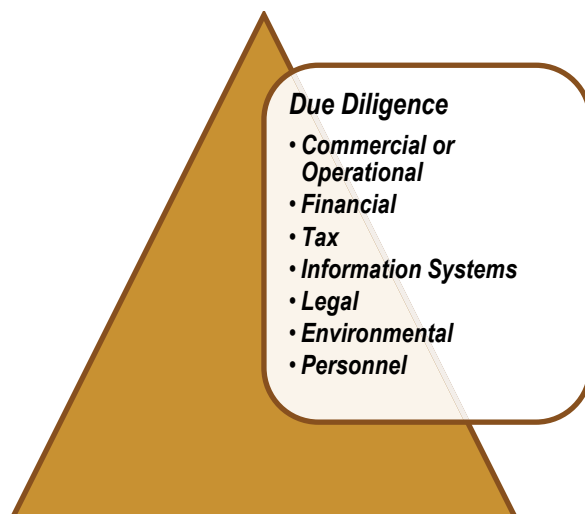
Due Diligence can be sub-classified into discipline-wise exercises in following manner:

- (i) **Commercial/Operational Due Diligence:** It is generally performed by the concerned acquire enterprise involving an evaluation from commercial, strategic and operational perspectives. For example, whether proposed merger would create operational synergies.
- (ii) **Financial Due Diligence:** It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence.
- (iii) **Tax Due Diligence:** It is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. The accountant has to look at the tax effect of the merger or acquisition.
- (iv) **Information Systems Due Diligence:** It pertains to all computer systems and related matter of the entity.
- (v) **Legal Due Diligence:** This may be required where legal aspects of functioning of the entity are reviewed.



1. The legal aspects of property owned by the entity or compliance with various statutory requirements under various laws.

- (vi) **Environmental Due Diligence:** It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity.
- (vii) **Personnel Due Diligence:** It is carried out to ascertain that the entity's personnel policies are in line or can be changed to suit the requirements of the restructuring.



Financial Due Diligence

At times, the financial due diligence review is interpreted as complete due diligence review since it is supposed to ascertain the financial implications of all the other due diligence reviews. This is, however, not appropriate. The term 'financial due diligence' should be used with caution. Unless the scope of financial due diligence to be performed is wide enough to cover all the aspects, it should not be confused with overall due diligence review.

It can be understood from the foregoing that the role of financial due diligence commences only after a price has been agreed for the business or a restructuring plan is framed. The initial price and other decisions are taken on the basis of net worth as well as trend of profitability of the target company, with an assumption that all contingent liabilities that may impact the future of the business have been recorded. The principal objective of financial due diligence, therefore, is usually to look behind the veil of initial information provided by the company and to assess the benefits and costs of the proposed acquisition/merger by inquiring into all relevant aspects of the past, present and future of the business to be acquired/merged with.

In order to achieve its objective, the due diligence process can include any or all of the following objectives for individual areas of the verification:

- ◆ Brief description of the history of business
- ◆ The background and standing of promoters
- ◆ Accounting policies and practices followed by the organization
- ◆ Management information systems
- ◆ Details of management structure

- ◆ Trading results both past and the recent past
- ◆ Assets and liabilities as per latest balance sheet
- ◆ Current status of Income tax assessments including appeals pending against tax liabilities assessed by tax authority.
- ◆ Cash flow patterns
- ◆ Brief description of commercial and/or other activities carried out by the organization
- ◆ The projection of future profitability

If a full-fledged financial due diligence is conducted, it would include the following matters, *inter alia*, in its scope:

(a) Brief history of the target company and background of its promoter;	(b) Accounting policies;
(c) Review of financial statements;	(d) Taxation;
(e) Cash flow;	(f) Financial Projection;
(g) Management and employees;	(h) Statutory Compliance.

(a) Brief history of the target company and background of its promoters - The accountant should begin the financial due diligence review by looking into the history of the company and the background of the promoters.

The details of how the company was set up and who were the original promoters has to be gone into, before verification of financial data in detail. An eye into the history of the target company may reveal its turning points, survival strategies adopted by the target company from time to time, the market share enjoyed by the target company and changes therein, product life cycle and adequacy of resources. It could also help the accountant in determining whether, in the past, any regulatory requirements have had an impact on the business of the target company. Broadly, the accountant should make relevant enquiries about the history of target's business products, markets, suppliers, expenses, operations. This could, *inter alia*, include the following:

- ◆ Nature of business(es)



2. Manufacturer/ trader, wholesaler,
financial services, import/export.

- ◆ Location of production facilities, warehouses, offices.

◆ Employment



3. By location, supply, wage levels, union contracts, pension commitments, government regulation.

◆ Products or services and markets



4. Major customers and contracts, terms of payment, profit margins, market share, competitors, exports, pricing policies, reputation of products, warranties, order book, trends, marketing strategy and objectives, manufacturing processes.

◆ History of the business with important suppliers of goods and services



5. Long-term contracts, stability of supply, terms of payment, imports, methods of delivery such as "just-in-time".

◆ Inventories



6. Locations, Quantities.

- ◆ Franchises, licenses, patents.
- ◆ Important expense categories.
- ◆ Research and development.
- ◆ Foreign currency assets, liabilities and transactions.
- ◆ Legislation and regulation that significantly affect the entity.
- ◆ Information systems.

(b) Accounting policies - The accountant should study the accounting policies being followed by the target company and ascertain whether any accounting policy is inappropriate.

The accountant should also see the effects of the recent changes in the accounting policies. The target company might have changed its accounting policies in the recent past keeping in view its intention of offering itself for sale.

The overall scope has to be based on the accounting policies adopted by the management. The accountant has to look at any material effect of accounting policies on the overall profitability and their correctness. It is reiterated that the accountant should have a detailed look at all material changes in Accounting Policies in the period subjected to review very carefully.

The accountant's report should include a summary of significant accounting policies used by the target company, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the target company are different from those adopted by the acquiring enterprise, the effect of such differences.

(c) Review of Financial Statements - Before commencing the review of each of the aspect covered by the financial statements, **the accountant should examine whether the financial statements of the target company have been prepared in accordance with the Statute governing the target company, Framework for Preparation and Presentation of the Financial Statements and the relevant Accounting Standards.** If not, the accountant should record the deviations from the above and consider whether it warrant an inclusion in the final report on due diligence.

After having an overall view of the financial statements, as mentioned in the above paragraphs, **the accountant should review the operating results of the target company in great detail.** It is important to make an evaluation of the profit reported by the target company. The reason being that the price of the target company would be largely based upon its operating results.

The accountant should consider the presence of an extraordinary item of income or expense that might have affected the operating results of the target company.

It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period. This comparison could lead the accountant to the reasons behind the variations. It is important that **the trading results for the past four to five years are compared and the trend of normal operating profit arrived at.**

The normal operating profits should further be benchmarked against other similar companies. Besides the above, and based on the trend of operating results, the accountant has to advise the acquiring enterprise, through due diligence report, on the indicative valuation of the business.

In the case of many enterprises, the valuation is mainly based on the value of net worth only. For valuation of immovable properties and plant, if required, the assistance of expert valuers could also to be taken. The exercise to evaluate the balance sheet of the target company has to take into consideration the basis upon which assets have been valued and liabilities have been recognised. The net worth of the business has to be arrived at by taking into account the impact of over/under valuation of assets and liabilities. The accountant should pay particular attention to the valuation of intangible assets.

The objective of the Due Diligence exercise will be to look specifically for any hidden liabilities or over-valued assets.



7. Hidden Liabilities:

- The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
- The company may have given “Letters of Comfort” to banks and Financial Institutions. Since these are not “guarantees”, these may not be disclosed in the Balance sheet of the target company.
- The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
- Tax liabilities under direct and indirect taxes.
- Long pending sales tax assessments.
- Pending final assessments of customs duty where provisional assessment only has been completed.
- Agreement to buy back shares sold at a stated price.
- Future lease liabilities.
- Environmental problems/claims/third party claims.
- Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
- Huge labour claims under negotiation when the labour wage agreement has already expired.
- Unresolved labour litigations



8. Over-Valued Assets:

- Uncollected/uncollectable receivables.
- Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.

-  Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
-  Litigated assets and property.
-  Investments carried at cost though realizable value is much lower.
-  Investments carrying a very low rate of income / return.
-  Infertuous project expenditure/deferred revenue expenditure etc.
-  Group Company balances under reconciliation etc.
-  Intangible assets of no value.

(d) Taxation - Tax due diligence is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. It is important to check if the company is regular in paying various taxes to the Government. The accountant has to also look at the tax effects of the merger or acquisition.

(e) Cash Flow - A review of historical cash flows and their pattern would reflect the cash generating abilities of the target company and should highlight the major trends. It is important to know if the company is able to meet its cash requirements through internal accruals or does it have to seek external help from time to time.

It is necessary to check that:

- (a) Is the company able to honor its commitments to its trade payables, to the banks, to government and other stakeholders?
- (b) How well is the company able to turn its trade receivables and inventories?
- (c) How well does it deploy its funds?
- (d) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
- (e) What is the investment pattern of the company and are they easily realisable?

(f) Financial Projections - The accountant should obtain from the target company the projections for the next five years with detailed assumptions and workings. He should ask the target company to give projections on optimistic, pessimistic and most likely bases.



9. The accountant evaluates the appropriateness of assumption used in the preparation and presentation of financial projections. If, the accountant is of the opinion that as assumption used by the target company is unrealistic, the accountant should

consider its impact on the overall valuation of the company. He should offer his comments on all the assumption, highlighting those which, in his opinion are not inappropriate. In case he feels the projections provided by the target company are not achievable or aggressive he has to mention this in his report. He should thoroughly check the arithmetical accuracy of the calculations made for financial projections.

(g) Management and Employees - In most of the companies which are available for take over the problem of excess work force is often witnessed. It is important to work out how much of the labour force has to be retained. It is also important to judge the job profile of the administrative and managerial staff to gauge which of these matches the requirements of the new incumbents. Due to complex set of labour laws applicable to them, companies often have to face protracted litigation from its workforce, and it is important to gauge the likely impact of such litigation.



10. It is important to see if all employee benefits like Provident Fund (P.F.), Employees State Insurance (E.S.I.), Gratuity, leave and Superannuation have been properly paid/ provided for/funded. In case of un-funded Gratuity, an actuarial valuation of the liability has to be obtained from a reputed actuary.

The assumptions regarding increase in salaries, interest rate, retirement etc. have to be gone into to see if they are reasonable. It is also necessary to see if the basic salary /wage considered for the valuation is correct and includes all elements subject to payment of Gratuity. In the case of PF, ESI etc. the accountant has to see if all eligible employees have been covered.

It is very important to consider the pay packages of the key employees as this can be a crucial factor in future costs. One has to carefully look at Employees Stock Option Plans; deferred compensation plans; Economic Value Addition and other performance linked pay; sales incentives that have been promised etc. It is also important to identify the key employees who will not continue after the acquisition either because they are not willing to continue or because they are to be transferred to another company within the 'group' of the target company.

(h) Statutory Compliance - During a due diligence this is one aspect that has to be investigated in detail. It is important therefore, to make a list of laws/ statutes that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance it could lead to punitive charges under the law. These may have to be quantified and factored into the financial results of the company.

TEST YOUR UNDERSTANDING 1

CA. Y is employed with a leading private sector BDFP Bank posted in NOIDA branch. One of the existing borrowers has approached branch with a proposal to sanction fresh term loan of ₹5 crore with commensurate increase in working capital credit facilities relating to expansion of its garment manufacturing unit. While performing due diligence, he notices that company was formed just two years ago and had availed term loan of ₹ 10 crore and cash credit facilities of ₹5 crore respectively. Its sales have increased from ₹ 25 crores in first year to ₹45 crores in year just ended. It is generating cash profits and is timely servicing its debts.

The borrower was earlier catering to domestic market. However, now it is in process of procuring export orders and working assiduously in this regard. The expansion plans are in line with development in area of marketing relating to exports.

However, there are a large number of units catering to domestic and export market of garments in NOIDA, Delhi and surrounding areas. There is also demand slump in biggest US market.

Besides, the unit is family-based and relies upon marketing skills of its main promoter. There is lack of well-paid qualified staff with the borrower to deal effectively with its customers both domestic as well as foreign.

He starts jotting down and elaborating above points. Identify what he is trying to do as part of due diligence.

**4. WORK APPROACH TO DUE DILIGENCE**

The purchase of business in many instances is the largest and most expensive assets purchase in life time and therefore some caution should be exercised through the due diligence process. Therefore, assessing the businesses fair value passes through.

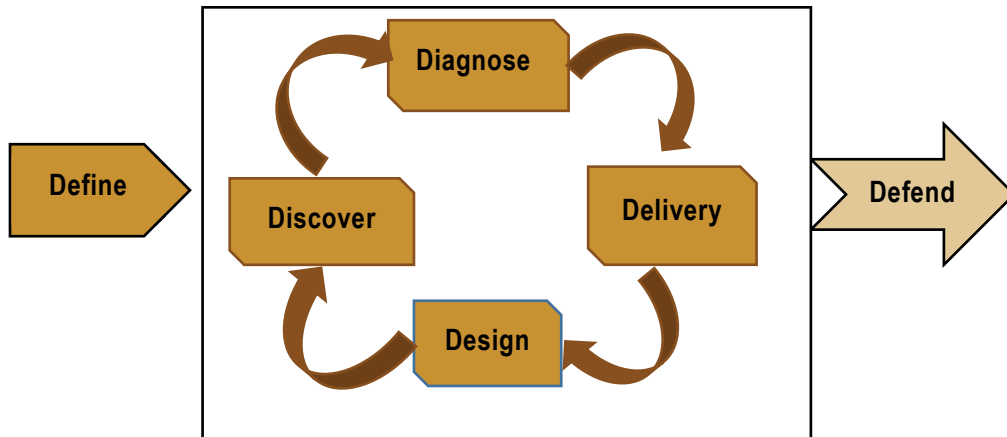
Reviewing and reporting on the financials submitted by the target company.

Assessing the business first hand by a site visit (if applicable).

Working through the due diligence process with the acquisition company or investor by defining the key areas.

Helping prepare an offer based on completion of due diligence.

Discovering the correct strategy is always challenging, and even more so during challenging economic circumstances. Each situation is unique. The variables are numerous, including factors such as company age, markets, geography, price levels, competitive dynamics, to name but a few. But when a company and its products are turned to match market needs and expectations—that is, the decision makers and influencers involved in purchase decision—exceptional changes in performance can occur. However, comprehensive model that describes this approach to the work is illustrated in the figure below:



5. HOW TO CONDUCT DUE DILIGENCE

-  Start with an open mind. Do not assume that anything wrong will be found and look for it. What needs to be done is to identify trouble spots and ask for explanations.
-  Get the best team of people. If you do not have a group of people inside your firm that can do the task (e.g. lack of staff, lack of people who know the new business because you are acquiring a business in an unrelated area, etc.), there are due diligence experts that you can hire. When hiring such professionals, look for their experience record in the industry.
-  Get help in all areas like finance, tax accounting, legal, marketing, technology, and any others relevant to the assignment so that you get a 360-degree view of the acquisition candidate.
-  Talk to customers, suppliers, business partners, and employees are great resources.
-  Take a risk management approach. So, while you want to do your research, you also want to make sure that you do not antagonise the team of people of the target company by bogging them down with loads of questions.
-  Prepare a comprehensive report detailing the compliances and substantive risks/issues.



6. CONTENTS OF A DUE DILIGENCE REPORT

The contents of a due diligence report will always vary with individual circumstances. Following headings are illustrative:

Example of Headings of a Due Diligence Report	
◆	Executive Summary
◆	Introduction
◆	Background of Target company
◆	Objective of due diligence
◆	Terms of reference and scope of verification
◆	Brief history of the company
◆	Share holding pattern
◆	Observations on the review
◆	Assessment of management structure
◆	Assessment of financial liabilities
◆	Assessment of valuation of assets
◆	Comments on properties, terms of leases, lien and encumbrances.
◆	Assessment of operating results
◆	Assessment of taxation and statutory liabilities
◆	Assessment of possible liabilities on account of litigation and legal proceedings against the company
◆	Assessment of net worth
◆	Interlocking investments and financial obligations with group / associates companies, amounts receivables subject to litigation, any other likely liability which is not provided for in the books of account
◆	SWOT Analysis
◆	Comments on future projections
◆	Status of charges, liens, mortgages, assets and properties of the company
◆	Suggestion on ways and means including affidavits, indemnities, to be executed to cover

unforeseen and undetected contingent liabilities

- ◆ Suggestions on various aspects to be taken care of before and after the proposed merger/acquisition.

7. INVESTIGATION



The term investigation implies a systematic and in-depth examination or inquiry to establish a fact or to evaluate a specific situation. In other words, investigation means inquiry into facts". Professional accountants are often required to investigate the accounts or the related matters and records of the enterprise.

The term investigation may be defined as an examination of books and records preliminary to financing or for any other specified purpose, sometimes differing in scope from the ordinary audit. Thus, investigation covers areas of financing decisions, investment decisions, fraud or profitability determination or cost determination etc.

7.1 Audit versus Investigation

Investigation differs substantially from an audit assignment. Audit aims at collection of sufficient appropriate audit evidence to enable the auditor to form a judgement and express an opinion on the financial statements or other data under examination. An investigation, on the other hand, requires special in-depth examination of the particular records or transaction with the objective of establishing a part or happening or assessing a particular situation. The scope of audit is broad based and general in nature whereas investigation is narrow and specific.

The difference is tabulated below:

Basis of Difference	Investigation	Audit
(i) Objective	An investigation aims at establishing a fact or a happening or at assessing a particular situation.	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.
(ii) Scope	The scope of investigation may be governed by statute or it may be non- statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.

(iii) Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either quarterly, half-yearly or yearly.
(iv) Nature	Requires a detailed study and examination of facts and figures. Investigation is voluntary in nature.	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion. It is mandatory for companies.
(v) Inherent Limitations	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent limitation.
(vi) Evidence	It seeks conclusive evidence.	Audit is mainly concerned with prima- facie evidence.
(vii) Observance of Accounting Principles	It is analytical in nature and requires a thorough mind, capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements.
(viii) Appointing Agency	Even third party can appoint Investigator	Auditor is appointed by owner/ shareholders of company/ enterprise
(ix) Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

The approach to an investigation is different from that followed in an audit. An investigation involves a more detailed examination of the selected areas than what is required in an audit. An investigation seeks substantive and, in some case, even conclusive evidence as compared to audit which mainly relies on persuasive evidence.

An investigator does not accept a stated fact as correct until it is substantiated. An auditor, in the absence of suspicious circumstances, relies on stated facts or figures. An auditor has to see whether the method of valuation and other accounting policies have been properly made in the financial statements or not. An investigator, however, is not bound by accounting conventions, policies and disclosure requirements. An auditor does not suspect unless circumstances are there to arouse suspicion, while an investigator approaches the work with a frame of mind to suspect, verify and satisfy.

The auditor seeks to report what he finds in the normal course of examination of the accounts adopting generally followed techniques unless circumstances call for a special probe: fraud, error, irregularity, whatever comes to the auditor's notice in the usual course of checking, are all looked into in depth and sometimes investigation results from the prima facie findings of the auditor.

8. STEPS IN INVESTIGATION

As investigation involves a variety of situations, it is not possible to lay down any standardised procedure. However, usually, an investigation requires the following steps in order of sequence:

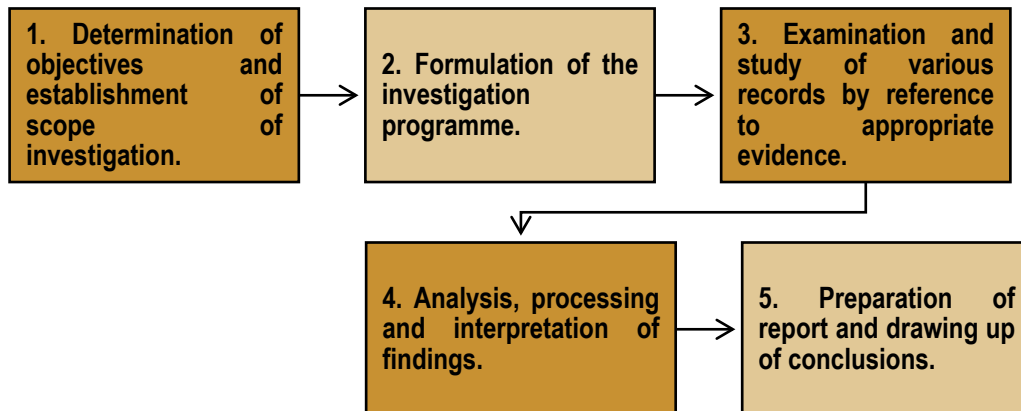


Diagram showing Sequence of Steps for Investigation

Step 1: Determination of objectives and establishment of scope of investigation

At the stage of acceptance of the assignment, the investigator should be absolutely clear about what is sought to be achieved by the investigation. If instructions from the client leave matters vague and non-specific, it would be proper for the investigator to have the matters discussed and obtain clearly written instructions covering the object, the scope and purpose of investigations and the issues incidental thereto.

The period to be covered under investigation should be clearly specified. The results of investigation are often seriously affected owing to change in circumstances which have occurred since it was contemplated, e.g., devaluation, import restrictions, starting of a new division, etc. Therefore, the purpose of the investigation should be borne in mind while determining the period which an investigation should cover.

Step 2: Formulation of the investigation programme

It is not possible to draw up one programme to serve different types of investigations which a professional accountant is called upon to carry out, for their scope and content have to be determined on a consideration of circumstances peculiar to each business or situation. The investigation programme should be drawn up having regard to:

- (a) The nature of the business
- (b) The structure of business organization
- (c) The instructions from the client embodying the objectives and scope of work
- (d) The consequent scope and depth of investigation
- (e) The necessity to extend the investigation into books and records belonging to others.
- (f) The investigator should concentrate on areas considered relevant rather than to undertake a wide-ranging verification.

The programme should also be flexible so that knowledge gained with the progress of work can be used to extend, reduce or modify the extent and areas of checking.



11. In case of an investigation on suspected payment of wages to ghost workers, the investigator should scan the areas having a bearing on the determination of wages and payments thereof. He should concentrate on time and job cards, appointment and termination of workers, attendance records, internal controls, internal checks, and preparation of wage sheets, withdrawal of money from bank for payment of wages and the actual disbursement of wages.

A conscious effort in investigation programming should be devoted to localise the enquiry into the relevant areas and, for that purpose, the initial wider base of inquiry should be gradually narrowed and fixed at a level that is meaningful. Matters not found to have a bearing on the subject matter of investigation should be gradually and progressively eliminated. This procedure alone will enable an in-depth examination of the matters relevant to the investigation.

Step 3: Collection of Evidence

Through examination, the investigator would be gathering relevant evidence connected with the matters to be investigated. In the course of examination of the documents and records, the investigator may require to obtain oral explanations from various personnel of the concerned business. In case his client is a person external to the business, it may be necessary for the

investigator to get the matter formally agreed to by the business through the client. The investigator should look for the most convincing evidence; he should seek and examine all the available evidence and by a process of elimination and corroboration, should endeavour to reach at the truth of the matter. He, unlike the auditor, is not to restrict himself to *prima facie* evidence ordinarily available. He should examine it and if circumstances demand should try to obtain evidence that may have to be specifically procured. The investigating accountant can take help of external experts/ persons like, related parties outside the organization, valuation experts etc. to obtain specific evidence. Further, the work of investigating accountant should ensure that the process of obtaining evidence does not interfere with the regular work of client.



12. In the matter of valuation of land, he should definitely have regard to the available evidence as per records of the business and records of any bid received for the land. In addition, he should have regard to the prices at which land was sold or purchased in the neighbourhood around the same time. This may require him to obtain evidence even by going to the land registration office. He may also call for the report of experts in land valuation.

Step 4: Analysis and Interpretation of Findings

Careful analysis and correlation of facts and figures will be necessary before the investigator can reach his conclusion. The conclusion should be well reasoned, backed by established facts and evidenced by proper records/ data. He must analyse the data objectively on the basis of evidence gathered by him and should not draw conclusions according to pre-conceived notions. While interpreting the figures, the investigator must keep in mind various factors e.g. the political and economic considerations, competition faced by the business, historical pattern of the data, nature of the business, etc. The interpretation should be brief, clear and free from doubts.

Step 5: Reporting of findings

Like all other work of an accountant, an investigation results in a report. It is submitted and addressed to the party at whose instance the investigation has been carried out. The nature of the report is governed mainly by two factors –

- (a) The instructions given by the client as regards the special aspects of the business which are required to be investigated;
- (b) The findings of the investigating accountant/ investigator.

The important issues to be kept in mind by the investigator while preparing his report are as follows:

(i)	The report should not contain anything which is not relevant either to highlight the nature of the investigation or the final outcome thereof.
(ii)	Every word or expression used should be properly considered so that the possibility of arriving at a different meaning or interpretation other than the one intended by the investigator can be minimized.
(iii)	Relevant facts and conclusions should be properly linked with evidence.
(iv)	Bases and assumptions made should be explicitly stated. Reasonableness of the bases and assumptions made should be well examined and care should be taken to see that none of the bases and assumptions can be considered to be in conflict with the objective of the investigation. For example, in an investigation into over-stocking of raw materials, inventories and spares etc. it should not be assumed that the ordering levels indicated on bin cards provide fair guidance about acquisition of further materials. Also, since investigation is a fact-finding assignment, assumptions should be made only when it is unavoidably necessary.
(v)	The report should clearly spell out the nature and objective of the assignment accepted its scope and limitations, if any.
(vi)	The report should be made in paragraph form with headings for the paragraphs. Any detailed data and figures supporting any finding may be given in Annexures.
(vii)	The report should also state restrictions or limitations, if any, imposed on the instructions given by the client. Preferably the reasons for placing such restrictions and their impact on the final result should also be stated.
(viii)	The opinion of the investigator should appear in the final paragraph of the report.

Due to non-availability of standardised procedure and lack of professional guidance, investigation calls for extreme care, caution and circumspection on the part of the investigator in exercising his judgement and discretion. Investigation often has a characteristic of very intimate and direct involvement of parties whose interest may be affected. Therefore, unlike auditing, chances of one or the other of the parties challenging the finding of the investigation are far greater.



9. SPECIAL ISSUES IN INVESTIGATIONS

Investigations broadly range between two extremes; on the one hand there are those in respect of which complete accounts, documents, records and other information are available, and on the other, those in respect of which little information, besides published accounts and statistical data, is available. Then again, investigation may cover the whole of accounting or may relate to only a part or parts of accounting as may be specified. Some more issues often arise in investigation. They are stated below:

- (a) **Whether an investigator is required to undertake a cent per cent verification approach or whether he can adopt selective verification** - The answer to this question depends on the exact circumstances of the case under investigation. If the investigator has to establish the amount of cash defalcated by the cashier, he has probably no option but to carefully examine all the cash vouchers and related records. On the other hand, if he is to arrive at the profitability of a concern, he may verify constituent transactions on a selective basis taking extreme care to see that no material transaction that affects profit has remained concealed from his eyes. In investigation, it is always safer to go by statistically recognised sampling methods than to depend on the so-called “test checks” where circumstances permit selective verification.
- (b) **Whether the investigator can put reliance on the already audited statement of account**- Here also no dogmatic views are possible. If the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh.

It was held in the case of *Short & Compton v. Brackert* (1904) that an accountant, when making an investigation for an incoming partner, was entitled to assume that the figures appearing in the books were correct.

In another case, *Mead v. Ball Baker & Co.* (1911), it was held that an accountant, when acting as an adviser to a proposed investor in a limited company, was not expected to check errors in stock sheets and the omission of liabilities.

These cases were decided long time ago. Therefore, much reliance cannot be placed on them. It is, therefore, desirable for the investigator to ascertain from the client, in advance, in writing, whether the audited statements of account produced to him should be taken as correct.

If the statements of account produced before the investigator were not audited by a qualified accountant, then of course there arises a natural duty to get the figures in the accounts properly checked and verified. However, when the accounts produced to the investigator have been specially prepared by a professional accountant, who knows or ought to have known that these were prepared for purposes of the investigation, he could accept them as correct relying on the principle of liability to third parties settled in the famous Hedley Byrne's case. Nevertheless, it would be prudent to see first that such accounts were prepared with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared.

- (c) **Whether an investigator necessarily requires assistance of expert** - Often an investigator may feel the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation. It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation and he should settle the question of costs for obtaining the views and other related implications.
- (d) **Investigation out of disputes and conflicting claims** - Cases for investigation sometimes arise out of disputes and conflicting claims. It is needless to emphasise that the investigator should remain above disputes or conflicting claims and be alert to the possibilities of the information or documents made available to him to be prejudiced. Even the client, overtly or covertly, may try to influence his reports. A seller of a business or controlling shares may request him to see that he gets the most favourable price. Similarly, if he is appointed by the buyer, he may be requested to deliberately depress the value. The investigator should keep him scrupulously professional and should keep the interest of all the involved parties in view. This is a challenging task and probably no other professional work offers this much of challenge. This work is exciting too and requires not only the best of skill but of a high degree of maturity and experience.
- (e) **Basis of opinion of an investor** - The investigator should refrain from issuing speculative opinion. He should confine his opinion to the established facts and nothing more. If the facts, as conveyed through the books, records, papers and other evidence, are not capable of being properly established, he should not express an opinion or, if at all he expresses any opinion,

he should qualify the opinion by clearly stating the reasons therefor. This problem may particularly arise in cases where incomplete books and records are produced for investigation.

- (f) **Whether an investigator can make futuristic statements – Even if the appointing authority is willing to obtain a futuristic statement**, the investigator should refuse to be futuristic. He may assume that the established trend in the business will continue in the near future, in the absence of any contrary evidence, in arriving at the present value of a business. He, however, should not project the trend into any future years to establish a value.
- (g) **Whether to retain working papers or not** - Another important precaution is that the investigating accountant should retain in his files full notes of the work carried out, copies of schedules and all working papers, annexures, facts, figures, record of conversations and the like. Also, the working papers should link up the figures as shown by the books of business with the final figures produced by the investigating accountant. Wherever required the investigator should take representation letter from the appointing authority. In the absence thereof, he would not be able to explain the figures when he is called upon to give evidence in a court of law to support his figures; for quite often the conclusions of the accountant are challenged by parties whose interest is adversely affected by his findings, for example, when the value of shares of a company taken over by the Government has been determined by him. This will also be of immense help to the investigator in correlating facts and events and later in drafting the report.

10. SPECIAL ASPECTS IN CONNECTION WITH BUSINESS INVESTIGATIONS

We discuss below the factors to be considered by a professional accountant while carrying out the investigation for attaining satisfactory results:

- (a) **Studying the overall picture** - In such a business investigation, it is of utmost importance first to have an overall picture of the position of the business which is being investigated before the details are gone into. This is because figures are only symbols; and it is impossible to interpret them intelligently without knowledge of the background in which they have emerged.



13. For investigating the accounts of a group of companies, it would not be possible to know the manner in which the profits had emerged in the past unless a chart is prepared, showing the relationship of different companies comprising the group; whether as subsidiaries or not, the nature of transactions entered into by one unit in the group

with another or others and the terms on which this has been done. Further, it is important to know whether the business is engaged in the manufacture of one or two important lines of products, is principally processing materials or is concerned only with the sale of a single product. Also, whether it is a business which depends for its success on imported raw materials or supply of parts and components from ancillary businesses or uses indigenous materials and parts which are manufactured locally.



14. If the business is labour - intensive, its future profitability would be dependent on availability of skilled labour and relations of the management with the trade unions. Labour relations thus can affect the future profitability of the business. The method of distribution of products, either through wholesalers or retailers also must be examined. Apart from these preliminary enquiries, the investigating accountant should study:

- (i) the character of management;
- (ii) the economic and political forces to which the business is subject; and
- (iii) the position it enjoys in the market as against its competitors.

At times, political or economic factors also may affect the fortunes of a business; for example, labour disturbances, changes in government policies in the matter of levy of excise and custom duties, imports, etc. It is, therefore necessary that the impact of all these factors should be studied and their effect on the business judged on a consideration of the profits in the past. For studying the economic and financial position of the business, the following should be considered:

- (i) The adequacy or otherwise of fixed and working capital. Are these sufficient for the growth of the business?
 - (ii) What will be the trend of the sales and profits in the future? Establishing the trend of sales, product-wise and area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in the future.
 - (iii) Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?
 - (iv) Whether the business is operating at its 100 percent capacity or improvements can be made to reach at full productivity?
- (b) **Statement of Profit and Loss** - To study the Statement of Profit and Loss of a concern, it is necessary to consider each item, included therein, in relation to the corresponding items in the

Statement of Profit and Loss of the previous years. It is therefore, necessary that a summary, in a columnar form, should be prepared of the balances included in the Statement of Profit and Loss of the business for a period, say of 5 to 7 years.

In the foregoing summary, in the place of figures of opening and closing inventories, the figures of inventory consumed, for each product, in different years should be entered. It should also be verified that the inventories have been valued on a consistent basis throughout the period under review. If there has been a change, the values of inventories should be adjusted. Further, in the summary, the gross profit ratios and the ratios showing the relationship between various items of expenses and sales should be entered. The trend of these ratios should be examined and, if there is a wide divergence in them, an explanation for the same should be sought. In the preparation of the summary attention should also be paid to the following matters:

Turnover - The figures of sales should be broken down between the various products sold to show variations in turnover of individual products from year to year. In this way, it would be possible to find out the products the sales of which have been increasing and those the sales of which have been falling.

By reference to the list of customers, in the Order Books, it should be ascertained whether the business has a very large turnover with a few customers or a small turnover with several customers.

The Order Books should also be examined to find out if fictitious sales have been entered in any year to boost up profits. If so, the figures of sales of the year or years should be adjusted.

If the business consists of activities which are dissimilar in operation, like manufacturing and agency, then apart from splitting the income between the two sources, expenses should also be apportioned between them to separately arrive at the figures of profit from each of the activities.

Wage structure - The method of computing wages and the rates of wages should be examined. On occasions a business may have to pay higher wages than those prevailing in other business in the same neighborhood in pursuance of an industrial award. Another factor which is important to consider in this connection is the relationship of the business with its workers/ labour unions. A business which has suffered several industrial disputes, strikes, etc. and has had its working interrupted by them frequently cannot be expected to prosper unless a proper settlement is reached with workers' unions.

Depreciation and Maintenance - The charge on account of depreciation and maintenance of machinery and other assets included in the accounts of different years should be compared to verify that depreciation has been provided from year to year on a consistent basis and that it is adequate. Also, the necessary adjustment in the depreciation charge should be made if it is the practice of the company to write off the assets on a renewal basis.

Further, if assets have been revalued, it should be confirmed that depreciation on the increased valuation has been adjusted. Generally, with age, the cost of maintenance of assets should increase. If it has not, the reason thereof should be ascertained.

In case of leasehold property, it should be ascertained whether an adequate provision has been made for the dilapidation charge which may be payable at the end of the lease.

Further, compliance of relevant AS should also be verified.

Managerial Remuneration - It should be verified that the remuneration payable to various members of managerial personnel is not excessive in relation to the profits of the business after taking into account the time devoted by each of them. However, it could also be that no or only a nominal remuneration has been charged in the accounts. In either case, an adjustment should be made to arrive at true profitability of the concern. Further, in case of company, requirement of relevant section of Companies Act, 2013 is to be seen. It has to be assured that calculation of profit for arriving at the remuneration is correct.

Exceptional and non-recurring items - It is customary to adjust exceptional items in the summary of Statement of Profit and Loss in order that they may not obscure the trend of the profits. In the matter of non-recurring items, it is necessary to remember that adjustments are to be made in respect of exceptional items which do not recur from year to year or can be considered exceptional having regard to their materiality or periodicity.

In this connection, it is worthwhile to examine the income tax assessment orders of the business to find out the items which have been treated as revenue but have been considered inadmissible by the taxing authority. Where the effect of these has been abnormal on the tax paid by the company from year to year, suitable adjustments should be made in the figures of taxes paid, as well as in the assets amounts. Likewise, adjustments should be made in respect of exceptional profits and losses like, profit or loss on sale of obsolete asset.

Repairs and maintenance - It is one of the recurring expenses of a business. Occasionally it is noticed that this expenditure is unduly heavy in some of the years, while quite low in some others. Generally, companies, as a matter of routine undertake major repairs, overhauls and maintenance programme at an interval of 3 or 4 years while running repairs and maintenance continue in the usual manner which gives rise to fluctuating charges in the accounts unless periodic major expenses are treated as deferred expenditure.

Besides, due to wrong allocation of expenses between capital and revenue, repair charges may appear to be heavy or low. If fluctuating and abnormal charges for repairs is noticed, it would be the duty of the investigating accountant to scrutinise this head thoroughly to establish correct and normal charge for repairs.

Unusual year - A company's record of profitability may show a trend of increasing or decreasing profit or loss or it may be highly erratic and fluctuating. Where a definite trend is discernible, the job of the investigating accountant is somewhat simplified. He can adopt recent years' record of profitability as the basis for estimating future maintainable profit having regard to the inflationary state in the economy. But if the same is fluctuating, there would be more demand on judgement of the accountant in selecting the period to be covered for estimation of profitability. In such cases it may even be necessary to take into consideration results of past 9 to 10 years with a view to iron out the fluctuation. If, however, it is noticed that results of one or more years under scrutiny were materially vitiated by exceptional factors like a long-term industrial dispute, natural calamities, pandemic, fire, war, ravage etc., the investigating accountant should eliminate such year / years from consideration altogether since they do not reflect the results obtained through normal business.

(c) Balance Sheet - Fixed Assets - Fixed assets, usually, are shown in accounts at cost less depreciation but the accounts do not show the ages of different assets. It is desirable, therefore, to obtain age analysis of various items of fixed assets. Assets which are old or are obsolete would naturally have to be replaced. It should be seen that their values are not in excess of the value of service that they could be expected to render to the business during the balance period of their active life and the amount they would fetch on sale as scrap. Title deeds should be verified to ascertain the extent of enterprise's ownership in such assets, like land and building jointly owned by two or more companies or their subsidiaries.

In addition, from a study of the maintenance expenses incurred from year to year, it should be judged whether the assets have been properly maintained. If not, it might be necessary to incur heavy expenditure on repairs to put them in a proper working order. In such a case, an allowance for this factor should be made in the value of assets. More particularly, it should be seen that if assets have been revalued, the increased depreciation charge has been adjusted against profit. Further, investigator has to assure whether assets whose recoverable amount is less than carrying amount are impaired and requirement of AS 28, "Impairment of Asset", has been complied.

Investments - Investments should be broadly classified into long term investments and current investments. A current investment is by its nature readily realisable and is intended to be held for not more than one year. All other investments are long term investments.

Current investments are valued on the basis of lower of cost and fair value determined either on an individual investment basis or by category of investment but not on an overall basis.

Long-term investments are usually carried at cost. However, when there is a permanent decline in the value of long-term investments, the carrying amount should be reduced to recognise the decline. The carrying amount of long-term investments is determined on an individual investment basis.

Interest, dividends and rentals receivable in connection with investment are generally regarded as income. However, in some cases, such receipts represent recovery of cost and should therefore be reduced from, the cost of investment (e.g. dividend out of pre-acquisition profits).

Inventories - It should be seen that inventories have been valued consistently and that the basis of valuation was such that the value placed on inventories did not include any element of profit. Also, there should be due allowance for damaged, obsolete and slow-moving inventories. In some cases, physical verification of inventories is necessary where the inventories belonging to the entity are held by other parties. Examine the appropriateness of valuation of work in progress as disclosed in the books.

Trade Receivables - In assessing their value, the following should be taken into account:

- (i) Whether provision for bad debts have been made in the years in which the relevant sales took place instead of in the year in which they have been written off, except when debts have had to be written off on account of a slump or a fall in international prices, during a period subsequent to the period in which sales had taken place.
- (ii) The length of the credit period allowed or any excessive discounts allowed throughout the period under investigation, to determine whether it has been necessary to increase continually the credit period in order to affect the sales. If it has been so, it would indicate that the demand for the goods manufactured by the concern in the market has been diminishing gradually.
- (iii) Debts should be classified according to their age. This would disclose the character of the parties with whom the company trades and the amount of working capital that will be necessarily blocked on this account in the course of business. Determine Debtors to Sales Ratio.

Other liquid assets - It should be ascertained that the assets so described are readily realisable. Money with a bank in liquidation should be taken only to the extent guaranteed by Deposit Insurance Scheme.

Idle assets -On a scrutiny, it may appear that certain assets are remaining idle and are not being properly applied in the business. These may come from all sections of assets. For example, certain plant and machinery may have been put to use after a considerable period of time after acquisition. Some of the fixed assets may be awaiting installation even at the valuation time. The company may hold large cash and bank balances, not warranted by the need of the business. Then again, there may be instances of obsolete and slow-moving inventories of large value in the accounts of the

company. It would be the duty of the investigating accountant to eliminate these idle assets, if any, after proper identification from the net worth of the business. However, proper value of these assets may be separately added to the value of the business.

Liabilities - The important matter to investigate in this regard is whether those are stated fully or understated or overstated. In other words, whether the profits of the business have been inflated by suppression of liabilities or there are any free reserves included in the liabilities. In either case, an adjustment would be necessary. Secondly, it should be ascertained that liabilities are not unduly large or are not outstanding for a long time, in such cases, it would be necessary to pay off some of them which would cause a drain on the liquid resources of the concern. The fact should be stated in the report.

Taxation - Orders in respect of assessments completed should be studied and it should be verified that an adequate provision has been made in respect of liabilities for taxes which have not been assessed. Also, it should be seen that in the past there has been no reopening of assessments. If so, the company may be liable for an undisclosed sum of taxes plus penalties. Any temporary tax benefit should also be disregarded.

Capital - In this regard, it is necessary to ascertain:

- (i) Whether the capital is well balanced. This would not be the case if the number of debentures and preference share capital are disproportionately large as compared to the equity capital. Low equity capital would handicap the company in raising further equity capital, on favourable terms for financing the business or to pay off capital commitment. Further, when the capital is highly geared, it would affect the value of the equity capital;
- (ii) That the amount of capital is reasonable compared to the value of fixed assets and the amount of working capital required. The terms associated with the issue of the capital should also be studied; restriction on transferability of shares usually depresses the value of share and of the business.

(d) Interpretation of figures - Fixed Assets - The amount of capital expenditure which would be necessary in the future for the continuation of the business, in its existing stage, should be assessed having regard to the under-mentioned factors:

- (i) the amount required for the replacement of assets when these would become worn out or obsolete;

- (ii) the expenditure which will be necessary to replace obsolete machinery by more sophisticated machinery for manufacturing different types of goods for which there is demand.

Turnover - In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

- (i) **Trend:** Whether in the past sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
- (ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- (iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
- (iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

Working Capital - In making assessment of the working capital requirements in the future, the following matters should be taken into account:

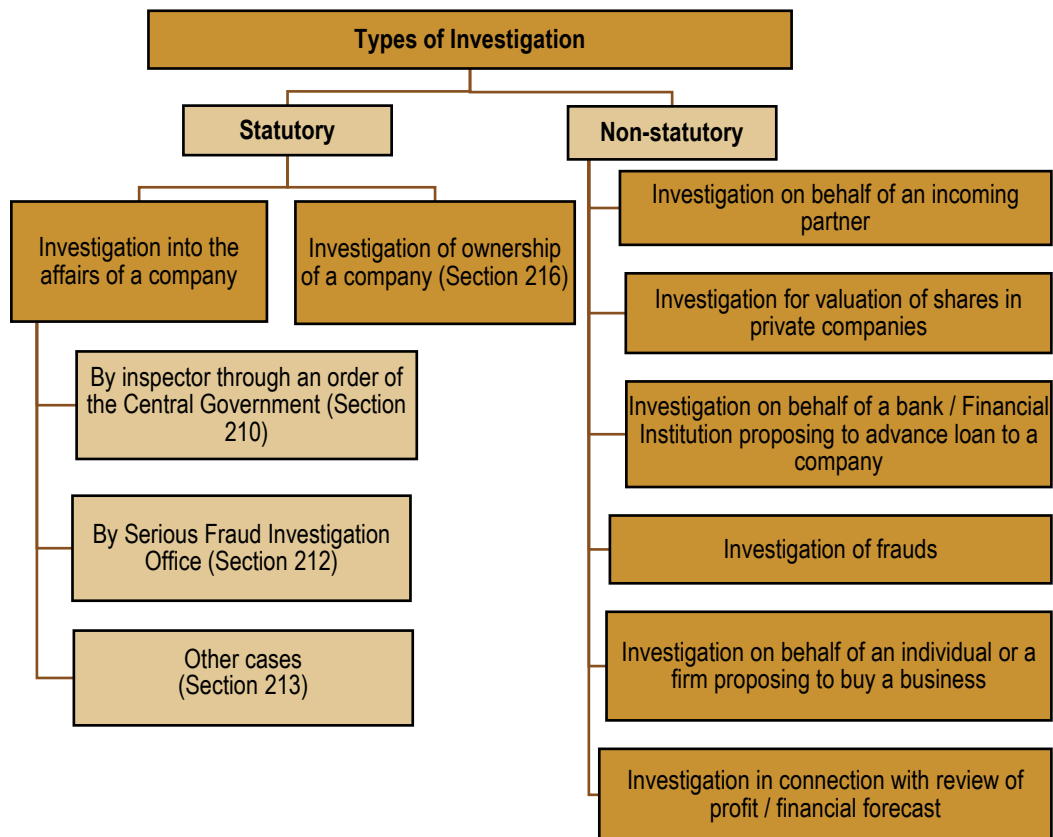
- (i) Has the ratio of inventory to turnover been increasing and if so, is it a continuing or only a temporary trend?
- (ii) Are the trade payables being paid promptly or is there a backlog which will have to be dealt with?
- (iii) What will be the effect on inventory, trade receivables and trade payables, if the turnover is increased or if new products are introduced?

Estimating Future Maintainable Profits - Fluctuations in profits during the years under review should be examined after adjusting the profits for extraneous factors, if any, that had given rise to fluctuations to determine whether the factors responsible for the fluctuations were temporary or was likely to recur in future. A statement should be prepared showing separately the profits after depreciation earned in each of the years during the period under review, after making adjustments therein, if considered necessary, as regards factors which have been responsible for any

extraordinary increase in profits. If the percentage of profits before taxation to capital has been stable or has been increasing, it would indicate that the business would continue to earn the same rate of profit as it has done in the past. If, on the other hand, the percentage has been falling, and there is no evidence that the factors responsible therefore have ceased to operate, investment of further capital in the business would not be commercially advisable.

11. TYPES OF INVESTIGATION

The different types of investigation that a chartered accountant is usually called upon to carry out are given hereunder:



Statutory - By an inspector under Sections 210, 212, 213 and 216 of the Companies Act, 2013 – discussed in details in Self-Paced Module Set A.

Non-statutory - These are listed as under:

(a)	Investigation on behalf of an incoming partner.
(b)	Investigation for valuation of shares in private companies.
(c)	Investigation on behalf of a bank proposing to advance loan to a company.
(d)	Investigation of frauds.
(e)	Investigation on behalf of an individual or a firm proposing to buy a business.
(f)	Investigation in connection with review of profit/financial forecast.

11.1 Investigation on behalf of an Incoming Partner

The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service.

Primarily, an incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital contribution, personal capability of the existing partners, socio-economic setting, etc., and whether he would be capable of deriving continuing benefit by the way of return on capital to be contributed and remuneration for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully.

Broadly, the steps involved are the following:

(a)	Ascertainment of the history of the inception and growth of the firm.
(b)	Study of the provisions of the deed of partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.
(c)	Scrutiny of the record of profitability of the firm's business over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits. Particular attention should, however, be paid to the nature of partners' remuneration, which may be excessive or inadequate in relation to the nature and profitability of the business, qualification and expertise of the partners and such other factors as may be relevant.
(d)	Examination of the asset and liability position to determine the tangible asset backing for the partner's investment, appraisal of the value of intangibles like goodwill, know how,

	patents, etc. impending liabilities including contingent liabilities and those pending for tax assessment. In case of firms rendering services, the question of tangible asset backing usually is not important, provided the firm's profit record, business coverage and standing of the partners are of the acceptable order.
(e)	Position of orders at hand and the range and quality of clientele should be thoroughly examined, which the firm is presently operating.
(f)	Position and terms of loan finance would call for careful scrutiny to assess its usefulness and implication for the overall financial position; reason for its absence or negative impact should be studied.
(g)	It would be interesting to study the composition and quality of key personnel employed by the firm and any likelihood of their leaving the organisation in the near future.
(h)	Various important contractual and legal obligations should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. Full impact of such standing agreements would be gauged before a final decision is reached.
(i)	Reasons for the offer of admission to a new partner should be ascertained and it should be determined whether the same synchronises with the retirement of any senior partner whose association may have had considerable bearing on the firm's success.
(j)	Appraisal of the record of capital employed and the rate of return. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organisation structure, if any, envisaged along with the admission of the partner.
(k)	It would be useful to have a firsthand knowledge about the specialisation, if any, attained by the firm in any of its activities.
(l)	Manner of computation of goodwill on admission as also on retirement, if any, should be ascertained.
(m)	Whether any special clause exists in the deed of partnership to allow admission in future of a new partner, who may be specified, on concessional terms.
(n)	Whether the incomplete contracts which will be transferred to the reconstituted firm will be a liability or a loss.

It would always be worthwhile to remember that, in a partnership, personal considerations count predominantly over other considerations and assessment of standing of the firm, standing and reliability of other partners, their personal reputation and the goodwill enjoyed by the products/services of the firm are important.

On the basis of the broad frame of considerations as given above, the investigating accountant should devise his own considerations in each case which may be quite diverse. Additional considerations may come up in the case of service-rendering firms where profit and business record, goodwill of the firm and of individual partners would assume greater significance.

Again, in the case of industrial firms, the network of customers, their scatter, size, etc., would be relevant for consideration.

11.2 Investigation for Valuation of Shares in Private Companies

The importance should be given on various purposes for which such a valuation is necessary, the different bases on which valuation is possible and the variety of economic factors, on a consideration whereof the price so determined needs to be adjusted.

The necessity for valuation of shares of a private company arises, for under the Companies Act, a private company must restrict the transfer of its shares. In consequence, the shares of a private company do not have a free market in which their prices could be determined by interaction of the forces of supply and demand.

In respect of equity shares, there are two main methods of valuation. According to the *first* method, value is determined on the basis of net worth of the company. The amount of net worth is divided by the number of shares comprising the equity capital to arrive at the value for one share. When this method is followed, goodwill of the business, and non-trading assets (like investments) based on the estimated future maintainable profit, is included among the assets to arrive at the amount of net worth. According to the *second* method, the average profit earned by the business during the preceding 5 to 7 years is computed. Afterwards, on the assumption that the same would continue to be earned in the future, the value of business is calculated by capitalising it at a reasonable rate of interest. If the rate assumed is high, the value of the business would be smaller. Correspondingly, it would be high if the rate of interest applied is low. A provision of the risk factor and restriction on transfers in the value of shares is made by varying the rate of interest applied. The rate of return that an investor expects to earn in a business of the type in which the company is engaged, is ascertained from the prices of the shares of companies engaged in a similar business quoted on the stock exchange.

The value of preference shares is estimated on the basis of the yield on preference shares of companies engaged in a similar trade or industry after making allowance for factors like restriction on transferability, average rate of earnings as compared to the rate of dividend, etc.

Special features -

Net worth basis

- (a) Each asset should be revalued on taking into account its utility to the business as a going concern. The value of different assets, on a revaluation, may be either more or less in comparison to their book values.



16. The book value of safes and furniture in the case of a bank is usually much less as compared to their utility. On the other hand, the book value of intangible assets, e.g., leasehold rights, patents, goodwill, etc., in case of an industrial concern may be higher in comparison with the advantage which accrues to it from these assets. In both the cases, the assets should be revalued at their replacement cost i.e., the cost of similar assets at the prevailing market price, reduced by the amount of depreciation which they would have suffered, if they were in use during the period that the corresponding assets have been in use. But the cost adopted, in cash, should be the cost of the assets as were originally purchased or that of their substitutes considered more suitable in the circumstances of the case.

- (b) The value of goodwill of a business is primarily dependent on its capacity to earn super-profit and the period over which these are expected to arise. The super profits that the business would earn in the future are estimated on the basis of profits earned in the past, after making an allowance therein for the continuation or otherwise of favourable factors, which in the past had enabled the business to earn super-profits. This is usually a difficult matter since, for the purpose, it is necessary to analyse the trend of economic, social and political forces which have an impact on the profitability of the business.



17. The installed capacity must be viewed against future national requirements on taking into account the government's licensing policy. Again, government policies like controls over selling price or advantages of marketing through its own organisations will have to be considered since any change therein might seriously affect the profit structure. Therefore, to determine the impact of these factors, the accountant must have knowledge of the company's working and experience of the business in general.

Yield basis

- (a) The value of shares on yield basis is arrived at on the basis of present value of the right to receive dividends in the future. Since dividends can be paid only out of profits, in this case

also, it is necessary to determine the amounts of profits which the company would be earning in future as well as the amounts thereof which would be distributed as dividend from year to year. In short, it is an exercise of projecting the trend of profits and predicting the policy that the company might follow in the matter of declaration of dividends.

- (b) The rate at which the amount of dividends should be capitalised is decided on taking into account the risk that shareholders are taking in the matter of declaration of dividends being continued in future, assessed in the background of past history of the company, the amount of reserves the company possesses, both secret and those disclosed in its books, future prospects of the line of manufacture or trade in which the company is engaged and the impact of various social and political factors that are likely to emerge on the company's profitability. Since the effect of these factors is reflected in the prices at which the shares of companies engaged in similar trades and businesses are quoted on the Stock Exchange, the investigating accountant should consider them. This would help him to know the rate at which their dividends were being capitalised. He should adopt the average rate of return expected by investors in the shares of such companies but it should be applied only after making due allowance for the factors peculiar to the case, such as restrictions on transfer of shares, majority holding, etc. In any valuation of shares, with the transfer of shares control is also to pass, a separate value should be ascertained for the control and added to the value otherwise obtained either on net worth basis or yield basis.

11.3 Investigation on behalf of a Bank/ Financial Institution Proposing to Advance/Loan to a Company

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

(i)	The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.
(ii)	The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more, for repayment of loans, on the annual profits and loss, and on the values of assets mortgaged to them.
(iii)	The financial standing and reputation for business integrity enjoyed by directors and officers of the company.

(iv)	Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
(v)	The history of growth and development of the company and its performance during the past 5 years.
(vi)	How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.
(viii)	Whether any loan application to any other Bank or Financial Institution was made, and if so, the reasons for rejection thereof.

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

- (a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
 - (i) Sales to Average Inventories held.
 - (ii) Sales to Fixed Assets.
 - (iii) Equity to Fixed Assets.
 - (iv) Current Assets to Current Liabilities.
 - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
 - (vi) Equity to Long Term Loans.
 - (vii) Sales to Book Debts.
 - (viii) Return on Capital Employed.
- (c) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

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

- (a) **Fixed assets** - A full description of each asset its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.
- (b) **Inventory** - The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued.

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

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

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

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

(i) debts due in respect of which the period of credit has not expired;

(ii) debts due within six months; and

(iii) debts due but not recovered for over six months.

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

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

11.4 Investigation of Frauds

In the Companies Act, 2013 meaning of fraud has been considered in two specific sections viz. Section 143(10), where the SAs specified by the ICAI are deemed to be the auditing standards for purposes of the Act, which, inter alia, define fraud, and in Section 447, where punishment for fraud has been prescribed.

Fraud has been defined in paragraph 11(a) of SA 240, “The Auditor’s responsibilities Relating to Fraud in an Audit of Financial Statements” as ‘an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.’

In the context of stating the provisions for punishment for fraud, Section 447 of the Act has explained the term ‘fraud’ as “fraud in relation to affairs of a company or any body corporate, includes any act, omission, concealment of fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.”

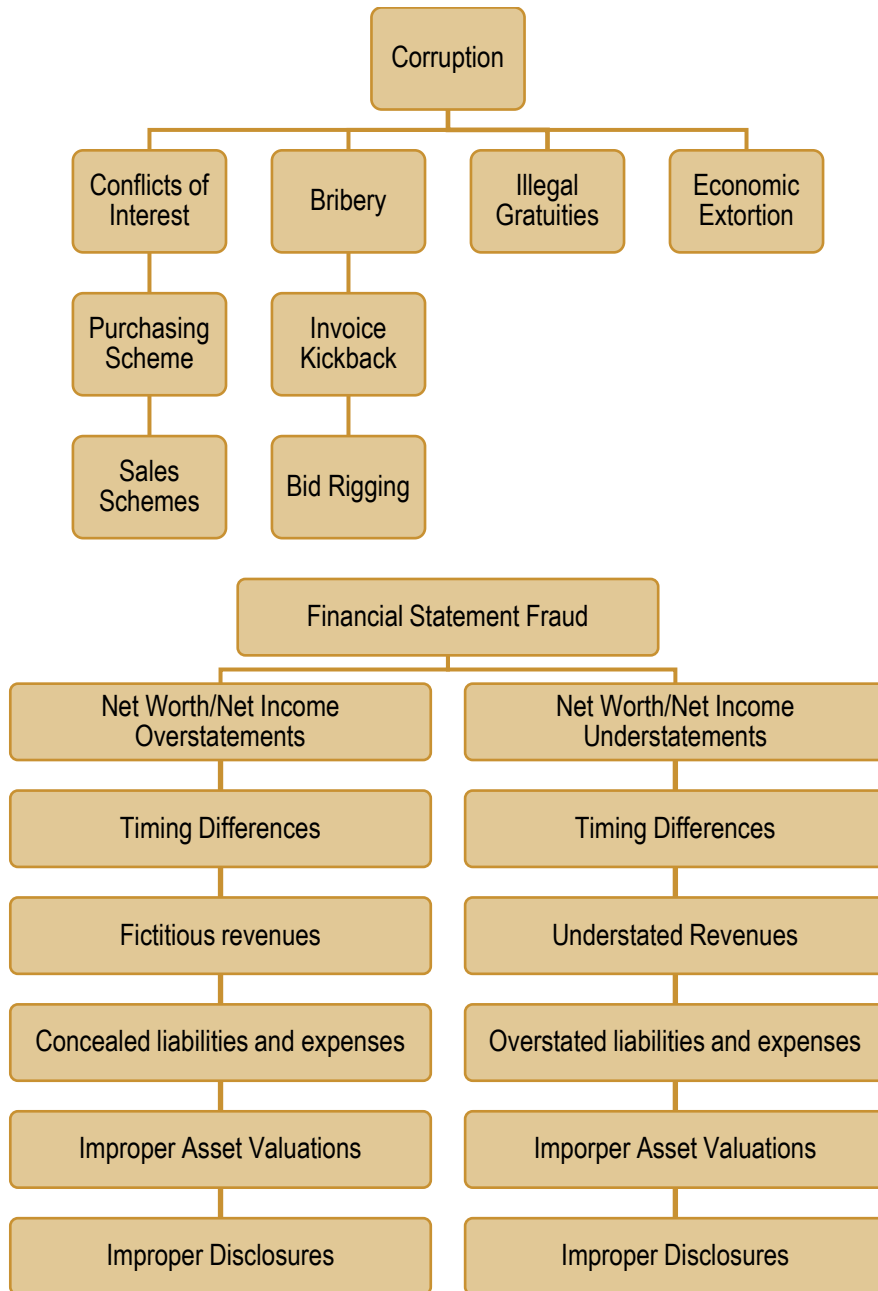
This Section further explains the terms ‘wrongful gain’ and ‘wrongful loss’ to mean the gain by unlawful means of property to which the person gaining is not legally entitled; and the loss by unlawful means of property to which the person losing is legally entitled, respectively.

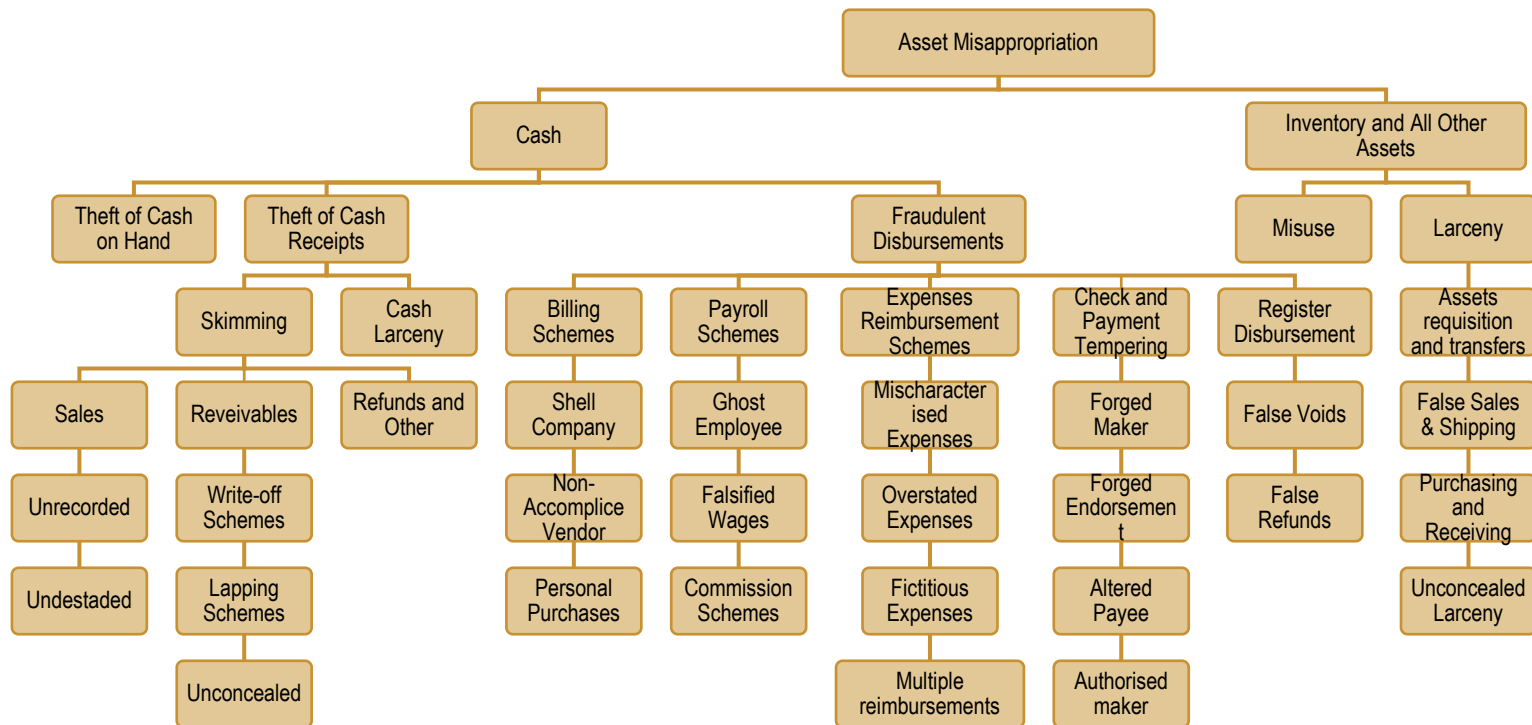
11.4.1. Types of Frauds

Frauds may broadly be categorized as –

Fraudulent Financial Reporting –	Mis-appropriation of Assets –	Corruption
 Alteration or falsification of records & documents  Misrepresentation in or intentional omission of events, transactions or information  Intentional misapplication of accounting principles  Fictitious Journal Entries  Adjusting assumptions and changing Judgments  Omitting, advancing or delaying the recognition of events or transactions.  Abnormal Year End Transactions.  Improper Asset Valuation  Overstatement of Revenue or Understatement of Liabilities	 Embezzlement of receipts in respect of written-off accounts – Skimming or Cash Larceny  Stealing physical assets or intellectual properties  Introduction of fictitious vendors  Payroll Schemes – Ghost Employees, Falsified Wages, & Commission Schemes  Reimbursement Schemes – Mischaracterised Expenses, Multiple Reimbursement, & Fictitious Expenses  Using entities assets for personal use.	 Conflict of Interest  Bribery  Illegal Gratuities  Money Laundering

<u>Fraudulent Entries -</u> • Late entry • No entry • Part entry • Inserting wrong entries to divert attention	<u>Sales Frauds -</u> • Price enhancement • Omission to make receipt of sale of scrap. • Billing and sales reversals in amusement parks. • Food production yield ratio in hotels and suppression of Revenue. • Using or hiring assets of the company in lean period • Omission in preparation of dispatch note for sale • Sale of Assets recorded as Income • Cash sale adjusted as credit sale. • Writing off a good debt as bad & irrecoverable	<u>Collection Frauds –</u> • Defalcation of contributions to charity funds • Crediting donation to loan accounts. • Rental collected in cash but not recorded.	<u>Expenses Frauds –</u> • Entering ineligible discount • Overcharging expenses • Falsification of documents • Untimely payment • Introduction of fictitious vendor. • Unnecessary/ huge provisioning of expenses.
<u>Payroll Frauds –</u> • Extra number of employees • Extra hours • Calculation of net pay by transferring rounding off amount to personal account. • Not deactivating the retired employees' IDs • Fictitious employees/ workers paid salary.	<u>Data Frauds –</u> • Change in computer data • Destroy, suppress or insert records • Using open fields in computerized accounting system		
<u>Technology related Frauds –</u> • Employing hostile Software Programs or malware attacks • Phishing mails • Vishing – Voice Mail • Smishing - Text messages • Whaling – Targeted phishing on high network individuals • Card duplications • Stealing confidential data	<u>Banking related Frauds -</u> • Forged Signatures • Cheque Frauds - Alteration in amounts, Alteration in accounts titles, Kite flying • Cash lending during working hours • Missing notes in bundles • Use of same notes bundles by two branches • Wrong posting in other accounts • Misuse of sensitive stationery • ATM transaction misuse • Using PINs of debit card/credit card holder • Advances - inflated stock statements, inflated projections, forged/duplicate land documents, L/Cs	<u>Others –</u> • Teaming and Lading • Process houses mixing inferior quality material to sale good quality material • Pilferage and theft in super markets • Selling classified information, • Withholding information from customer about free product schemes, discount and concession. • Enhancement of performance • Taking advantage of disaster or natural calamity. • Trust FDs • Fictitious journal entries to inflate expenses or income.	





Source: Occupational Fraud 2022: A Report to the Nations

Frauds may be classified as defalcations involving misappropriation, either of money or that of goods, and manipulation of accounts not involving a defalcation. The detections of manipulations of accounts being one of the objects of an audit, for the detection of frauds perpetrated for misappropriating either money or goods, knowledge of the various circumstances under which these may be committed and that of different forms they take is essential. On this account, a brief description thereof at different level is given below:

1. Fraud for Personal Gains

Bribery: Money, gift or other favours offered to procure (often illegal or dishonest) action or decision in favour of the giver. These are also relatable to contract fraud or procurement fraud and are, generally, out of books transactions. The auditor normally conducts a propriety audit over the veracity of the transactions and review of any undue favours to vendors.

When money, gift or other favours are offered to public official to influence an official act of government then such kind of Bribery is called Official Bribery. In contrast to Commercial Bribery or favours to vendors, in case of Official Bribery, Company usually is criminally prosecuted.

2. Corporate Frauds/ Irregularities

- (i) **Advance Billing:** Advance billing is a situation where the company officials indulge in booking fictitious sales in anticipation of actual sales. This results in misrepresentation of revenue in the books thereby misleading financiers and stakeholders. When the management treats borrowings from money lenders as customer advances in the books against sale orders or for adjusting bills receivables, the fraudulent act gets unnoticed for an extended period. This situation results in a death knell for the corporation as the company is dragged into an irredeemable debt trap.

Use of Shell Company, false vendors, purchases of personal nature booked as official expenses enable falsification of accounts and diversion of funds for purposes other than an intended purpose. These could also be mechanism for employees or cartel of employees engaging in personal gain at the cost of the company. In the former incident this could be termed as management fraud.

- (ii) **Shell/ Dummy Company Schemes:** Generally, represents a fictitious company or a 'paper company' to transfer profits or funds from the main company. This could also involve fictitious bills (mostly for services rendered or consultancy charges that cannot be corroborated) which are used in the name of dummy companies diverting the funds taken from banks and financial institutions.

The books could be falsified by wrong classification of expenses, inflating the expense claims, fictitious expenses or multiple reimbursements. A review of controls, normally, leads to the uncovering of expense booking that are prima facie not incurred.

- (iii) **Money-Laundering Activities:** As per the Prevention of Money-Laundering Act, 2002, “whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering.”

The person indulging in money laundering looks for avenues with weak banking controls for converting illegal money into the banking system. Any excess credit in the bank accounts that does not belong to the customer or is parked for a temporary period should raise suspicion of such activities. This person indulging in money laundering activity looks for avenues to enter into ‘benami’ (could be called ‘proxy’ name lending) transactions. Companies with extensive cash handling and inadequate control over source of money or involved in remittance of money for import/ export of goods etc. are susceptible to money laundering activities.

3. Fraud at Operational Level Employees

- (i) **Tampering of Cheques/Drafts/On-line payments/receipts:** Tampering of cheques, payee name being altered, or preparation of cheques without the same being issued to payee, etc., are methods that may also lead to falsification of accounts.

On-line payments generally are considered a transparent mechanism to prevent the above frauds. The ATM is a popular technological advancement that has inherent control gaps. For example, credit cards once swiped the transaction is put through in the system without the need for a signature of the payer. Similarly, unauthorised credits in bank accounts through ATMs are an immense source of threat to recipients including bribery allegations, unless they lodge a complaint with the bankers or the regulatory authorities in a prompt manner of such unauthorised credits to their accounts/or company bank accounts.

Care should be taken that the name of the payee in the payment transactions in books and cheque issued therein for payment is not fabricated to wrongly codify and book against an improper account head.

- (ii) **Off Book Frauds:** In off book frauds, the fraud perpetrator misappropriates the cash before these are recorded in the books or before the sale is recorded in the books.

These frauds are difficult to unearth as the cash or collection is taken off before the accounting entries are made in the books. This situation arises especially in unorganized markets and in rural economies where banking habits are relatively under developed. These are difficult to establish due to absence of audit trails and are more prevalent in businesses that have extensive cash dealings. These are difficult to uncover as the means adopted could include printing of receipts/ bills outside the system.

The above fraudulent schemes can be established based on circumstantial evidence or validation through external sources such as, customer balance confirmations (where feasible) and customer copy of the receipts or other documents that are retained by them. These are also further supplemented by external evidence in the form of background checks and surveillance mechanism. Verification of all the receipts and issues of stock recorded in stock register is another way to identify this type of fraud.

- (iii) **Cash Misappropriation:** Cash is misappropriated after the accounting entries are already passed in the books. These are identified through surprise checks and through shortages in cash balances. These occur when there are delays in accounting of cash collections and there are no laid down cash flow controls. Unaccounted money in any form in an entity is a serious red flag in uncovering of irregularities. Improper daily fund monitoring mechanism is another factor that results in creating unauthorised float by employees in their personal account or in fictitious surrogate (proxy) entities by fraudsters.
- (iv) **Teeming and Lading:** This is also achieved through cash deposits or cheques collected from customers being overlapped with the collections from subsequent customers and the amount collected is diverted to personal account. Reconciliation of customer accounts at a single point of time and confirmation from customers for amounts outstanding in their accounts helps in identifying any leakage in collections.
- (v) **Fraudulent Disbursements:** Fraudulent disbursements or reimbursements take place either by issuing or submission of false bills, or personal expense bills being converted into official expenses bills. The other method that is resorted to by the perpetrator of fraud is to inflate the refunds due to a customer and skim the excess refunds.
- (vi) **Expense Reimbursement Schemes:** These fraudulent schemes involve employees resorting to treating their personal expenses as incurred for business purpose and

claiming reimbursement. In some cases, employees may get reimbursed by third parties (such as distributors) as well as by claiming these expenses from the company. Multiple expense claims based on duplicate bills or photostat copies.

- (vii) **Payroll Fraud:** The payroll fraud could include payment to non-existent employees or in a contractual arrangement inflating of the manpower resources than those actually deployed while billing the client. It may also include showing higher pay than actual disbursement to employees/ workers, etc. The process would require a detailed review of statutory declarations/filings under various labour law statutes including disclosures in financial statements of retirement benefits such as P.F, Gratuity and Superannuation benefits from an evidence gathering perspective.
- (viii) **Commission Schemes:** The salesman exaggerates the sales through fictitious billings to earn higher commission or alter the sales prices of the products sold from those stipulated by the company or share the sales volumes achieved with other employees to share higher commission. Commission schemes in mega deals backed by legal documents are often tools used to camouflage kickbacks. These are often difficult to uncover and would need to be supplemented by the monetary trails across entities and geographies.

Procedure for Investigation of Fraud: Before proceeding to investigate frauds of the type afore mentioned, the investigating accountant should ascertain the exact duties of the person concerned who is suspected to have committed a fraud; his relationship to the general routine of the office, and the circumstances in which any known instances of defalcation have come to light. Such an enquiry would give a clue to promising avenues of investigation. Greater the authority of the individual suspected of a fraud, wider would be the field which would have to be covered by the investigation. At times, an accountant is called upon to investigate a suspected fraud, the details or the nature whereof is not known. In such a case, for localising the source of the fraud, the investigating accountant will have to study the financial and accounting structure of the organisation. As a first step, he should examine the line of responsibility between the various members of the staff. He should have a look at the system of internal control in operation for spotting out the weaknesses, if any, that may exist in it. Relying on the above study, he should direct his enquiry towards those aspects of the business where there has been excessive control in the hands of single persons/ employee, without any supervision by any other person/ employee or, any other inherent weakness that may be in existence in the system.

Some of the situations in which money may be embezzled and the various forms that such frauds usually take place alongwith their investigation procedure include the following:

- (a) **Cash receipts** - In cases like holding back cash sales, collections by travelling salesmen, V.P.P receipts, or casual receipts, e.g., sales of scrap, recoveries out of debts written off earlier, etc., the amount or amounts of receipts embezzled may be subsequently covered up by the perpetrator adopting one or other of the under-mentioned devices:
- (i) Issuing a receipt to the payee for the full amount collected and entering only a part of the amount on the counterfoil.
 - (ii) Showing a larger cash discount than actually allowed.
 - (iii) Adjusting a fictitious credit in the account of a customer for the value of goods returned by him.
 - (iv) Adjusting a cash sale as a credit sale, and raising a debit in the account of the customer.
 - (v) Writing off a good debt as bad and irrecoverable to cover up the amount collected which has been misappropriated.
 - (vi) Short-debiting the customer's account in the ledger with an intention to withdraw the difference when the full amount payable by him is collected.
 - (vii) Under-casting the receipts side of the Cash Book or over-casting the payment side.
 - (viii) Carrying over a shorter total of the receipts from one page of the Cash Book to the next or over-carrying the total of the payment from one page of the Cash Book to the next with a view to covering up misappropriation; either short banking of cash collection or a part of the amount of withdrawal from the bank.

Verification of Cash Receipts: On the assumption that some of these may have been diverted before being entered in the books, evidence as regards income received from different sources should be scrutinised, e.g., inventory, sales summaries, rental registers, correspondence with customers, advices of travelling salesmen and counterfoils or receipts. Carbon copies of receipts marked 'duplicate', should be scrutinised to confirm that they are in fact copies of receipts issued earlier. In addition, by recalling paying-in-slips from the bank the details of cash deposited on each day should be compared with those shown in the Cash Book. The record of sales of scrap of waste paper, that of collection of rents from labourers temporarily accommodated in the company's quarters, that of refunds of amounts deposited with the electric supply co., or any other Government authorities should be examined for

finding out if any of these amounts have been misappropriated. Cash sales should be vouched in detail. Recoveries from customers and sundry parties should be checked with the copies of receipts issued to them; deductions made on account of cash discounts should be reviewed. All withdrawals from the bank should be checked by reference to corresponding entries in the bank pass book.

(b) Inflating cash payment – Cash payment frauds may be in the form of:

- (i) Making double payment of an invoice or paying a false invoice.
- (ii) Paying personal expenses out of the business by falsifying details. e.g., showing betting losses as advertisement charges.
- (iii) Withdrawing unclaimed credit balances of customers or amounts falsely credited in the accounts of parties.
- (iv) Falsely adjusting a refund in the account of a customer and withdrawing the credit balance.
- (v) Wrong totalling of the wage sheets and misappropriating the excess amount withdrawn from the bank for payment of wages.

Verification of Cash Payments: All the evidence as regards cash payments made, including acknowledgement by parties for payments shown to have been made to them, should be carefully scrutinised. In the case where a figure appears to have been erased or altered on the receipts issued by the party, on reference to the party concerned, the actual amount paid to him should be confirmed. The same procedure should be adopted in respect of amounts acknowledged on blank papers. All payments by bearer cheques should be examined. The system of recording of wages should be reviewed, specially as regards possible over-totalling of wage sheets, and entries in them of dummy workmen. The system of ordering and receiving goods should be reviewed so as to confirm that no payment has been made in respect of supplies which have not been received. Confirmations should be obtained from partners or Directors in respect of amounts shown to have been paid to them.

The Petty Cash Book should be vouched and totaled. Special attention should be paid to payments made on account of salaries and wages; confirmation should be obtained from the management that all payments of such salaries and wages were made to persons who were actually in the service of the company. All the withdrawals from the bank should be checked by reference to entries in the bank's pass book. All the bills receivable or payable should be checked by reference to the Bills Books.

(c) Frauds through suppliers' ledger -

- (i) Adjusting fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.
- (ii) Suppressing the Credit Notes issued by suppliers and withdrawing the corresponding amounts not claimed by them.
- (iii) Withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid to them.
- (iv) Accepting purchase invoices at prices considerably higher than their market prices and collecting the excess amount, paid in cash, from the suppliers.

Verification of balances in suppliers' ledger - The Purchase Journal should be vouched by reference to entries in the Goods Inward Book and the suppliers' invoices to confirm that amounts credited to the accounts of suppliers were in respect of goods, which were duly received and the suppliers' accounts had been credited correctly. All the suppliers should be requested to furnish statements of their accounts to see whether or not any balance is outstanding or due so as to confirm that allowances and rebates given by them have been correctly adjusted and were duly authorized by the authorized person/ officer. Examine the system of internal control in relation to purchase orders issued and identify possibilities of collusion with suppliers.

(d) Customers' ledger -

- (i) By the 'teeming and lading' method, i.e., misappropriating the amount collected from a customer and crediting his account by the amount paid by him only when an amount is subsequently collected from another customer; repeating this practice with several items collected and depositing back the amount or amounts so misappropriated before the close of the year.
- (ii) Misappropriating the amount collected from a customer and subsequently adjusting his account by crediting the amount on account of allowance or a rebate for excess price charged.
- (iii) Crediting the amount received from a customer to the account of another customer and subsequently withdrawing the amount wrongly credited.

Verification of balances in customers' ledger: Special attention should be paid to allowances adjusted on account of goods returned or difference in price or on any other

account as well as to amounts written off as bad debts. To confirm that the accounts of customers have been debited in respect of goods supplied to them, entries in the Order Book should be cross-checked with those in the Sales Day Book where the same is kept. The investigating accountant should obtain confirmation of customers in respect of the amounts standing in their accounts. Those of them who have no balance in their accounts should be requested to confirm the statement of their account (which should be sent to them) for ascertaining that the entries shown therein were genuine.

- (e) **Inventory Frauds**-Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.
- (i) Employees may simply remove goods from the premises.
 - (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
 - (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.
 - (iv) Inflating the quantities issued for production is another way of defalcating raw materials and store items.
 - (v) Stocks actually dispatched but not entered in sales/ debtor's account.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and dispatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of: (a) a system of inventory control, and existence of detailed record of the movement of inventory, or (b) availability of sufficient data from which such a record can be constructed. The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book. Investigating accountant should ascertain the exact duties of persons handling the stocks received in and issued from store for production/ sale or any other purpose. Identify the excessive control in the hands of a single person, without any supervision as it will widen the scope of investigation.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

11.4.2 Indicators of Fraud

Several indications of possible frauds can be listed as follows :-

i.	Discrepancies in Accounting Records including non-recording or partial recording or incorrect recording or delayed recording of amounts, misclassifications, etc.
ii.	Conflicting or missing evidence including missing documents, altered documents, significant unexplained items in reconciliations, discrepancies between entity's records and confirmations received etc.
iii.	Unacceptable management responses such as – denial of access to records/facilities/employees, undue time pressure to resolve complex issues, unusual delays in providing requested information, denial for use of Computer Assisted Audit Techniques, unwillingness to address identified deficiencies in internal control etc.
iv.	Other indications such as – Accounting Policies in variance with Industry Norms, Frequent changes in accounting estimates etc.

The Fraud Diamond: Considering the Four Elements of Fraud: Many frauds, especially some of the multibillion-dollar ones, would not have occurred without the right person with the right capabilities in place. Opportunity opens the doorway to fraud, and incentive and rationalization can draw the person toward it. But the person must have the capability to recognize the open doorway as an opportunity and to take advantage of it by walking through, not just once, but time and time again. This gives rise to the fourth element of fraud.

Fraud Diamond i.e. four elements of fraud is a theory which was established by David T. Wolfe and Dana R. Hermanson. Under this Wolfe and Hermanson classified the indicators of fraud into 4 categories

Fraud Diamond: Four Elements of Fraud	
• Incentive:	I want to, or have a need to, commit fraud.
• Opportunity :	There is a weakness in the system that the right person could exploit. Fraud is possible.
• Rationalization:	I have convinced myself that this fraudulent behavior is worth the risks.
• Capability:	I have the necessary traits and abilities to be the right person to pull it off. I have recognized this particular fraud opportunity and can turn it into reality.

A pictorial depiction of the Fraud Diamond is as follows:



11.4.3 Responses to Fraud

SA 330 states the auditor's responses to assessed risks. It requires auditor to assign and supervise personnel taking into account of the knowledge, skill and ability of the individuals, evaluation of selection and application of accounting policies by the entity and incorporation of an element of unpredictability in the selection of the nature, timing and extent of audit procedure.

Response to the risks related to management override of controls includes Testing the appropriateness of journal entries and other adjustments made in preparation of the Financial Statements, review of accounting estimates for biases and also review the significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.

Auditor need to assessed fraud risk factors for material misstatement or misappropriation of assets due to fraud, such as incentive / pressures, opportunities and attitudes /rationalizations.

The responses to fraud will include communications to management and with those charged with governance, communication to regulatory and enforcement authorities and appropriate documentation on his assessment of the risks of material misstatement.

Auditor's ability to detect fraud depends on factors such as –	
—	the skillfulness of the perpetrator
—	the frequency & extent of manipulation
—	the degree of collusion involved
—	the relative size of Individual amounts manipulated; and
—	the seniority of those individuals involved.

Detection of Fraud depends upon effectiveness of Audit Procedure. Detection risk, however, can only be reduced, not eliminated.

TEST YOUR UNDERSTANDING 2

A company has installed an Effluent treatment plant (ETP) in compliance with pollution control regulations of the state government. The authority structure in the company is fairly decentralized and top management of the company has given considerable leeway to different departments for meeting their manpower requirements in accordance with emerging and changing needs from time to time. Of late, the top management has grown suspicious over manpower expenditure in section maintaining and beautifying area around ETP. There is a system in the company where time cards are punched by all employees to mark attendance.

Suggest any one procedure you would perform as an investigator to bring out the facts.

11.5 Investigation on behalf of an Individual or Firm Proposing to Buy a Business

Scope of investigation - The objective of such an investigation is to collect such information as would enable the purchaser to decide whether it is worthwhile to buy the business and if so, for what amount. The investigation should proceed broadly on the same lines as for valuation of shares.

Additional matters which must receive the attention of the investigating accountant on which, if appropriate, information to the client should be given.

(A) In case of proprietary concerns or partnerships -

- (i) Reasons for the sale of the business and the effect on turnover and profits that there would be on retirement of the present proprietor (or partners).
- (ii) The length of lease under which the premises are held, the prospects of its renewal or extension.
- (iii) The unexpired period of any patents owned by the vendors.
- (iv) The age of the present managerial staff and the prospects of continuing in service under the new proprietorship and the possible liability, not already provided for that would arise as regards payment of pensions or gratuities in case of old and aged employees/ retrenched employees.
- (v) If the bulk of sales are made to customers whose number is small, the profitability of the business would be greatly shaken on withdrawing their support. This would be an element of weakness which should be investigated as it might affect future profitability.
- (vi) The valuation that could be placed on goodwill to determine whether that appearing in the book is less or more; if none is included to determine the amount that should be included, if at all.

(B) If the business belongs to a limited company -The vendors' interest in this case will be purchased by the acquisition of shares. On that account, the following additional matters would also require consideration:

- (i) The authorised and issued capital of the company.
- (ii) Whether there is any uncalled liability on the shares.
- (iii) If the capital is divided into different classes of shares - the rights that are attached to each class.
- (iv) Particulars of dividends paid in the past and the amounts thereof which are in arrear (on cumulative preference shares).

- (v) If there are any mortgages/ charge created on the assets appearing in the company's books, a search should be made in the Register of Charges in the office of the Registrar of Companies.
- (vi) The price at which the shares are being offered. If the company is a public company, the price will usually be in excess of market price quoted on the Stock Exchange, but in the case of unquoted shares particularly where the company whose shares are being acquired is a private company, a valuation will have to be placed on the shares for the purpose of purchase.

11.6 Investigation in connection with review of Profit/Financial Forecasts

There are many investigations which involve an examination of future profits like,

- (1) Profit reports can be required as part of a general investigation into the purchase of a business or,
- (2) By banks and financial institutions with regard to project cash flow and profitability statements for appraisal of loan applications submitted by the intending borrowers.

All forecasts depend, to a large extent, on the nature of the business with its numerous and substantial uncertainties. Therefore, such forecasts are not capable of verification by the reporting accountants in the same way as financial statements which present the results of a completed accounting period. Normally, such situations involve special review as these depart from the auditor's traditional role of expressing an opinion in relation to past events.

12. FORENSIC ACCOUNTING

The number of fraudulent activities and ambiguous financial activities have been accelerating all over the world. Consequently, businesses are exposed to risks of fraudulent activities. With all of the recent corporate accounting scandals at Parmalat, Xerox Corporation, and Satyam Computer Services, and all the high-profile corporate frauds at Enron, WorldCom, and HealthSouth followed by Bernie Madoff's colossal ponzi scheme, the media has made Forensic Accounting and Forensic Accounting into a growth industry.

Forensic Accounting has established itself as dynamic and strategic tool in combating corruption, financial crimes and frauds through investigations and resolving allegations of fraud and embezzlement. Thus, a new area, known as Forensic Accounting, was needed to detect the frauds in companies that suspected fraudulent transactions.

“Forensic” means “suitable for use in the court of law”. Bologna said that it is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence. As an emerging discipline, it encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of legal system.

However, the definition of Forensic Accounting keeps on changing in response to the growing needs of corporations. Simply stated, Forensic Accounting includes the use of accounting, accounting and investigative skills to assist in legal matters.

Important Definitions:

Forensic: The word forensic comes from the Latin word forensis, meaning "of or before the forum." It is -

-  Relating to, used in, or appropriate for courts of law or for public discussion or argumentation.
-  Relating to the use of science or technology in the investigation and establishment of facts or evidence in a court of law.

Forensic Accounting: The integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting. It is the study and interpretation of accounting evidence. It is the application of accounting methods to the tracking and collection of forensic evidence, usually for investigation and prosecution of criminal acts such as embezzlement or fraud.

Book definition: *Forensic Accounting* by Hopwood, Leiner, and Young

- Forensic accounting is the application of investigative and analytical skills for the purpose of resolving financial issues in a manner that meets standards required by courts of law.
- Forensic accountants apply special skills in accounting, auditing, finance, quantitative methods, certain areas of the law, research and investigative skills to collect, analyse and evaluate evidential matter and to interpret and communicate findings.

Red Flag: Red flags are indicators or warning of any impending danger or inappropriate behavior. Red flag does not necessarily indicate the existence of fraud however are indicators that caution needs to be exercised while investigating the situations. Red flags are classified in categories such as financial performance red flag, accounting system red flags, operational red flags and behavioral red flags.

Forensic Accounting can be conducted in order to prosecute a party for fraud, embezzlement or other financial claims. In addition, an audit may be conducted to determine negligence in addition, an audit may be conducted to determine negligence.

Example of Forensics

The Company received an anonymous handwritten letter through the mail in which there were serious death threats against the CEO and his family. The letter alluded to the fact that bodily harm may be inflicted on the Children of the CEO unless he took some specific action to send a specific amount of cash in currency notes within a specified time period in such a manner where the identity of the receiver was to remain unknown. The CEO immediately informed the police who took the letter, and the envelope it came in, for "forensic analysis".

The lab undertaking the forensic work examined the paper used, the possibility of capturing some fingerprints on the letter and envelope, scrutinise the manner in which the writing was done, such as the ink used to find out the nature of the writing implement, deployed the expertise of a handwriting expert to decipher the possibility of the writer etc. The police also undertook an investigation of the possible suspects and collected various samples of handwritings of these suspects to allow the forensic experts to match the handwritings and shortlist the most likely suspect.

All the above-mentioned techniques deployed to analyse the only clue available (letter and envelope) are generally referred to as forensic work.

Example of Forensic Accounting

The Accounting Officer in the pharma company performs a regular reconciliation between the physical inventory counted in the factory and the inventory as calculated by the books and accounts. He takes the opening physical inventory as reconciled last month and adjusting for purchases and sales during the month along with any production wastage/shrinkage etc. he calculates the theoretical inventory at the close of the last day of the month. This time he noticed a large discrepancy and after double checking the figures could not understand why he had a large reconciliation variance.

To identify the reason of the variance, he undertook a review of the quantities of some of the large inventory items to see if he could identify the variance in kilogram weight terms. He noticed that some large expensive raw inventory items receipts during the month could neither be located in the storeroom or the factory production floor. He tried to trace these receipts to specific production runs to see if they had been used for making the medicines sold during the month. Finally, he reviewed the wastage records to see if these had been discarded due to quality control purposes. When he received no plausible explanation, he came to the conclusion that there is a serious possibility of pilferage of these expensive raw materials and asked the security head to investigate the matter during and after the time of receipt. This investigation led the security people to review the CCTV footage and records during delivery to identify a few instances of short delivery by the inward people.

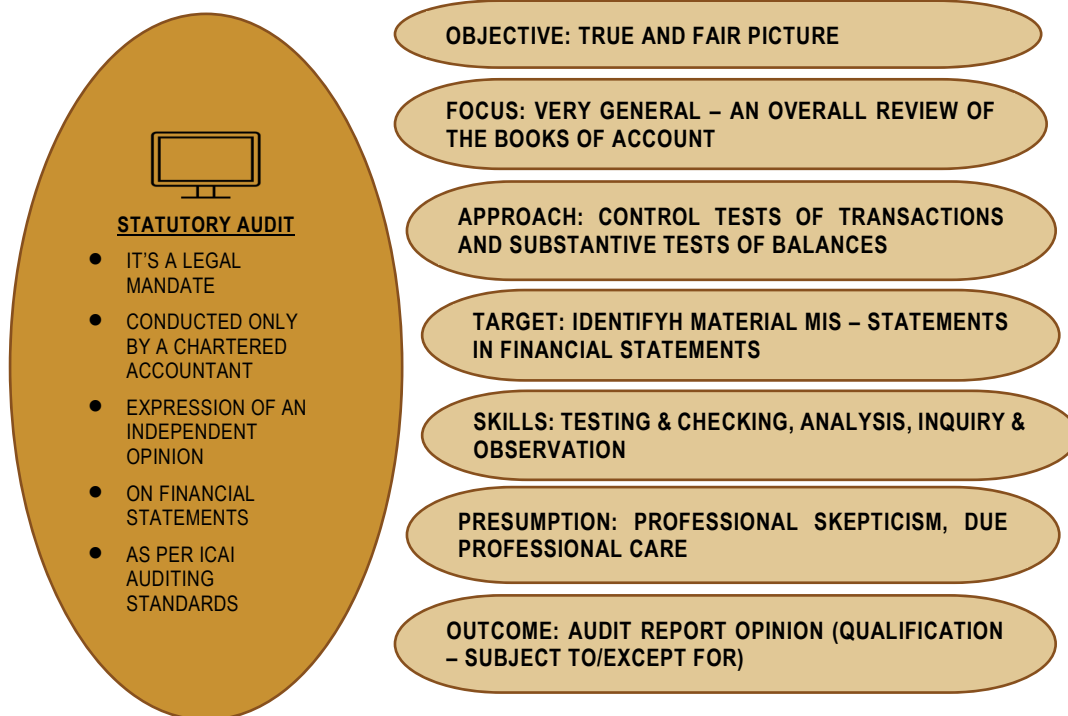
This detailed analysis by the Accounting Officer was an example of some Forensic Accounting techniques to identify a case of accounting fraud.

How is a forensic accounting analysis different from an audit?

The general public believes that a financial auditor would detect a fraud if one were being perpetrated during the financial auditor's audit. The truth, however, is that the procedures for financial audits are designed to detect material misstatements, not immaterial frauds. While it is true that many of the financial statements and frauds could have, perhaps should have, been detected by financial auditors, the vast majority of frauds could not be detected with the use of financial audits. Reasons include the dependence of financial auditors on a sample and the auditors' reliance on examining the audit trail versus examining the events and activities behind the documents. The latter is simply resource prohibitive in terms of costs and time.

There are some basic differences today between the procedures of Forensic Accounting and those of financial auditors. In comparison, forensic accounting and audit differ in specific ways, as shown below:

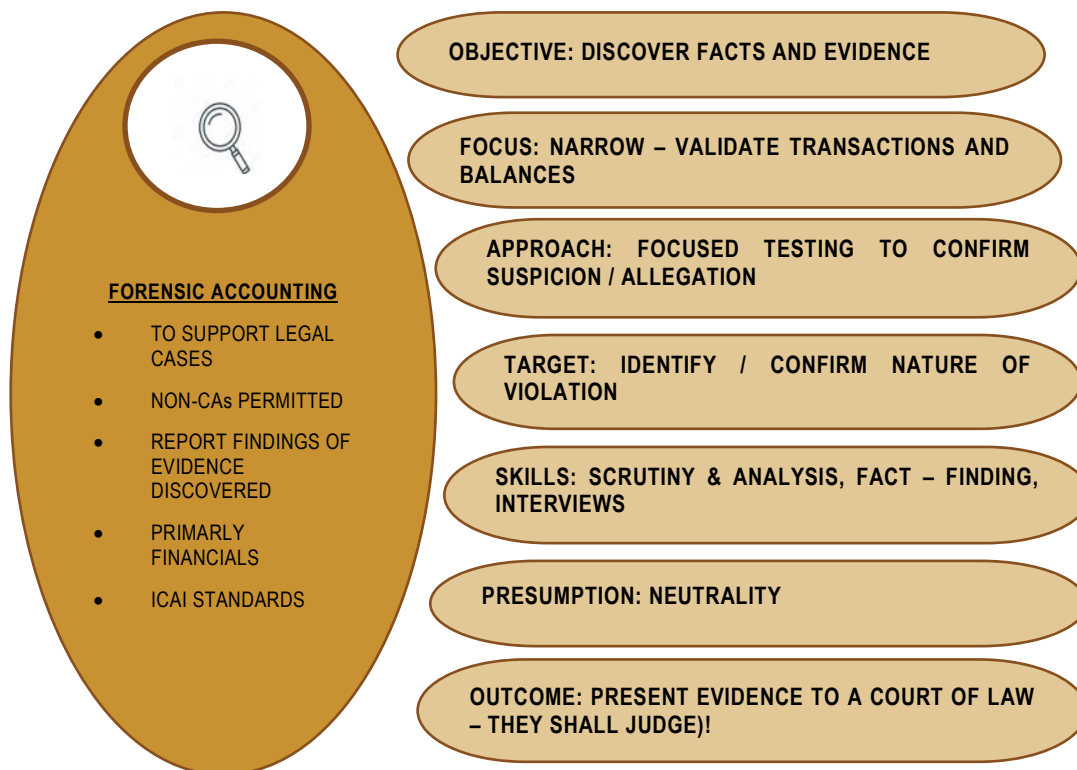
Key elements of the **Statutory Audit** are presented here:



This shows clearly how the Statutory Audit is a legal mandate and designed to provide an overall assurance to the shareholders of true and fair nature of the annual financial statements primarily from a materiality perspective. Individual transactions and balances do not play a major role except

in so far as they have a material impact on the overall financial statements. The Auditor has the overall responsibility to issue his independent opinion without any influence from anyone.

Key elements of Forensic Accounting are presented here:



This infographic shows how Forensic Accounting is a separate mandate altogether and designed primarily to provide support to legal cases. The Forensic professional does not conduct an audit using sample selection methodologies to perform substantive or compliance tests. The professional undertakes a scrutiny and detailed examination of all transactions and balances relevant to the mandate so that the evidence discovered is suitable for a court of law (i.e., in compliance with legal requirements) where it can be challenged through cross examination by the defending party. No audit report with any opinion is issued by the professional as his mandate is limited to present his findings to a superior authority (e.g., a judge) who will examine these from a legal point of view to establish whether the law has been violated or not.

Forensic Accounting

- *In response to an event
- *Financial investigation
- *Finding used as evidence in court or to resolve disputes

Audit

- *Mandatory
- *Measures compliance with reporting standards
- Obtain reasonable assurance that financial statements are free of material misstatement

A Forensic Professional will often look for indications of fraud that are not subject to the scope of a financial statement audit. Forensic Accounting has **Investigative mentality** however auditing is done with **"professional scepticism"**. A Forensic Professional will often require more extensive corroboration. A Forensic Professional may focus more on seemingly immaterial transactions.

Sr. No.	Particulars	Other Audits	Forensic Accounting
1.	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually taken place in books
2.	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
3.	Period	Normally for a particulars accounting period.	No such limitations
4.	Verification of stock, Estimation realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
5.	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.



13. FORENSIC PROFESSIONAL

A Forensic Professional is often retained to analyze, interpret, summarize and present complex financial and business-related issues in a manner which is both understandable and properly supported. Forensic Accountants Professional are trained to look beyond the numbers and deal with the business reality of the situation.

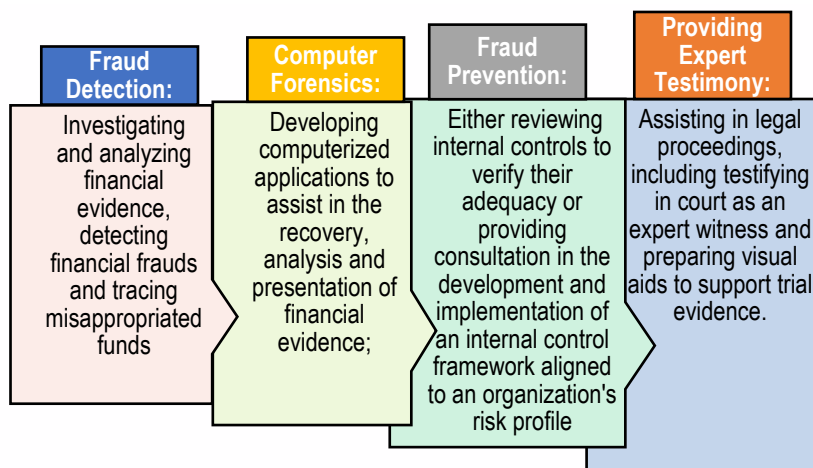
A Forensic Professional must initially consider whether his/her firm has the necessary skills and experience to accept the work. Forensic Accounting is highly specialized, and the work requires detailed knowledge of fraud investigation techniques and the legal framework. Forensic Professional needs to have an understanding on various frauds that can be carried off and how evidence need to be collected.

Forensic Professional can be engaged in public practice or employed by insurance companies, banks, police forces, government agencies and other organizations.

Forensic Accounting Services: An indicative list of services that can be provided by the Professional in this area are as follows:

-  Financial Statement manipulations
-  Fund diversions/Asset tracing
-  Anti-Money laundering
-  Licence Fees/Dues/Tax Evasion
-  Related party transactions/valuations
-  Valuations/Estimations of loss/damage
-  Suspicious transactions under IBC (Insolvency and Bankruptcy Code)

A Forensic Professional is often involved in:



In order to properly perform these services a Forensic Professional must be familiar with legal concepts and procedures and have expertise in the use of IT tools and techniques that facilitate data recovery and analysis. In addition, a Forensic Professional must be able to identify substance over form when dealing with an issue.

TEST YOUR UNDERSTANDING 3

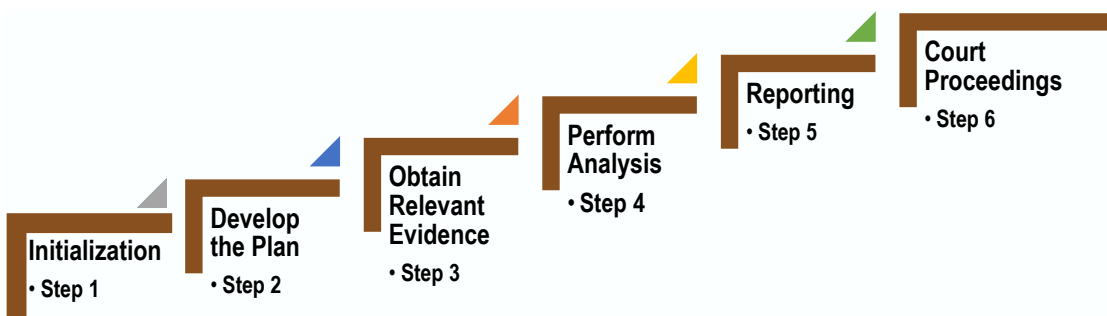
X Limited engaged in manufacturing of floor coverings has taken a Product Liability Insurance policy (PLI). Such a policy covers risk of liabilities for damages for bodily injury resulting from sale and distribution of floor coverings by vendors of X Limited's products. The policy is also subject to "claim series" clause. A Claims Series event is a series of two or more claims arising from one specific common cause which are attributable to the same fault in design or manufacture of products or to the supply of the same products showing the same defect. A claim series event is deemed to be one claim under the terms & conditions of PLI policy.

The company has been asked to shell out damages of ₹5 crore due to supply of faulty products to one of its vendors. The vendor had sold floor coverings to a 5-star hotel which has alleged that harmful chemicals used in dyeing of floor coverings have resulted in skin ailments to some of its guests.

Being in capacity of Forensic Professional appointed by insurance company, what special issues you would keep in mind while dealing with claims involving PLI policy covering such matters?

14. PROCESS OF FORENSIC ACCOUNTING

Each Forensic Accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps detailed below.



Step 1. Initialization

It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand. A conflict check should be carried out as soon as the relevant parties are established. It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. Develop Plan

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event. In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- | |
|---|
| • calculating economic damages; |
| • summarizing a large number of transactions; |
| • performing a tracing of assets; |
| • performing present value calculations utilizing appropriate discount rates; |
| • performing a regression or sensitivity analysis; |
| • utilizing a computerized application such as a spread sheet, data base or computer model; and |
| • utilizing charts and graphics to explain the analysis. |

Step 5. Reporting

Issuing an report is the final step of a forensic accounting. Accountant / Investigators will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

 15. FORENSIC ACCOUNTING AND INVESTIGATION REPORT

This Forensic Accounting and Investigation Standard (FAIS or “Standard”) 510 deals with the responsibility of the Professional to issue a written report to the stakeholders at the conclusion of the assignment.

Reporting results of the work procedures completed and the findings from those procedures, is the concluding part of the assignment. Since one engagement may include multiple assignments, multiple reports may have to be issued; one for each assignment.

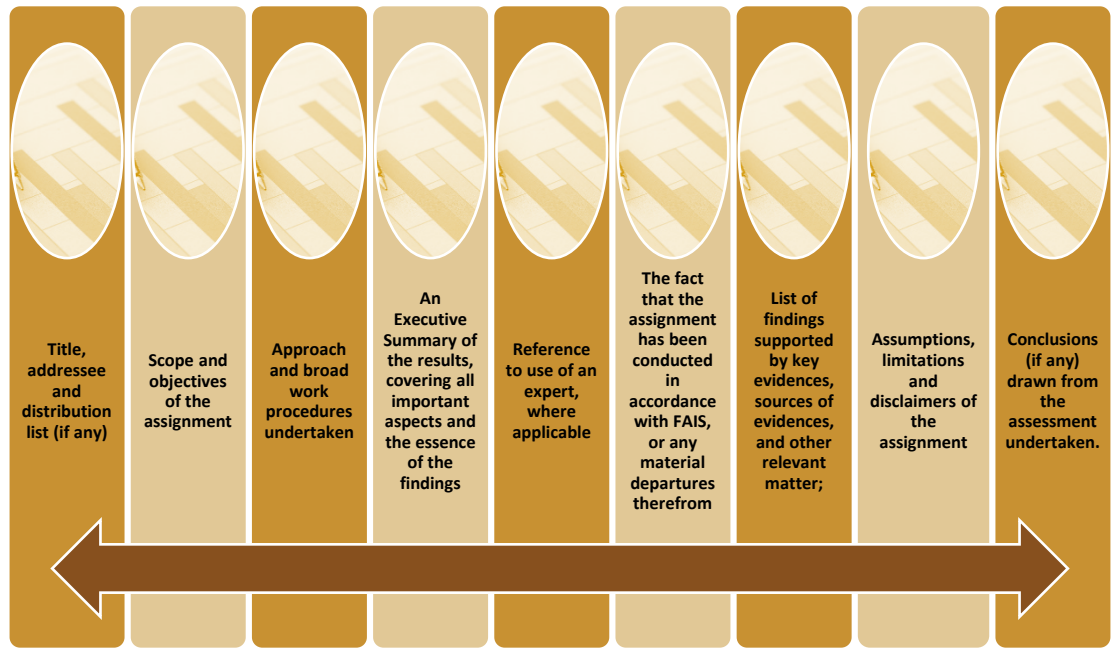
1. **Written Report:** The Professional shall issue a written report which conveys the results of the assignment clearly and accurately. The findings reported shall be based on evidence gathered which are reliable and relevant. Thus, the Professional shall issue a written report which is precise and unambiguous.

2. **Report addressee and distribution:** The report shall be addressed to the Primary Stakeholders and shared with other stakeholder(s) if required or otherwise permissible
3. **Format or Content of Report:** While no fixed form or content of the report is mandated by this Standard, the report shall include certain key elements to enable the recipient to understand the purpose of the assignment, the extent and scope of work performed by the Professional, any limitations, assumptions or disclaimers, the facts and evidence gathered and the conclusions drawn.

Where the form and content of the report is mandated by the stakeholders, or specified by the statutory or regulatory requirements, the Professional shall report in line with those requirements, while keeping in mind the key elements.

Key Elements of the Report: The Professional shall consider the inclusion of the following key elements in the report (indicative list):

-  Title, addressee and distribution list (if any)
-  Scope and objectives of the assignment
-  Approach and broad work procedures undertaken
-  An Executive Summary of the results, covering all important aspects and the essence of the findings
-  Reference to use of an expert, where applicable
-  The fact that the assignment has been conducted in accordance with FAIS, or any material departures therefrom
-  List of findings supported by key evidences, sources of evidences, and other relevant matter;
-  Assumptions, limitations and disclaimers of the assignment
-  Conclusions (if any) drawn from the assessment undertaken.



4. **Discussion of Draft report:** Where the mandate of the engagement requires a discussion of the findings with the subject party prior to finalisation, a summary of the responses received from them shall be included in the report. Further, the Principles of Natural Justice requires a discussion of the observations with the subject party. In some cases, this is done by the Primary Stakeholders through their own internal processes (e.g., disciplinary committee, show-cause notice, etc.). At times, the Professional is requested to incorporate the discussion of draft findings as part of the interview process with the subject. Where the engagement mandate requires a discussion of the draft findings with the subject party, any response received from them shall be included in the written report issued by the Professional.
5. **Assumptions and Limitations:** The Professional shall list any relevant assumptions made during the assignment having a significant bearing on the subject matter. In addition, the Professional may encounter limitations that restrict the methodologies or procedures applied in carrying out the assignment. Such limitations can be in the form of lack of (or limited) management support, restricted (or denied) access to required records, information or people, due to any reason such as court orders, short timelines, etc. These disclaimers would be covered in the report as a key element of the report.

The report shall not express an opinion or pass any judgement on the guilt or innocence. Determination of culpability is either a disciplinary process internal to the organization under review, or a judicial process depending on the specific situation under review. The report can,

at best, highlight the circumstances and facts that may aid a stakeholder decision or further a civil or criminal investigation.

6. **Reporting Timelines:** The report shall be issued within reasonable time frame as per the engagement terms. The Professional may be required to provide interim reports as per the engagement terms which can be given to the extent practicable without compromising the progress of the investigation. Such interim reports are also subject to this Standard.

16. OVERVIEW OF FORENSIC ACCOUNTING AND INVESTIGATION STANDARDS (FAIS)

The Institute of Chartered Accountants of India (ICAI) was formed with many mandates, one of which places a responsibility of “Ensuring Standards of Performance of its Members”. In keeping with this obligation, the ICAI has recently published a full set of standards in the area of forensic science. These are referred to as the “Forensic Accounting and Investigation Standards (FAIS for short). The FAIS are issued to ensure that the ICAI members deliver high quality output in the area of Forensic Accounting and Investigations.

The Framework Governing Forensic Accounting and Investigations (the “Framework”) lays down the underlying principles and boundaries for undertaking such services. It aims to preserve and enhance the quality of practice of a member of the Institute of Chartered Accountants (ICAI) performing forensic accounting and investigation services. This Framework needs to be read in conjunction with the Preface to the Forensic Accounting and Investigation Standards (FAIS).

The main objectives of the Framework are to: 1 Provide an overall understanding of Forensic Accounting and Investigations and its key components; 2 Outline the manner in which these components come together in an inter-related cohesive manner when providing such services; 3 Maintain and improve the quality of forensic accounting and investigation services.

The Framework establishes the structure which governs the professions of Forensic Accounting and Investigations. It is based on the "Definition of forensic accounting and investigation" (as covered under para 3, above), and the Code of Ethics forms the foundation of the Framework. It comprises of four components inherent to the process of forensic accounting and investigations. These components implicitly form part of the FAIS, even though they may not be mentioned explicitly in the particular Standards. Hence, as explained in the Preface, they all are mandatory in nature, except the Guidance which is recommendatory.

The four key components (forming the pillars) of the Framework are:

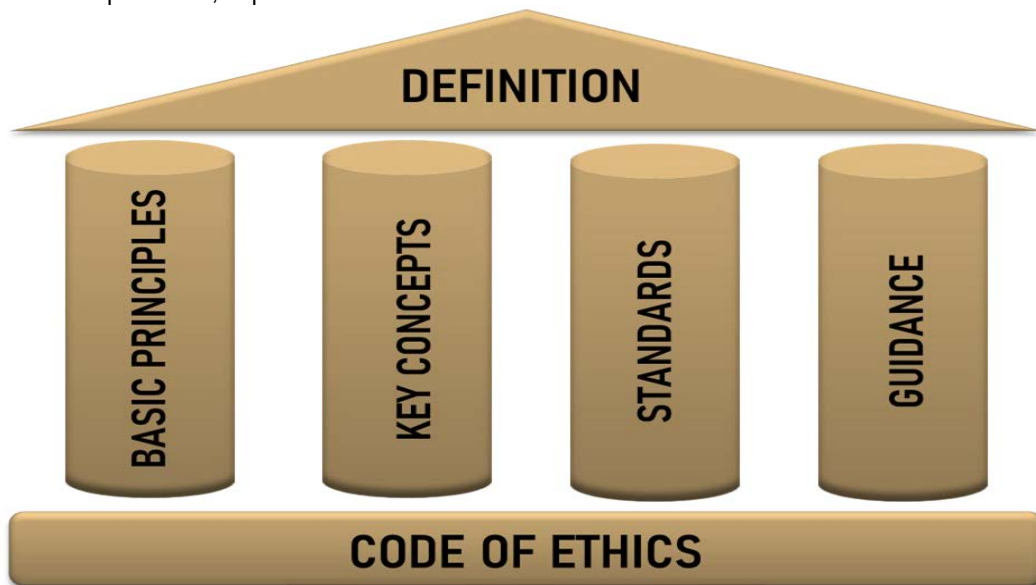
(i) Basic Principles of Forensic Accounting and Investigations.

(ii) Key Concepts.

(iii) Standards on Forensic Accounting and Investigations.

(iv) Guidance.

A pictorial depiction of the Framework Governing Forensic Accounting and Investigations, in the form of a pantheon, is presented below.



The Forensic Accounting and Investigation Standards (referred to as “FAIS” or the “Standards”) at a broad level seek to provide:

- (a) The Professionals with the minimum standards for undertaking forensic accounting and investigation (FAI) assignments;
- (b) The Users of FAI services with an indication of the quality of service that can be expected from such engagements;
- (c) The Regulators and Governmental agencies with an appreciation of what can be expected from FAI services; and
- (d) To everyone, guidance on matters of implementation and related practical issues.

The Standards are intended to be principle-based, rather than rule based, thereby providing ample room for professional judgment when applying such principles to unique situations and under specific circumstances. The unique nature of forensic assignments would necessitate that the application of forensic accounting and investigative skills, together with the use of digital forensic tools, may vary depending on the nature of specific engagements.

If, for any reason, a member is unable to comply with any of the requirements of the FAIS, or if there is a conflict between the Standards and other mandates, such as a statutory or regulatory requirement, the FAI report (or such similar communication) should draw attention to the material departures therefrom along with appropriate explanation.

The FAIS, as and when issued, will be classified, and numbered in a series format, as follows:

Forensic Accounting and Investigation Standards (FAIS)
100 Series:: Standards on Key Concepts FAIS 110 : Nature of Engagement FAIS 120 : Fraud Risk FAIS 130 : Laws and Regulations FAIS 140 : Applying Hypotheses
200 Series: Standards on Engagement Management FAIS 210 : Engagement Objectives FAIS 220 : Engagement Acceptance and Appointment FAIS 230 : Using the Work of An Expert FAIS 240 : Engaging with Agencies FAIS 250 : Communication with Stakeholders
300 Series: Standards on Executing Assignments FAIS 310 : Planning the Assignment FAIS 320 : Evidence and Documentation FAIS 330 : Conducting Work Procedures FAIS 340 : Conducting Interviews FAIS 350 : Review and Supervision FAIS 360 : Testifying Before a Competent Authority

400 Series: Standards on Specialised Areas

FAIS 410 : Applying Data Analysis

FAIS 420 : Evidence Gathering in Digital Domain

FAIS 430 : Loans Or Borrowings

500 Series: Standards on Reporting

FAIS 510 : Reporting Results

600 Series: Standards on Quality Control

FAIS 610 : Quality Control

Key Takeaways

- Due Diligence implies a general duty to exercise care in any transaction. It is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depends on the relative facts of the special case.
- Due Diligence may also require to be performed in cases of corporate restructuring, venture capital financing, lending, leveraged buyouts, public offerings, disinvestment, corporatisation, etc.
- Contents of a due diligence report vary with individual circumstances and the purpose of such exercise.
- Investigation implies a systematic and in-depth examination or inquiry to establish a fact or to evaluate a specific situation. It is the systematic and critical examination of facts, records and documents for a specific purpose.
- Investigation differs substantially from an audit assignment. Audit aims at collection of sufficient appropriate audit evidence to enable the auditor to form a judgement and express an opinion on the financial statements or other data under examination. An investigation, on the other hand, requires special in-depth examination of the particular records or transaction with the objective of establishing a part or happening or assessing a particular situation. The scope of audit is broad based and general in nature whereas investigation is narrow and specific.

- Investigation by Chartered Accountants can be statutory or non-statutory. Non-statutory investigations could include investigation of frauds or investigations in case of proposals to buy a business etc.
- Forensic accounting is the use of professional accounting skills in matters involving the possibility of a fraud, in order to collect relevant evidence and facts which could help support an expert view for potential or actual civil or criminal litigation. It is also called forensic accounting.
- Forensic accounting is different from audit of financial statements. A Forensic Professional will often look for indications of fraud that are not subject to the scope of a financial statement audit. Forensic accounting has investigative mentality" however auditing is done with "professional skepticism". A Forensic Professional will often require more extensive corroboration and may focus more on seemingly immaterial transactions.
- Services of forensic accountants may be used by banks, insurance companies, government agencies, courts and even by business community.
- Forensic Accounting and Investigation Standards (FAIS) aim to preserve and enhance the quality of practice of a member of the Institute of Chartered Accountants (ICAI) performing forensic accounting and investigation services.

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *Sri Rajan is above 80 years old and wishes to sell his proprietary business of manufacture of specialty chemicals. Ceta Ltd. wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business.*
What procedures you would adopt before you could render any advice to Ceta Ltd.?
2. *An American Company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of more than 65% of the industrial gas business in India. It requests you to conduct a "Due Diligence" of this Indian Company and submit your Report. List out the contents of your Due Diligence Review Report that you will submit to your USA based Client.*

3. *KDK Bank Ltd., received an application from a pharmaceutical company for takeover of their outstanding term loans secured on its assets, availed from and outstanding with a nationalised bank. KDK Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.*
4. *"Due diligence is different from audit" – Explain the difference between due diligence and audit.*
5. *PB Ltd. entered into a deal with SV Ltd. for buying its business of manufacturing wooden products/ goods. PB Ltd. has appointed your firm for conducting due diligence review and they want to know the cash generating abilities of SV Ltd. What points will you check in order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally?*
6. *CA. Sanjana is acting as Credit manager in branch of DFC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth ₹10 crore for meeting usual business requirements. It is a prospective new client. She checks past history of the company, back ground of promoters & directors, shareholding pattern and nature of business. Assessment of financial results of past years and future projections is also undertaken. She also carries out SWOT analysis of the company.*

Besides, assessment of net worth of directors is also undertaken. Status of CIBIL score and position of name of promoters/directors in RBI defaulter list is also verified.

She also makes discreet inquiries from few clients of the branch engaged in similar line of activity regarding credit worthiness of company, its promoters and directors.

Based on above-

- (a) *Identify activity being performed by CA Sanjana and discuss its nature.*
 - (b) *Would your answer be different if this activity was to be performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.*
 - (c) *Name any three other areas where identified activity can be undertaken.*
7. *A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation*

of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

List out the points you will cover in your investigation before submitting your report to the General Manager.

8. *What are the important steps involved while conducting Investigation on behalf of an Incoming Partner?*
9. *Mr. Clean who proposes to buy the proprietary business of Mr. Perfect, engages you as investigating accountant. Specify the areas which you will cover in your investigation.*
10. *In a Company, it is suspected that there has been embezzlement in cash receipts. As an investigator, what are the areas that you would verify?*
11. *J Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd., what factors would you consider in assessing the future maintainable turnover?*
12. *MF. Ltd., engaged in the manufacturing of various products in its factory, is concerned with shortage in production and there arose suspicion of inventory fraud. You are appointed by MF Ltd. To evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory?*
13. *In a Public Limited Company, it is suspected by the Management that there has been embezzlement in supplier's ledger. As an auditor of the Company, you have been asked to investigate the matter. What are the major areas that you would verify in this regard?*
14. *General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose.*

In view of the above, you are required to brief out the difference between Audit and Investigation.

15. *Enumerate the steps to be undertaken in case of forensic accounting process.*
16. *Briefly discuss the key content of Forensic Accounting and Investigation Report.*
17. *ABC Ltd. is a listed company having turnover of ₹ 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of ₹ 20 crore.*

Rupees (In crore)	Purpose
10.0	- for Building
8.5	- for Machinery
1.5	- for Working Capital
20 Crore	Total

Project gets implemented in 2022-23 and one of the accountants report to the Managing Director that some suspicious transactions are noticed in the purchase of building material. But the Management is confused as to whether they should get an audit or Forensic Accounting done for the same. Advise Management about the difference in forensic accounting and audit.

Answers to Test Your Understanding

- As part of due diligence exercise, he is performing SWOT analysis of borrower. He is making analysis of strengths, weaknesses, opportunities and threats (SWOT) pertaining to borrower. Features such as rise in sales, generation of cash profits and timely service of debts represent borrower strengths. Lack of well-paid qualified staff to deal effectively with its domestic and foreign customers is an area of weakness. Entering into export market presents opportunity for borrower and presence of large number of competitors and demand slump in US market reflect threats.
- The attendance record of employees pertaining to that section can be analysed with regards to in and out time. Further, surprise visit to the site can be conducted to see the actual number of workers at a point of time. It may reveal ghost workers. Discrepancies in attendance records vis-à-vis actual number of workers present could reveal dummy workers. Such a visit would also give indication of actual work done in the area and give an inkling of productivity of employees.
- In claims involving product liability insurance policies, many documents are required from third parties. The third party may be unwilling to provide relevant documents to Forensic Professional concerning the very organization responsible for causing damages.
 - Independence of Forensic Professional become paramount in such types of assignments because it involves engagement with parties who are not directly claiming from insurance company. Forensic Professional needs to resist any pressure or interference in establishing the scope of the assignments or the manner in which the work is conducted and reported.

- (iii) The company might be willing to negotiate it to salvage its reputation. It can lead to additional complexities.
- (iv) Quantification of legal liability under the policy can prove to be a challenging task and it has to be determined in accordance with policy terms & conditions.
- (v) Careful analysis of date of loss when first claim occurred in accordance with “claim series” clause and whether the same falls under the policy

Hints /Answers to Theoretical Questions

1. Refer Financial Due Diligence given in Para 3.
2. Refer Para 6.
3. Refer Over-Valued Assets Part given in Para 3.
4. Refer Para 1.
5. In order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally, one is required to verify:
 - (a) Is the company able to honor its commitments to its trade payables, to the banks, to the government and other stakeholders?
 - (b) How well is the company able to convert its trade receivables and inventories?
 - (c) How well the Company deploys its funds?
 - (d) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
 - (e) What is the investment pattern of the company and are they easily realizable?

Refer Cash Flow in Para 3.

6. (a) The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the

verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.

Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

- (b) There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.
 - (c) The areas where due diligence may be undertaken are: -
 - (i) Corporate restructuring
 - (ii) Venture capital financing
 - (iii) Public offerings
- 7. Refer Para 11.3.
 - 8. Refer Para 11.1.
 - 9. Refer Para 10 and 11.5.
 - 10. Refer Cash Receipts embezzlement in Para 11.4.1.
 - 11. In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:
 - (i) **Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
 - (ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
 - (iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether

the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?

- (iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

12. Refer Inventory Fraud in Para 11.4.1.
13. Refer Areas to be verified in case of embezzlement in supplier's ledger in Para 11.4.1.
14. Refer Para 7.1.
15. Refer Para 14
16. Refer Para 15
17. Refer Para 12

SUSTAINABLE DEVELOPMENT GOALS(SDG) & ENVIRONMENT, SOCIAL AND GOVERNANCE (ESG) ASSURANCE

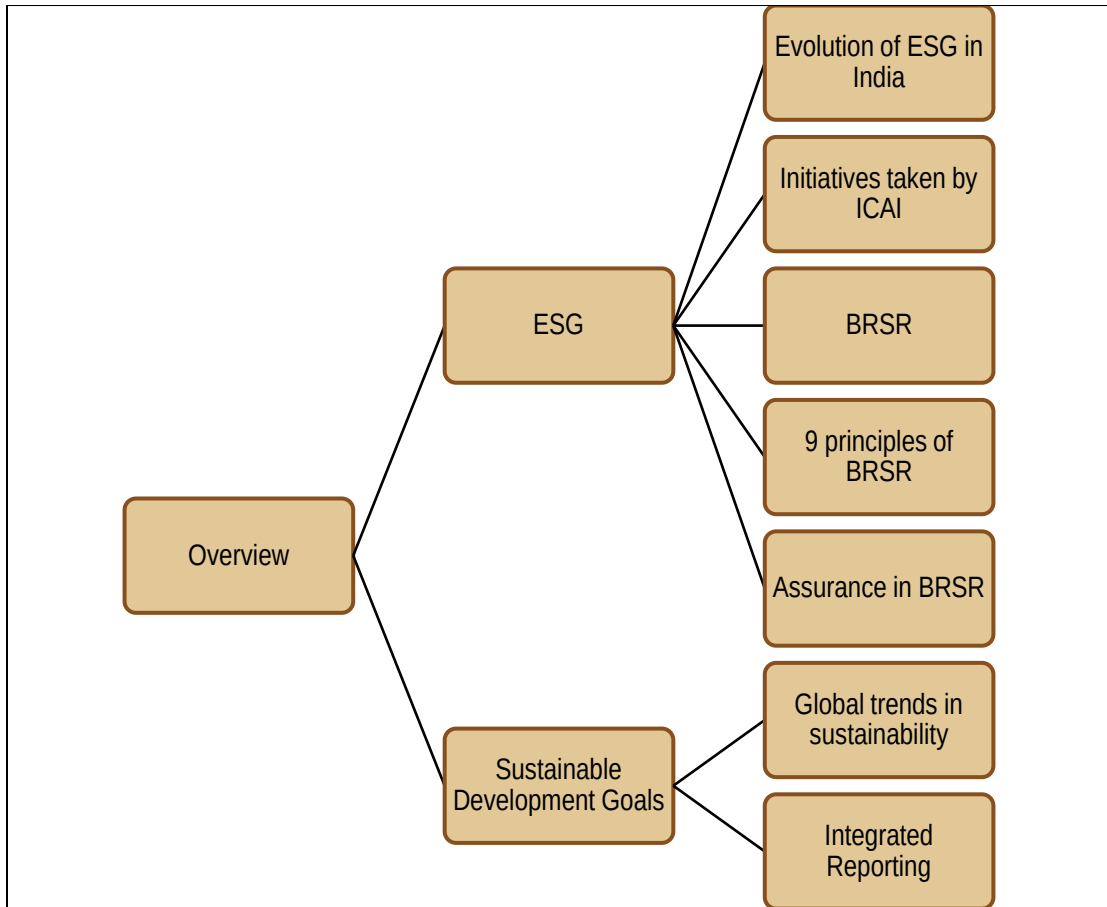


LEARNING OUTCOMES

After reading this chapter student shall be able to:

- ☐ Understanding Environment, Social and Governance (ESG) pillars of sustainability
- ☐ Learn the Sustainable Development Goals which have been accepted by all the United Nation Members
- ☐ Creating an awareness of the Global trends of Sustainability
- ☐ Understanding the evolution of ESG in India
- ☐ Gaining knowledge of ICAI's role in Sustainability
- ☐ Learning about Integrated Reporting and how it can help our profession.
- ☐ Gain the knowledge of Role of Auditor in Sustainability forum and certifying the BRSR.
- ☐ Analyze the Business Responsibility and Sustainable Reporting requirements.

CHAPTER OVERVIEW



CA Ajoy was keen to understand about sustainability reporting by corporates in light of mandatory regulatory requirements. One of his corporate clients was required to do such reporting and assurance report was also needed. In this context, he wanted to familiarize himself with terms like Sustainable development and Sustainable Development Goals (SDGs) thoroughly.

Sustainable development simply means development that meets the needs of the present without compromising the ability of future generations to meet their own needs. SDGs are a universal call for action to end poverty, protect the planet and improve the lives and prospects for everyone- everywhere.

Our country has always been in forefront of welfare of humanity. Our ancient texts say: *“Keep pure! For the earth is our mother! And we are her children!”* How can a country with such a universal vision can be left behind in this noble endeavour? And corporates also contribute to the SDGs. It is due to the fact that world is in need of solutions that the private sector can deliver representing a large market for innovation.

It is in line with this spirit that Sustainability reporting frameworks have evolved over time and companies worldwide have adopted these frameworks for measuring, monitoring and disclosing performance in areas related to environmental, social and governance (ESG). Many countries have stipulated some form of ESG disclosures.

ESG reporting stands on three pillars viz. *environmental, social and governance*. Certain listed companies have to disclose their sustainability performance in accordance with key performance indicators and 9 principles. Doesn't it sound interesting? These principles range from conducting business in ethical manner to promoting human rights.

As part of ESG reporting, it is mandatory for certain listed companies to prepare and disclose sustainability reports in shape of Business responsibility and sustainability reports (BRSR). Like in case of meeting requirements of the principle that business is conducted with integrity and in ethical manner, disclosures on anti-bribery policy like internal control mechanisms and mechanisms to deal with bribery/corruption complaints are to be made. Such disclosures are now mandatory for certain listed companies considering each of the 9 principles.

Isn't such a reporting framework a giant leap forward?

1. INTRODUCTION

Sustainability is a word that has gained its momentum in the past few years, but we don't often understand the extent of the meaning in totality. It encompasses how natural systems work, continue to be diverse, and yield everything required for the environment to remain in balance now and in the future.

Sustainability is a concept related to the development of products, goods and services that involves meeting our present needs without compromising the ability of future generations to fulfil their own needs.

Sustainability as a concept recognises that the environment is an exhaustible resource. Therefore, it is important to use the environment and its resources rationally and protect it for the good of the Earth, our environment, humanity, and all living things.

The concept of sustainable development is named after the Brundtland report, which reports sustainable consumption in developed countries.

Sustainable Development defined in this report is as follows:

"Sustainable development is development that strives to meet the needs of developing countries seeking to achieve a more sustainable world. Sustainable development addresses the needs of the present moment without compromising current and future generations to meet their own sustainable lifestyles."

Sustainable development can be applied to corporate policy in the business world as it encompasses following three pillars of sustainability:

A. Environment (E)

B. Social (S)

C. Governance (G)

These three pillars constitute the term ESG. Let us understand each element of ESG in depth.

A. Environment (E):

Environmental stands for corporate climate policies, energy use, waste, pollutions, natural resource conservation, and treatment of animals. It includes the natural resources that every entity absorbs for its functioning like that of coal, electricity, water and so on. Processing this energy into products / services which will leave behind certain wastes like that of carbon emissions, water discharges, e-wastes and so on. Thus, one is dependent on the environment for carrying out its operations.

B. Social (S):

It addresses the relationships the entity has and the reputation it fosters with people and institutions in the communities where you do business and the value chain involved. It further includes labour relations, diversity, and inclusions. Every company operates within a broader and diverse society.

C. Governance (G):

It is the internal system of practices, controls, and procedures entity adopts in order to govern itself, make effective investment decisions, comply with the law, and meet the needs of all stakeholders. Every entity, which is itself a legal creation, requires governance.

The above pillars include the following elements as under:



Environmental, Social and Governance (ESG) reporting is all about disclosure of information, data, metrics that explain the added value in these three areas. ESG reporting can be both quantitative and qualitative in nature.

Qualitative reports tend to describe a company's strategy or policy around the relevant topics, while a quantitative approach includes metrics, and key performance indicators (KPIs) linked to each area in order to measure progress against goals and report on achievements. Naturally, a mixed approach that makes use of both qualitative and quantitative information tends to add the maximum value to the quality of disclosures.



2. SUSTAINABLE DEVELOPMENT GOALS

In 2015, Sustainable Development was adopted by all United Nations Members states to provide a blueprint, which mentioned the Sustainable Development Goals (SDGs).

There were 17 SDGs which are considered as an urgent call for action by all countries, whether developed or developing countries. They recognized that by ending poverty and other deprivations must go hand in hand with strategies that improve health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests.

Today, the Division for Sustainable Development Goals (DSDG) in the United Nations Department of Economic and Social Affairs (UNDESA) provides substantive support and capacity building for the SDGs and their related thematic issues including water, energy, climate, oceans, urbanization, transport, science and technology, the Global Sustainable Development Report (GSDR), partnerships and Small Island Developing States. SDG plays a key role in the evaluation of UN systemwide implementation of the 2030 Agenda and on advocacy and outreach activities relating to the SDGs. In order to make the 2030 Agenda a reality, broad ownership of the SDGs must translate into a strong commitment by all stakeholders to implement the global goals. DSDG aims to help facilitate this engagement.

Following are the 17 SDGs:

1 NO POVERTY	No Poverty	10 REDUCED INEQUALITIES	Reduced Inequalities
2 ZERO HUNGER	Zero Hunger	11 SUSTAINABLE CITIES AND COMMUNITIES	Sustainable Cities & Communities
3 GOOD HEALTH AND WELL-BEING	Good Health & Well Being	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	Responsible Consumption & Production
4 QUALITY EDUCATION	Quality Education	13 CLIMATE ACTION	Climate Action
5 GENDER EQUALITY	Gender Equality	14 LIFE BELOW WATER	Life Below Water
6 CLEAN WATER AND SANITIZATION	Clean Water & Sanitization	15 LIFE ON LAND	Life on Land
7 AFFORDABLE AND CLEAN ENERGY	Affordable & Clean Energy	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	Peace, Justice & Strong Institutions
8 DECENT WORK AND ECONOMIC GROWTH	Decent Work & Economic Growth	17 PARTNERSHIPS FOR THE GOALS	Partnership for the Goals
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Industry Innovation & Infrastructure		



3. GLOBAL TRENDS IN SUSTAINABLE REPORTING

The mandatory reporting requirements are mostly associated with the public sector or government-run companies, large corporations, multi-national business conglomerates, and listed companies in the stock exchanges. Furthermore, sector-specific, and thematic reporting provisions are also becoming more common.

The most widely used framework in the world is the Global Reporting Initiative (GRI) Sustainability Reporting Standards having 93% of the world's largest 250 corporations report on their sustainability performance through GRI. It is used in over 100 countries to report sustainability. This independent international organization is based in Amsterdam, the Netherlands, and has operational hubs in Brazil, China, Colombia, India, South Africa, and the United States. The GRI Sustainability Reporting Standards are developed with true multi-stakeholder contributions and rooted in the public interest.

1. **Global Reporting Initiative (GRI)** – helps the organizations to report on economic, environmental, and social impacts. The general disclosures which are required to be reported under this standard are Economic, Environment and Social. This report is addressed to all the stakeholders of the entity.
2. **Carbon Disclosure Project (CDP)** – captures the environmental performance data which is related to GHG emissions, water, forests, and supply chain. Major details required to be reported are climate change, Forest, and Water security. This report is addressed to all the investors, buyers, and other stakeholders of the entity.
3. **International Integrated Reporting Framework (IIRC)** – has established guiding principles and content elements in order to allow the companies to produce integrated reports. This report consists of Organisational overview, Governance structure, Business model, risks and opportunities, strategy, performance, outlook etc.

In September 2020, these framework & standard setting institutions came together to show a commitment to working towards a comprehensive corporate reporting system.

The intent of the collaboration was:

- Joint market guidance on how the frameworks & standards can be applied in a complementary and additive way.
- Joint vision of how these elements could complement financial generally accepted accounting principles (Financial GAAP) and serve as a natural starting point for progress towards a more coherent, comprehensive corporate reporting system.

- Joint commitment to drive towards this goal, through an ongoing programme of deeper collaboration between the 5 institutions and stated willingness to engage closely with other interested stakeholders.

In November 2021, the IFRS Foundation Trustees published a revised *Constitution* and a Feedback Statement that responds to the feedback from Exposure Draft *Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards*.

International investors with global investment portfolios are increasingly calling for high quality, transparent, reliable, and comparable reporting by companies on climate and other environmental, social and governance (ESG) matters.

On 3 November 2021, the IFRS Foundation Trustees announced the creation of a new standard-setting board—the *International Sustainability Standards Board (ISSB)*—to help meet this demand.

The intention is for the ISSB to deliver a comprehensive global baseline of sustainability-related disclosure standards that provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities to help them make informed decisions.

Task Force on Climate-Related Financial Disclosures (TCFD) - It was created in 2015 by the Financial Stability Board (FSB) with the goal of helping companies create consistent climate-related disclosures. Unlike GRI, which works on a wide range of organizations, TCFD is targeted at companies that predominantly handle financial-related interests, such as banks and insurance firms.

The Climate Disclosure Standards Board (CDSB) was an international group of business and committed to making climate-rated disclosures in the mainstream global corporate reporting.

The CDSB framework was formed to help organizations to disclose climate related risks and opportunities. The CDSB framework has also set out an approach on for reporting environmental information.

Further, the ISSB has taken the technical guidance for developing IFRS Sustainability Disclosure Standards.

The Value Reporting Foundation (VRF) is a non-profit organization which was a result of the merger between SASB Foundation and the International Integrated Reporting Council (IIRC). The International Accounting Standards Board (IASB) and the ISSB has agreed to work together in order to build an Integrated Reporting Framework.

The International Sustainability Standards Board (ISSB) in March 2022 launched a consultation on its first two proposed standards—one on climate-related disclosures and one on general sustainability-related disclosures. The proposed standards, when finalised, would form a comprehensive global baseline of sustainability-related disclosures designed to meet the information needs of investors in assessing enterprise value.

IFRS S1 : The proposed requirements in the Exposure Draft IFRS S2 Climate-related Disclosures (Climate Exposure Draft) build upon the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) and incorporate industry-based disclosure requirements derived from the Sustainability Accounting Standards Board (SASB) Standards.

TEST YOUR UNDERSTANDING 1

You have recently joined a listed company after qualifying CA final exams through campus placement programme conducted by CMI&B at ICAI. Although the company you have joined in is not amongst top 1000 listed companies in the country, it wants to include “Sustainability reporting” in accordance with Global Reporting Initiative framework (GRI) in its annual report on voluntary basis. “Sustainability reporting” seems to be new buzzword in corporate circles and you are assigned responsibility for collating all the information required for such reporting.

In above context, dwell upon what is your understanding of “Sustainability reporting”? Can you list some of its expected benefits?

4. INTEGRATED REPORTING

There are 6 Cs of Integrated Reporting – also known as 6 capitals:

(i) **Financial Capital:**

- Pool of funds that is available to the organization for use in the production of goods or provision of services.
- Obtained through financing, such as debt, equity, or grants, or generated through operations or investments.

(ii) **Manufactured Capital:**

- Seen as human-created, production-oriented equipment and tools.

- Available to the organization for use in the production of goods or the provision of services, including buildings, equipment, infrastructure (such as roads, ports, bridges & waste, and water treatment plants).

(iii) Natural Capital:

- Is an input to the production of goods or the provision of services.
- An organization's activities also impact, positively or negatively, on natural capital.
- Includes water, land, minerals and forests, biodiversity, and ecosystem health.

(iv) Human Capital:

People's skills and experience, their capacity, and motivations to innovate, including their:

- Alignment with and support of the organization's governance framework & ethical values such as its recognition of human rights.
- Ability to understand and implement an organization's strategy.
- Loyalties and motivations for improving processes, goods, and services, including their ability to lead and to collaborate.

(v) Social Capital:

- Institutions and relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being.
- Includes:
 - o Common values and behaviour.
 - o key relationships, the trust and loyalty that an organization has developed and strives to build and protect with customers, suppliers, and business partners.
 - o an organization's social license to operate.

(vi) Intellectual Capital:

Key element in an organization's future earning potential, with a tight link and contingency between investment in R&D, innovation, human resources, and external relationships, which can determine the organization's competitive advantage.

Asia Pacific region continues to dominate in presenting sustainability data in annual reports. Approximately with 60% of Companies reporting in 2022. Integrated reporting is strong in the Middle East.

TEST YOUR UNDERSTANDING 2

Trustworthy Industries Limited (a listed company) has already been preparing and disclosing its sustainability report based upon internationally accepted reporting framework of “Integrated Reporting” on a voluntary basis even some years before BRSR reporting became mandatory. Even after BRSR reporting became mandatory, it is cross-referencing disclosures made under such reporting to disclosures sought under BRSR. The key thrust of “Integrated Reporting” is how company creates value over short, medium and long term.

Following further information is provided in respect of the above company: -

[i] It has increased the number of customers using digital customer mobile app of the company from 2 lac users to 4 lac users. There is 100% increase in digital collection. It has benefitted customers of the company and resulted in use of digital methods for business operations of the company.

[ii] It has increased the number of beneficiaries under its flagship CSR programmes from previous 10000 to 75000. It has provided value for communities and provided sustainable livelihood to them.

Discussing above information, identify which of the capitals of “Integrated Reporting” are being referred to at [i] and [ii] respectively?



5. GLOBAL SCENARIO IN VARIOUS COUNTRIES

5.1 United States

In March 2022, the US Securities and Exchange Commission (SEC) proposed climate-risk disclosure requirements, which would expand the annual reporting requirements of publicly traded companies. In their SEC filings, companies would be required to discuss financially material, climate-related risks guided by the TCFD recommendations. Reporting would include:

- The company's climate risk management processes
- How the risks identified would impact financial performance
- How these risks are managed and mitigated
- Any scenario analysis, transition plans, and publicly announced climate goals

5.2 United Kingdom

In 2019, the UK passed a law targeting net zero greenhouse gas (GHG) emissions by 2050.

A key regulation for UK ESG disclosures is the Companies Act of 2006, which includes requirements for annual reporting. These rules apply to large companies that are either listed, exceed £500 million in annual turnover, or have more than 500 employees. Non-financial information has always been required in annual reports, but in 2022, the Act was expanded to include sustainability matters. The new requirements align with the recommendations from the Task Force on Climate-Related Financial Disclosure (TCFD). As such, companies are required to discuss the strategy, processes, and due diligence regarding matters of:

- The environment (including the company's impact on the environment)
- The company's employees
- Social matters
- Respect for human rights
- Anti-corruption and anti-bribery

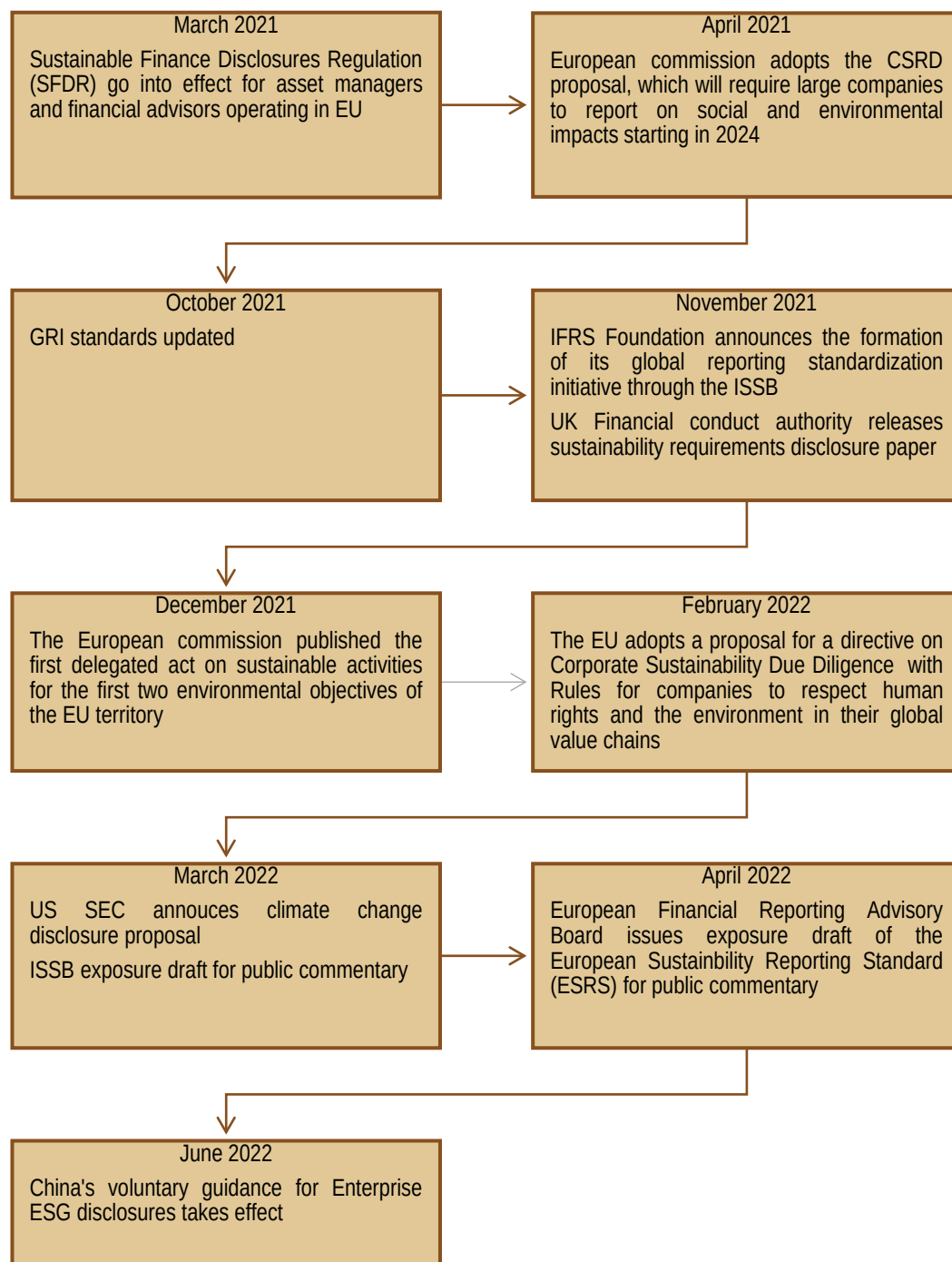
Specifically for the environment, climate-related disclosures must include:

- Climate change-related risks and opportunities
- How these risks and opportunities are managed through targets and KPIs
- How climate change is addressed in corporate governance
- How climate risk impacts strategy

Additionally, large UK companies are required to report on their UK energy use and carbon emissions within their annual reports through the Streamlined Energy and Carbon Reporting.

Further, in 2023 ESG reporting in the UK will be further formalized through the Sustainability Disclosure Requirements (SDRs). The SDRs will provide a framework for corporates to manage sustainability-related risks, opportunities, and impacts, as well as set relevant metrics and targets.

Following table showcases the evolution of sustainable development reporting in the recent past:





6. EVOLUTION OF ESG IN INDIA

In India, the Ministry of Corporate Affairs (MCA) took the initiative to guide the corporates towards responsible conduct and a sustainable future by issuing Corporate Social Responsibility Voluntary Guidelines in December 2009.

The “Voluntary Guidelines on Corporate Social Responsibility”, announced by the MCA in 2009, was one of the earliest initiatives taken by the Government of India. Its ultimate goal was to integrate sustainability into business practices and into decision making process.

The MCA further issued additional guidelines, known as the “National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business, 2011” (NVGs), emphasising the importance of corporate entities’ environmental, social, and economic responsibilities, as well as the need to integrate them into business practices and investment decision making processes.

2009 – ‘Corporate Social Responsibility Voluntary Guidelines 2009’

MCA issued CSR voluntary guidelines for the businesses to add value to the operations and contribute towards the long-term sustainability of the business. The most important element of these was to encourage the corporates to focus on Ethical functioning, Rights and welfare of workers, Human Rights, Environmental development and taking social development activities.

2011 – ‘National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business’

In July 2011 ‘National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business’ came which contained comprehensive principles to be adopted by companies as part of their business practice.

2012 – SEBI Mandates top 100 listed companies to file Business Responsibility Report

Top 100 listed companies by market capitalization were required to file Business Responsibility Report (BRR). This report was in line with the ESG principles.

2015 – BRR became part of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

SEBI vide Circular no. CIR/CFD/CMD/10/2015 dated November 04, 2015, had prescribed the format for the Business Responsibility Report (BRR) in respect of reporting on ESG (Environment, Social

and Governance) parameters by listed entities in line with clause (f) of sub regulation (2) of regulation 34 of SEBI(LODR) Regulations 2015. Top 500 listed companies by market capitalization were required to file Business Responsibility Report (BRR).

2017 – SEBI recommended Integrated Reporting for top 500 listed companies

On 6 February 2017, SEBI issued a circular advising top 500 listed companies which are required to prepare BRR to adopt IR on a voluntary basis from the financial year 2017-18.

2019 - National Guidelines on Responsible Business Conduct (NGRBC) 2018

MCA revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and formulated the National Guidelines on Responsible Business Conduct (NGRBC).

2019 – BRR became mandatory for top 1,000 listed companies

As per SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2019, with effect from December 26, 2019, the annual report of the top 1,000 listed entities based on market capitalization shall contain a business responsibility report as per clause (f) of sub regulation (2) of regulation 34 of Listing Regulations.

2021 - New reporting requirements on ESG parameters called the Business Responsibility and Sustainability Report (BRSR).

Under notification no. SEBI/LAD-NRO/GN/2021/22 dated May 05, 2021, SEBI introduced new reporting requirements on ESG parameters called the Business Responsibility and Sustainability Report (BRSR).

The BRSR seeks disclosures from listed entities on their performance against the nine principles of the 'National Guidelines on Responsible Business Conduct' (NGBRCs) and reporting under each principle is divided into essential and leadership indicators.

The essential indicators are required to be reported on a mandatory basis while the reporting of leadership indicators is on a voluntary basis. Listed entities should endeavour to report the leadership indicators also.

The BRSR is intended towards having quantitative and standardized disclosures on ESG parameters to enable comparability across companies, sectors, and time.

<u>2009</u> National Voluntary Guidelines (NVGs) (MCA issued NVGs on corporate social responsibility)	<u>2012</u> Business Responsibility Report (BRR) The top 100 listed companies file BRR based on NVGs along with their annual reports	<u>2014</u> Corporate social responsibility (CSR) is mandated, and CSR Rules come into force	<u>2015</u> Extension to top 500 listed companies for filing BRR	<u>2017</u> Integrated Reporting (IR) may be adopted on a voluntary basis from FY 2017- 18 by the top 500 companies which are required to prepare BRR	<u>2019</u> - National Guidelines on Responsible Business Conduct (NGRBC) released - Extension to the top 1,000 listed companies for filing BRR	<u>2021</u> Business Responsibility and Sustainability Report (BRSR) Introduction of BRSR in May 2021	<u>2022</u> Mandatory reporting of top 1,000 listed companies to file BRSR along with the annual reports
							

7. INITIATIVES BY ICAI

In Feb 2020, ICAI constituted Sustainability Reporting Standards Board (SRSB). Mission of the SRSB is to take appropriate measures to increase awareness and implement measures towards responsible business conduct, developing audit guidance for Integrated Reporting

ICAI, encouraged by SEBI, introduced India's first award to celebrate the business practice of Integrated Reporting, internationally acknowledged as the emerging best practice in corporate reporting

ICAI has also started a Certificate Course on Sustainable Development Goals (SDGs), Business Responsibility Reports (BRR), Integrated Reporting (IR) & also proposed an ICAI Executive Development Program on Business Responsibility Reporting (BRR)

In last 2 years, ICAI has issued following publications:

- Standard on Assurance Engagements (SAE 3410) – Assurance Engagements on Greenhouse Gas Statements
- Background Material on BRSR (revised 2021)
- Sustainable Development Goals – Accountants creating sustainable World – Parts 1 covering SDGs 1 to 5

- Sustainable Development Goals – Accountants creating sustainable World – Parts 1 covering SDGs 6 to 11
- Sustainable Development Goals – Accountants creating sustainable World – Parts 1 covering SDG 12 to 17
- FAQs on Sustainability Reporting – Heart of Good Governance
- Sustainability Reporting Maturity Model (SRMM) – Version 1.0

7.1 BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORT (BRSR)

Reporting under BRSR is mandatory from financial year 2022-23. However, disclosure was voluntary in financial year 2021-22.

The reporting questionnaire is divided into three sections:

(i) Section A – General Disclosures

This section contains the details of the listed companies, its products, services, operations, employee related details, its holding, subsidiary, associate companies etc.

(ii) Section B – Management Process and disclosures

It contains questions related to policy and management processes, governance, leadership, and oversight.

(iii) Section C – Principle-wise performance disclosures

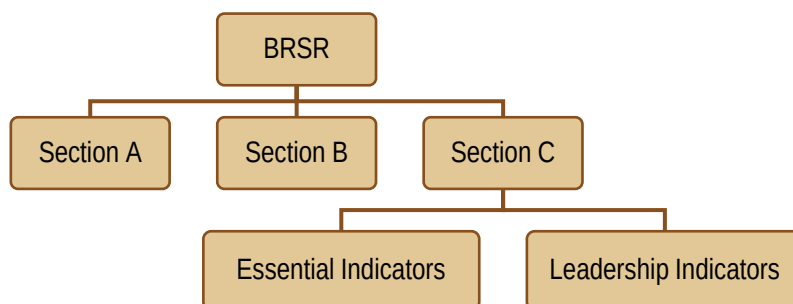
Companies are required to report upon Key performance indicators (KPIs) in alignment with the nine principles of the NGRBC. The section classifies KPIs into two categories that companies are required to report upon:

- Essential indicators (Mandatory disclosures)

This would include data on training programs conducted, environmental data on energy, emissions, water, waste management etc.

- Leadership indicators (Optional disclosures)

It would include life cycle assessments, details of conflict management policy, additional data, on biodiversity, energy consumptions, supply chain managements etc.



7.1.1 Nine Principles of BRSR

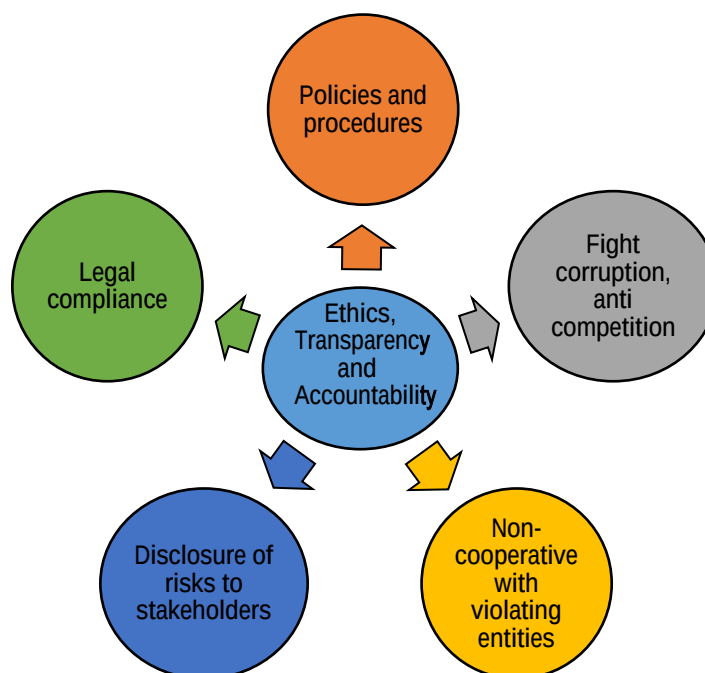
The nine principles in BRSR are categorized into the ESG components of Environment, Social and Governance with two of the nine in Environment, three in social and four in Governance. Even though they are separate, they are interlinked to each other in some way. For example, the environmental protection is closely linked to the stakeholder engagement and inclusive growth.

Principle 1 – Ethics, Transparency and Accountability:

The first principle emphasizes that the business decisions in an organisation should be open to disclosure and accessible to the relevant interested parties.

The essence of the core elements associated with the first principle are:

- a) The entities' governing structure should develop policies, procedures, and practices for their offices, factories, and work areas, ensuring that ethics is not compromised.
- b) The information relating to the policies, procedures, and practices along with the performance should be made available to the stakeholders.
- c) In case of adverse effects, more care has to be taken for transparent disclosures.
- d) The entities in the value chain should be encouraged to adopt these principles by the governance structure.
- e) The entities should proactively respond to the outside entities that violate the nine principles of the BRSRs. This includes their suppliers, distributors, sub-contractors, or regulatory officers that may engage with the business concern.



Principle 2 – Safe and Sustainable Goods and Services:

The entities should make sure that their goods, services, and the operations result in better life for the consumers and end-users.

The essence of the core elements associated with the second principle is:

- a) When a product is designed by the entity, the production methods and technologies have to be devised in such a way so as to minimize the resource usage to make it sustainable.
- b) The entities are also responsible to educate and make aware their consumers and clients about their rights.
- c) The entities should take measures that reduce the over exploitation of the nature's resources by consuming sustainably and encourage methods for reduce, reuse and recycling of the resources.

Principle 3 – Promote well-being of all employees including those in the value chain:

The third principle relates to all the initiatives an entity has to take for the benefit of its employees from the point of view of their dignity, health, well-being.

The essence of the core elements associated with the principle is:

- a) The entity should ensure compliance with all regulatory requirements as far as employees are concerned.
- b) The entities are to respect the dignity of employee as a human being and should not restrict their freedom of associations, unions, and other participatory mechanism for collective bargaining of their rights and redressal of issues they face at the workplace.
- c) The entities should prevent all kinds of child labour, bonded labour, and any other forms of involuntary labour.
- d) The entities should have a system in which the work-life balance of the employees is not compromised.
- e) The businesses have to ensure timely payment of the worker's wages and compensation.
- f) The payment of the wages has to be as per the living wages, that can take care of the basic needs and provide economic security to the employees.
- g) The entities are responsible to create a workplace and work environment that is safe, hygienic, and comfortable for people to work for long durations.
- h) The skill development, career development and training of the workforce is another responsibility of the entities employing them.
- i) The creation of a workplace which is free of harassment and violence is also a responsibility of the entity.

Principle 4 - Respect for stakeholders' interests and responsiveness:

The concept of interested party or stakeholders to a business has been a point of discussion in all the regulatory and voluntary systems that relate to the management system of any organisation, be it related to the quality, environment or the occupational health and safety of the workers.

The essence of the core elements associated with the principle is:

- a) The entities have to be transparent and communicate with the stakeholders about the impacts of their operations and business decisions on the people and the nature. The policies, decisions, and the impact of the operations of the organisation to the stakeholders have to be disclosed transparently with no ambiguity on the extent of the issues.
- b) The entities have to systematically determine the context of their operation and identify their interested parties.

- c) The entities should fairly share the benefits to the stakeholders or give an opportunity to them to benefit from the operations in an equitable manner.

Principle 5 - Respect and promote human rights:

The concept of human rights is a vast topic that covers a wide variety of violence and belligerent abusive issues faced by people. It refers to the human rights issues that happen directly or indirectly due to the operation of the business.

The essence of the core elements associated with the principle are:

- a) The entities should have a clear understanding of the human rights and various ways by which human rights can be violated from the perspective of the Constitution of India, national laws and policies and the content of International Bill of Human Rights.
- b) The entities when developing their management systems, should integrate the human rights element into their policies, procedures, and practices.
- c) Businesses should recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace, including that of communities, consumers, and vulnerable and marginalized groups.

Principle 6 – Protection and restoration of Environment:

The sixth principle looks at the environmental responsibility as a basic requirement for the economic prosperity and sustainability.

The core elements associated with the principle are:

- a) The entities should have policies, procedures, and practices in place to assess and rectify impacts to the environment. This should cover the whole life cycle of the product.
- b) The entities have to make use of natural and manmade resources in an optimum manner to ensure their sustainability by taking feedback from the stakeholders.
- c) The entities have to measure their performance relating to the prevention of pollution, destruction of forests, waste generation, energy use, land use, etc.
- d) The entities have to contribute towards climate change resilience in line with India's commitment to various international mechanisms such as, Paris Agreement and National Action Plans for Climate Change.
- e) The entities should explore the comparison of its activities with industry best practices to reduce, reuse and recycle/ recover materials, resources.

- f) The companies have to look out for avenues by which they can improve their performance towards various environmental responsibilities.

Principle 7 – Influence on Public and Regulatory Policy:

The seventh principle of influencing the policy formulation positively recognizes that the businesses operate within the framework of statutory and legislative policies of the governing authority.

The principle further highlights that -

- a) The core elements of BRSR are to have met holistically when the organisation go ahead with their contributions to policy formulation and policy advocacy.
- b) The collective associations such as, the trade groups and industry chambers have to be utilized when moving ahead with the policy advocacy and formulation.
- c) The role in policy advocacy by the organisation should be in such a way that it encourages fair competition and prevents human rights abuses.

Principle 8 – Promote Inclusive Growth and equitable development:

This can work only with close participation and collaboration amongst the entities, authorities, the civil associations contributing to one another for a better livelihood, and assistance to the marginalized communities.

The core elements of the eighth principle are:

- a) The entities should have systems in place to identify and address impacts of their activities on the social, cultural, and economic aspects of the people. This includes business created issues like, land acquisition and use and construction activities for new facilities.
- b) The entities should review, measure, and track the adverse impacts of their activities on the society and environment and make action plans to mitigate them adequately.
- c) The entities should make efforts to bring up creative products, technologies, and business concerns that help the marginalized communities to have well-being and a better quality of life.
- d) Entities when designing their CSR activities should review the local and regional development priorities to help the marginalized groups and communities.
- e) The entities should take care to ensure that business induced displacement or relocation of communities does not happen, and in unavoidable cases, should make sure to have mutually

agreed, participative, and informed negotiations to provide fair compensation to the affected people.

- f) All forms of intellectual property and traditional knowledge should get the deserved respect from the organisation, and efforts should be made to ensure that benefits derived from their knowledge are shared equitably.

Principle 9 – Provide value to the consumers in a responsible manner:

The primary purpose of any business is to create or provide useful products and services to the customer in exchange of reasonable profits.

The core elements associated with the principle are:

- a) Entities should put in their efforts to reduce the negative impacts of their products and services on consumers, natural environment, and society at large.
- b) When conceptualizing, designing, and marketing their products, the organisation should not in any manner prevent the freedom of choice and fair competition.
- c) The entities should transparently and accurately disclose all kinds of adverse impacts to the user, planet, society, on the biodiversity from their products.
- d) When handling customer data, the right to privacy of the customer needs to be maintained.
- e) Entities should inform the customers on the safe and responsible ways of usage, reuse, recycling, and disposal of their products, and ways to eliminate over-consumption.
- f) When advertising about their products, the organisations should ensure that misleading and confusing information is not exposed to the customers about their products or its usage.
- g) Business enterprises should make available transparent and accessible grievance redressal and feedback management system for their customers to raise their voices or to seek clarifications.
- h) Entities, when in the business of providing essential goods and services (e.g., Utilities), should enable universal access, including to those whose services have been discontinued for any reason, in a non-discriminatory and responsible manner.

7.1.2 Alignment of BRSR Principles with SDGs

Principles/ SDGs	P1	P 2	P 3	P 4	P 5	P 6	P 7	P 8	P 9
SDG 1			☑	☑				☑	
SDG 2		☑				☑	☑	☑	☑
SDG 3			☑					☑	
SDG 4			☑					☑	☑
SDG 5			☑	☑	☑			☑	
SDG 6		☑				☑		☑	
SDG 7		☑				☑	☑		
SDG 8		☑	☑		☑			☑	
SDG 9		☑					☑		
SDG 10		☑					☑		
SDG 11			☑	☑			☑	☑	
SDG 12		☑				☑			☑
SDG 13		☑				☑	☑	☑	
SDG 14		☑				☑	☑	☑	☑
SDG 15		☑				☑	☑	☑	☑
SDG 16	☑		☑	☑	☑			☑	
SDG 17	☑						☑	☑	

7.1.3 Assurance in BRSR

SEBI has currently started with the top 1,000 listed companies. But very soon, remaining listed companies would also need to comply with the provisions of BRSR.

Further, BRSR is expected to be used as a single means for disclosing sustainability related information in India. This would be the main document which the stakeholders, investors would review and do industry analysis.

Hence, assurance in this reporting becomes more critical. ESG audit would be a process that would help the companies to evaluate the environmental and social risks for the Company's products, services, operations etc. Conducting an ESG audit also helps businesses look at their supply-chain risks, risk management capabilities and transparency with shareholders.

ICAI has recently issued *Standard on Sustainability Assurance Engagements (SSAE) 3000 Assurance Engagements on Sustainability Information*

This Standard deals with assurance engagements on an entity's sustainability information. This is an umbrella standard applicable to all assurance engagements on Sustainability information.

The intended users of this Standard include:

- Assurance providers providing assurance on sustainability information.
- Entities seeking to engage a professional auditor.
- Regulators, investors, and other users of Sustainability Reporting data.

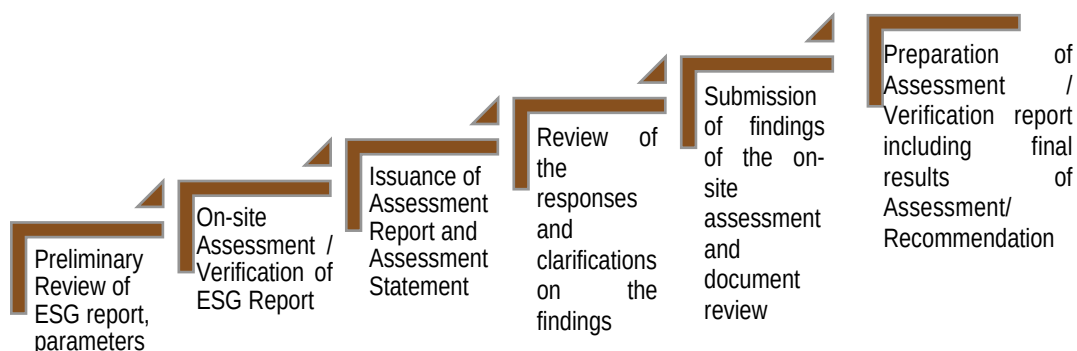
This Standard applies for assurance engagements which pertain to providing reasonable or limited assurance on sustainability information.

The effective date of application of SSAE 3000 is as follows:

- Voluntary basis for assurance reports covering periods ending on 31st March 2023.
- Mandatory basis for assurance reports covering periods ending on or after 31st March 2024.

ICAI has also issued SSAE 3410, *Assurance Engagements on Greenhouse Gas Statements* which deal with assurance engagements on an entity's sustainability information including assurance of BRSR.

7.1.4 Methodology to provide assurance on BRSR:



7.1.5 Social Audit Standards

The Sustainability Reporting Standards Board (SRSB) of the ICAI has recently issued Social Audit Standards (SAS 100 to 1600). These Standards aim to provide the Social Auditor with the necessary guidance in relation to independent impact assessment engagement of Social Enterprises engaged in various areas and the audit steps and procedures that should be applied while conducting the social impact assessment. The Standard sets out the minimum requirements to be followed while conducting impact assessment. Laws or regulations may establish additional requirements which should be followed, as applicable. Following SASs are issued:

SAS	Particulars
100	Eradicating hunger, poverty, malnutrition and inequality
200	Promoting health care including mental healthcare, sanitation and making available safe drinking water
300	Promoting Education, Employability, and Livelihoods
400	Promoting Gender Equality, Empowerment of Women and LGBTQIA+ communities
500	Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation
600	Protection of national heritage, art and culture
700	Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports
800	Supporting incubators of social enterprises
900	Supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building
1000	Promoting Livelihoods for rural and urban poor including enhancing income of Small and Marginal Farmers and workers in the non-farm sector
1100	Slum area development, affordable housing and other interventions to build sustainable and resilient cities
1200	Disaster Management, including Relief, Rehabilitation and Reconstruction Activities
1300	Promotion of financial inclusion
1400	Facilitating Access to Land and Property Assets for disadvantaged Communities
1500	Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection
1600	Promoting welfare of migrants and displaced persons



8. ROLE OF AUDITOR - CONSIDERATION OF CLIMATE RELATED RISKS IN AN AUDIT OF FINANCIAL STATEMENTS

The role of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, to enable auditor to report whether the financial statements are prepared and presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

In developing the understanding of an entity, the auditor should include the consideration of climate-related risks and how these risks may be relevant to the audits. The climate-related risks could be more relevant in certain sectors or industries, e.g., banks and insurance, energy, transportation, materials and buildings, agriculture, food, and forestry products.

Many investors and stakeholders are seeking information from auditor's reports about how climate-related risks were addressed in the audit. With this increased user focus on climate change, auditor need to be aware of, and may face, increasing pressure for transparency about climate matters in our auditor's reports. However, the auditor's reports must follow the requirements of applicable auditing standards.

The auditor's report is a key mechanism of communication to users about the audit that was performed. In addition to the audit opinion, it provides information about auditor's responsibilities and, when required, an understanding of the matters of most significance in our audit and how they were addressed.

In some circumstances, it may warrant inclusion of an Emphasis of matter paragraph to draw attention to disclosures that are of fundamental importance to users' understanding of the financial statements. The auditor should also determine whether the entity has appropriately disclosed relevant climate-related information in the financial statements in accordance with the applicable financial reporting framework e.g., Indian Accounting Standards or Accounting Standards, when relevant before considering climate-related matters in the auditor's report.

The auditor should also read the other information for consistency with information disclosed in the financial statements and information that may be publicly communicated to stakeholders outside the financial statements, such as management report narratives in the annual report, press releases, or investor updates. This is a requirement under ISA 720 and SA 720, The Auditor's Responsibilities Relating to Other Information.

Case Study

The agrochemical sector is about a \$35 billion industry in India. The Indian agrochemicals market is segmented by product type (fertilizers, pesticides, adjuvants, and plant growth regulators) and application (crop-based and non-crop-based). India is one of the most prominent exporters of agrochemicals in the world and is being keenly looked at as an ideal hub for export-oriented production of agrochemicals. There has been a recent surge in the production of agrochemicals to overcome problems such as lack of right nutritious elements required for proper growth of crops, etc. While there is low awareness about the use and impact of agrochemicals, there is also a push from the industries to use more agrochemicals, linking it to better yield. The continuous and increased use of agrochemicals seems to have an adverse effect on humans, animals, and nature in whole.

The toxicity levels of the agrochemicals are harmful, not only to the workers in the manufacturing process but also to farmers, the soil, and the end consumers. The Central Insecticide Board (CIB) of India has categorized agrochemical toxicity levels based on a labeling system—using red, yellow, blue, and green labels—where red is the most toxic and green is the least. Most of the red-labeled products are banned abroad but are being sold in India due to the lack of a strong regulatory environment.

In India, it is estimated that almost 25% of the total amount of agrochemicals sold are counterfeit products. The quality and the efficacy of these counterfeit products differ from the original products, which can lead to reputational damages for the companies. Agrochemical companies need to add barcodes or other identifying technologies to their product packaging, to allow end-use consumers to check for authenticity. Also, since India is a multilingual country, the companies will have to publish the usage instructions in multiple languages.

Company A and B are both listed companies and part of top 1000 listed companies. They are engaged in the production of agrochemicals. Company A has been looking for opportunities to comply with the recently launched and evolving guidelines for ESG in India while Company B on the other hand is just focused to increase revenue and profits. In December 2022, Company A made a decision to eliminate red-labeled products from its portfolio and to increase its research and development (R&D) spending to safeguard itself from the market shift due to the new regulatory norms; in 2022, it also discontinued yellow-labeled products. Company A is also planning to incur a small expenditure to improve their backend systems and provide for all its products a unique labeling system that is user friendly and interactive. At the other end of the spectrum, 14% of Company B's top-selling products are derived from red- and yellow labeled

products.

Initially, Company A's phasing out of its toxic products negatively affected its revenues by 8%. But as the country's regulatory landscape evolves toward more stringent norms, Company A will be cushioned for regulatory changes and thus, would not face potential future downsides. Company B has recently witnessed a 9% year on year growth in revenue from the last financial year and is planning to increase the production of its bestselling product, an insecticide DDT, categorized as red labelled by the Central Insecticide Board. Company B has recently been approached by the regulatory authority for an investigation for its products which include performing additional tests and studies to testify that its products have no adverse effects.

1. What would be the reporting requirements for each of the two companies?
2. Which Company has absorbed the impacts of possible future regulatory changes? What are the steps taken by that Company for complying with the regulatory standards?
3. What would be the consideration by the auditors of Company A and B in the audit of financial statements?



9. CONCLUSION

The overarching importance of sustainability reporting continues to gain momentum globally with demands from various stakeholders and substantial research and developments toward a uniform set of sustainability standards. The uniformity is not achieved yet due to lack of a common language for sustainability reporting. As reporting of sustainability information becomes the trend being observed globally, the demand for independent assurance of sustainability information is anticipated to grow as entities around the globe look to enhance the integrity of their sustainability reporting. Hence, it is imperative that auditors and assurance providers understand the current landscape and continue to monitor ongoing developments. The demand for assurance on "sustainability branded" reporting continues to grow and therefore there is an urgent need for globally accepted sustainability/ ESG assurance standards that can be used by all assurance professionals.

Integrated Case Scenario

"Quick Push Finance Limited" is one of the top listed 1000 companies by market capitalization. As per a SEBI circular, Business Responsibility and Sustainability Report (BRSR) based on ESG parameters is mandatory from financial year 2022-23 for top listed 1000 companies. The company is an NBFC and is engaged mainly in providing finance for commercial vehicles.

The report is to be prepared in three sections- Section A, B and C. Whereas Section A and B relate to general disclosures and management & process disclosures respectively, Section C of the report relates to principle wise performance disclosures. Under this section C, information is sought on each of the 9 principles of “National Guidelines on Responsible Business Conduct” (NGBRCs). This information is categorized on two indicators i.e., “*Essential indicators*” and “*Leadership indicators*”.

The said company has an anti-corruption/anti-bribery policy which is available on its website. Besides, the company has regularly conducted awareness programmes for its dealers highlighting relevant governance practices of the company.

The company is sensitive to environmental concerns. It has established mechanisms to recycle hazardous e-waste in accordance with applicable laws. Further, disposal of paper waste is also made responsibly. It is also a member of 5 prominent industry chambers/trade associations including FICCI, CII and ASSOCHAM. Besides, regular inputs to government are provided by the company through various forums for improvement in administrative processes relating to automobile and financial sectors.

One of the NGBRC principles states that businesses should promote inclusive growth and equitable development. The scope of this principle is wide and quite encompassing. Many activities of company could fall under promotion of inclusive growth and equitable development.

The CFO of company is clueless as to preparation of BRSR. Help him out by answering the following questions.

Based upon above, answer the following questions: -

1. As regards anti-corruption/anti-bribery policy and organization of awareness programmes for dealers conducted during the year, which of the following is most likely to be true?

(a) Having an anti-corruption/anti-bribery policy and organization of awareness programmes for dealers are in nature of essential indicators.

(b) Having an anti-corruption/anti-bribery policy and organization of awareness programmes for dealers are in nature of leadership indicators.

(c) Having an anti-corruption/anti-bribery policy is in nature of essential indicators. Organization of awareness programmes for dealers is in nature of leadership indicators.

(d) Having an anti-corruption/anti-bribery policy is in nature of leadership indicators. Organization of awareness programmes for dealers is in nature of essential indicators.

2. As regards established mechanisms for recycle of hazardous e-waste and disposal of paper waste by company, which of the NGBRC principle(s) are involved?

- (a) Principle 5 only
- (b) Principle 9 only
- (c) Principles 6 and 9
- (d) Principles 2 and 6

3. Considering description of membership of various industry chambers/ trade associations and providing of inputs to government for improvement in administrative processes, which of the NGBRC principle is referred to?

- (a) Principle 8
- (b) Principle 4
- (c) Principle 3
- (d) Principle 7

4. Which of the following activities relates to the principle that businesses should promote inclusive growth and equitable development?

- (a) CSR projects undertaken by the company in designated aspirational districts of country
- (b) Carrying out real time digital Net Promoter score (NPS) with all public customers to gauge customer reactions and satisfaction
- (c) Getting conducted "energy audits" in the company
- (d) Conducting programmes to assist employees in finding employment after retirement

5. Which of the following statements is true in respect of essential indicators and leadership indicators as far as their reporting in BRSR is concerned?

- (a) Both types of indicators are mandatorily required to be disclosed.
- (b) Essential indicators require mandatory disclosure whereas leadership indicators require voluntary disclosure.
- (c) Essential indicators require voluntary disclosure whereas leadership indicators require mandatory disclosure.
- (d) All indicators based information whether relating to essential indicators or leadership indicators is voluntary.

Key Takeaways

- Sustainable development is development that strives to meet the needs of developing countries seeking to achieve a more sustainable world. Sustainable development addresses the needs of the present moment without compromising current and future generations to meet their own sustainable lifestyles.
- Environment, social and governance form three pillars of ESG. Environmental, social and governance (ESG) reporting is all about disclosure of information, data, metrics that explain and added value in these three areas. ESG reporting can be both quantitative and qualitative in nature.
- Sustainable Development Goals (SDGs) are set of 17 goals in line with the 2030 Agenda for Sustainable Development” adopted by UN.
- International investors with global investment portfolios are increasingly calling for high quality, transparent, reliable, and comparable reporting by companies on climate and other environmental, social and governance (ESG) matters.
- The Integrated Reporting Framework is used to connect financial statements and sustainability-related financial disclosures. It has been established to develop high-quality, understandable, enforceable and globally accepted accounting and sustainability disclosure standards.
- The Integrated reporting framework identifies 6 capitals- financial capital, manufactured capital, natural capital, human capital, social capital and intellectual capital.
- ESG disclosure and reporting is mandatory for top 1000 listed companies in form of Business responsibility and sustainability reports. (BRSR).
- As reporting of sustainability information becomes the trend being observed globally, the demand for independent assurance of sustainability information is anticipated to grow as entities around the globe look to enhance the integrity of their sustainability reporting.

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *What type of companies are required to mandatorily furnish the Business Responsibility and Sustainability Report (BRSR) as per the SEBI circular with effect from FY 2022-23?*
2. *What are the nine principles of BRSR? How are the nine principles of BRSR linked with the 17 UN Sustainable Development Goals?*
3. *What are the global trends in sustainable reporting?*
4. *What are the 6 C's of Integrated reporting?*
5. *What is the methodology of providing assurance in BRSR?*
6. *What is the auditor's role on ESG aspects in an audit of financial statements of the Company?*

Answers to Test your Understanding

1. Sustainability reporting is an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development

Sustainability reporting refers to the information that companies provide about their performance to the outside world on a regular basis in a structured way. It is the comprehensive mechanism of measuring and disclosing sustainability data with performance indicators and management disclosures.

Expected Benefits: It can help stakeholders to understand organizations performance vis a vis sustainability and impacts. The reporting process emphasizes the link between financial and non-financial performance.

Such reporting can help entities to focus on long-term value creation, by addressing environmental, social and governance (ESG) issues. Since investors are increasingly recognising that environmental and social issues provide both risks and opportunities in respect of their investments and are seeking disclosures on environmental and social performance of businesses, they can use ESG performance of companies to make investment decisions.

Investing in social and environmental issues will not only improve own business continuity of companies but also put them in a better position with their B2B (Business to Business) customers as well as enable them to acquire new ones.

2. The information at [i] states that company has increased the number of customers using digital mobile app. Besides, it has led to 100% increase in digital collection. Therefore, it involves use of technology for deriving business benefits. It has invested in innovation deriving business benefits from digitization. The capital referred to at [i] is “Intellectual Capital”.

Increase in number of beneficiaries under flagship CSR programmes providing value for communities and sustainable livelihood is an example of relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being. The capital referred to at [ii] is “Social and Relationship Capital.”

Answers to Integrated Case Scenario

1. (c)
2. (d)
3. (d)
4. (a)
5. (b)

Answers to Case Study

1. Both Companies A and B are among part of top 1000 listed companies. Hence, these companies have to mandatorily provide BRSR reporting (Business responsibility and Sustainability reporting) in accordance with 9 principles of NGBRC as mandated by SEBI.
2. Company A has absorbed impact of regulatory changes. It has decided to eliminate red-labelled and yellow-labelled products from its portfolio which are toxic in nature. Besides, it has increased its expenditure on R & D to meet with new regulatory norms. It has also incurred expenditure for improving its labelling system which would help end users to know about the nature of the product. All these steps have been taken by Company A for complying with regulatory standards.

Company A is trying to meet with requirements of Principle 2 by making R & D expenditure. Further, it has also eliminated red-labelled/yellow-labelled products from its portfolio. Principle 2 relates to the requirement that businesses should provide goods and services in

a manner that is sustainable and safe. Besides, by adopting a friendly bar-coded packaging labelling system, company is adhering to requirements of Principle 9 which states that businesses should engage with and provide value to their consumers in a responsible manner. Steps taken by a company to inform its consumers about safe and responsible usage of products fall in its domain.

Since toxic agrochemicals are also harmful to workers engaged in their manufacturing process, their discontinuation bodes well for workers in the company A in line with Principle 3 which states that businesses should respect and promote the well-being of all employees including those in their value chains. By discontinuing products which are harmful to soil, company A is meeting requirements of Principle 6 which states that businesses should respect and make efforts to protect and restore the environment.

3. Company A is complying with regulatory norms whereas 14% of company B's revenue are derived from red and yellow labelled products. In fact, company B is planning to increase production of its red labelled product i.e., insecticide DDT which has been categorized as such by Central Insecticide Board. The auditor of Company B would have to keep in mind requirements of SA 250 in this regard. Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements. It can result in material misstatements. Central Insecticide Board has already launched its investigation into products of company. All these factors would be taken into consideration by auditor of Company B.

Auditors of Company A and Company B need to obtain audit evidence regarding compliance with laws and regulations and audit procedures have to be designed accordingly. Auditor of Company A can obtain assurance from regulatory compliance by the company. Fall of revenue by 8% in one year is not a matter of concern to them as it is a transitory phase.

However, auditors of Company B would also have to take into consideration requirements of SA 570 as non-compliance with regulatory requirements could result into claims from such proceedings which the company may not be able to satisfy.

Hints /Answers to Theoretical Questions

1. Refer para 7.1
2. Refer para 7.1.1
3. Refer para 3.
4. Refer para 4.
5. Refer para 7.1.4
6. Refer para 8.

PROFESSIONAL ETHICS & LIABILITIES OF AUDITORS



LEARNING OUTCOMES

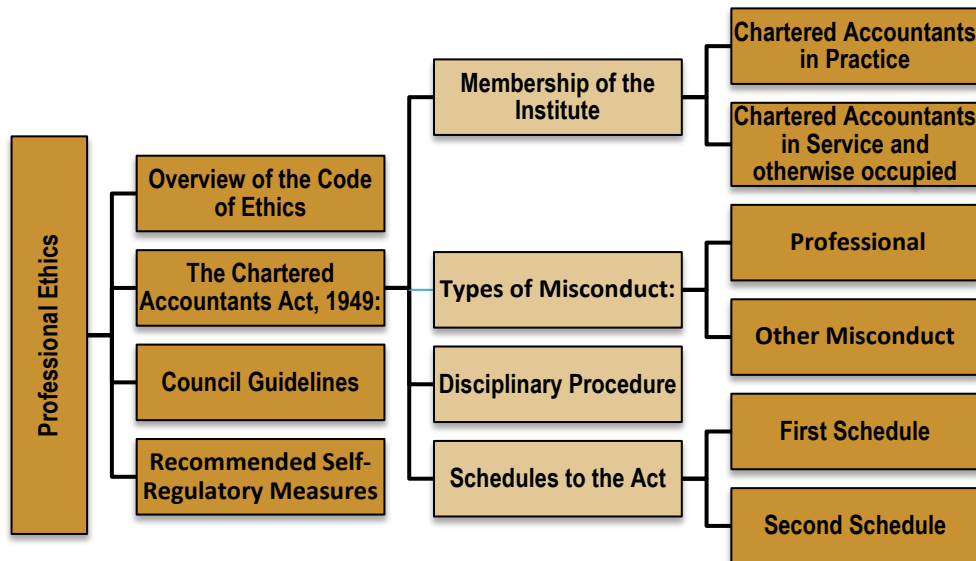
After reading this chapter student shall be able to:

- ☐ Understand the Application of the International and Indian Code of Ethics theoretically/practically.
- ☐ Learn the Application of Fundamental Principles of Professional Ethics by Professional Accountants in practice, service or otherwise occupied.
- ☐ Identifying threats and Safeguards measures while Compliance of Fundamental Principles of Professional Ethics.

CHAPTER OVERVIEW



This chapter encapsulates the relevant professional ethics guidelines, requirements and the standards of conduct expected from a Chartered Accountant. The Chapter has been divided into various sections to facilitate systematic and easy learning by the students.



CA R is one of the leading practitioners in Varanasi and is a partner in audit firm consisting of 8 partners. The firm is allotted branch audit of a leading public sector bank in the same city having advances of ₹450 crore. Advances portfolio of the branch consist of some reputed export firms.

It is noticed during audit that drawing power in stock statements submitted to bankers by these firms is not arrived at properly. There are no apparent errors as such. The issue he is raising can be overlooked, if he chooses to do so. Besides, his staff also digs out certain frivolous procedural irregularities in relation to these accounts. The accounts of all these firms are, otherwise, operating satisfactorily. He intends to report these accounts as NPAs in memorandum of changes and is creating headache for AGM every other day. Completion of audit is being delayed on one pretext or another. Even informal calls by Circle DGM prove to be futile. The amounts involved are huge and much is at stake for branch management.

Frustrated and harassed AGM of branch advises owners of these firms to meet CA R in his office and sort out the matter themselves. Out of 7 such firms, 3 owners meet him in his office and assure to avail services of his firm in immediate future. They also try to assuage his ego. He leaves out these accounts from reporting. Owners of the remaining firms do not meet him. Peeved by this, their loan accounts are reported as NPA and adverse comments are made in LFAR.

Is Chartered accountant acting ethically? The answer is resounding NO. He is trying to put his personal benefit and interest above all things. He is overlooking certain matters falling in his discretion selectively for obvious reasons. He is not looking at things objectively. A distinguishing feature of Chartered Accountancy profession is the acceptance of responsibility to act in public interest. Such a behavioural attitude is not expected from professionals. Ethics is something which comes from an individual intrinsically. It has to be ingrained in the temperament of an individual to withstand any selfish motive or temptation. It is a state of mind to act and perform in accordance with moral principles. Spirit of ethics is to be followed and not only what is expressly stated or codified.

Consider another case of a practicing Chartered Accountant who comes to know of certain information by virtue of his association with a client. He is also dealing with another client in same line of business. Can he use information acquired from first client to advantage or disadvantage of second client? Again, answer would be in negative. As by doing so, he could breach confidentiality. It can lead to conflict of interest. A professional accountant is not supposed to allow a conflict of interest to compromise professional or business judgment.

Professional work of accountants could involve ethical situations on a daily basis consisting of perceived benefits, pressures or dilemmas. There could be a thin line of difference between ethical and unethical. It requires judgment in every situation in accordance with spirit of ethics and its principles.

Exhaustive code of ethics is in place for public accountants. It not only contains fundamental principles governing professional ethics along with conceptual framework but also deals with independence requirements for assurance engagements. Besides, there are specific provisions of Chartered Accountants Act, 1949 dealing with professional misconduct.

1. INTRODUCTION

The Oxford Dictionary states ethics as “the moral principle that governs a person's behavior or how an activity is conducted”. It is the branch of knowledge that deals with moral principles, whereas “*Professional Ethics*” consist of personal, organizational and corporate standards of behaviour expected for professionals.

Chartered Accountants as professionals are engaged in building trust to vast variety of users, whether shareholders, government, banks, investors, employees or others, which imposes a public interest responsibility on their profession. Like other professionals, Chartered Accountants also have some set of code of ethics. **This Code of Ethics establishes ethical requirements for Professional Accountants.**

A Chartered Accountant, either in practice or in service, has to abide by these ethical behaviours. They are expected to follow the fundamental principles of professional ethics while performing their jobs. Service users of professionals should be able to feel secure that there exists a framework of professional ethics which governs the provision of those services. Any deviation from the ethical responsibilities brings the disciplinary mechanism into action against the Chartered Accountants.



Fig: Professional Ethics*

Code of Ethics– Its Necessity: Ethics are as old as human civilization. It is nothing but the laws or rules of acceptable behaviour. The whole foundation of any profession, particularly CA profession, is its credibility. The sole purpose of Code of Ethics is to ensure and uphold this credibility. The main ingredient of our profession is independence. An auditor needs to be independent while carrying out his audit. The provisions discussed in the same ensure that the independence of members of the Institute is not affected.

Our Institute's Motto – '**Ya Esha Supteshu Jagrati**' is adopted from Kathopanishad and it denotes 'eternal vigilance' – awakening when the world is asleep.

A distinguishing feature of the accountancy profession is its acceptance of the responsibility to act in the public interest. Code of Ethics seeks to protect the interests of the profession as a whole. It is a shield that enables us to command respect.



2. OVERVIEW OF THE CODE OF ETHICS

The revised Code of Ethics contains the following material:

- **Part 1** – Complying with the Code, Fundamental Principles and Conceptual Framework, which includes the fundamental principles and the conceptual framework and is applicable to all professional accountants.
- **Part 2** – Professional Accountants in Service, which sets out additional material that applies to professional accountants in service when performing professional activities. Professional accountants in service include professional accountants employed, engaged or contracted in an executive or non-executive capacity in, for example:
 - Commerce, industry or service.
 - The public sector.
 - Education.

- The not-for-profit sector.
- Regulatory or professional bodies.

Part 2 is also applicable to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm as an employee.

- **Part 3 – Professional Accountants in Public Practice**, which sets out additional material that applies to professional accountants in public practice when providing professional services.
 - **Independence Standards**, which sets out additional material that applies to professional accountants in public practice when providing assurance services, as follows:
 - **Part 4A – Independence for Audit and Review Engagements**, which applies when performing audit or review engagements.
 - **Part 4B – Independence for Assurance Engagements Other than Audit and Review Engagements**, which applies when performing assurance engagements that are not audit or review engagements.
- **Glossary**, which contains defined terms (together with additional explanations where appropriate) and described terms which have a specific meaning in certain parts of the Code. For example, as noted in the Glossary, in Part 4A, the term “audit engagement” applies equally to both audit and review engagements. The Glossary also includes lists of abbreviations that are used in the Code and other standards to which the Code refers.



The Code contains sections which address specific topics. Some sections contain subsections dealing with specific aspects of those topics.

Each section of the Code is structured, where appropriate, as follows:

- **Introduction** – sets out the subject matter addressed within the section, and introduces the requirements and application material in the context of the conceptual framework. Introductory material contains information, including an explanation of terms used, which is important to the understanding and application of each Part and its sections.
- **Requirements** – establish general and specific obligations with respect to the subject matter addressed.
- **Application material** – provides context, explanations, suggestions for actions or matters to consider, illustrations and other guidance to assist in complying with the requirements.

A professional accountant shall comply with the Code. There might be circumstances where laws or regulations preclude an accountant from complying with certain parts of the Code. In such circumstances, those laws and regulations prevail, and the accountant shall comply with all other parts of the Code.

2.1 Fundamental Principles

In order to achieve the objectives of the Accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles. The fundamental principles as discussed in Code of Ethics of ICAI, to be complied, are given below:



(a) Integrity – Subsection 111

1. A professional accountant shall comply with the principle of integrity, **which requires an accountant to be straightforward and honest** in all professional and business relationships. Integrity implies fair dealing and truthfulness.
2. A professional accountant shall not knowingly be **associated with** reports, returns, communications or other information where the accountant believes that the information:
 - (a) Contains a materially false or misleading statement;
 - (b) Contains statements or information provided negligently; or
 - (c) Omits or obscures required information where such omission or obscurity would be misleading.

However, a professional accountant will **not be considered to be in breach** of matters mentioned above in paragraph 2 if the professional accountant provides a modified report in respect of such above mentioned matter.

3. When a professional accountant becomes aware of having been associated with information described in paragraph 2, the accountant shall **take steps to be disassociated** from that information.

(b) Objectivity- Subsection 112

A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

(c) Professional Competence and Due Care – Subsection 113

1. A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:
 - (a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
 - (b) act diligently in accordance with applicable technical and professional standards.

2. **Serving** clients and employing organizations **with professional competence** requires the **exercise of sound judgment** in applying **professional knowledge** and **skill** when undertaking professional activities.
3. **Maintaining professional competence** requires a **continuing awareness** and an **understanding** of relevant **technical, professional and business developments**.
4. **Continuing professional development** enables a professional accountant to **develop** and **maintain** the **capabilities** to perform competently within the professional environment.
5. **Diligence** encompasses the **responsibility to act** in accordance **with the requirements** of an assignment, **carefully, thoroughly** and on a **timely** basis.
6. In **complying** with the **principle of professional competence and due care**, a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

Where appropriate, a professional accountant shall make clients, the employing organization, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities.

(d) Confidentiality- Subsection 114

1. A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships. An accountant shall:

Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;

Maintain confidentiality of information within the firm or employing organization;

Maintain confidentiality of information disclosed by a prospective client or employing organization;

Not disclose confidential information acquired as a result of professional and employment relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;

Not use confidential information acquired as a result of professional and employment relationships for the personal advantage of the accountant or for the advantage of a third party;

Not use or disclose any confidential information, either acquired or received as a result of a professional or employment relationship, after that relationship has ended; and

Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

2. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

- (a) Disclosure is **required by law**,



☞ Production of documents or other provision of evidence in the course of legal proceedings.

☞ Disclosure to the appropriate public authorities of infringements of the law that come to light

- (b) Disclosure is **permitted by law and is authorized by the client** or the employing organisation;

- (c) There is a **professional duty or right to disclose**, when not prohibited by law:

- (i) To comply with the requirements of Peer Review or Quality Review of the Institute;
- (ii) To **respond** to an inquiry or investigation by a professional or regulatory body;
- (iii) To **protect** the professional interests of a professional accountant in legal proceedings; or
- (iv) To **comply** with **technical and professional standards**, including ethics requirements.

3. In deciding whether to disclose confidential information, professional accountants should consider the following points:

- (a) Whether the interests of any party, including third parties whose interests might be affected, could be harmed if the client or employing organization consents to the disclosure of information by the professional accountant;

(b)	Whether all the relevant information is known and substantiated, to the extent it is practicable; and
(c)	The proposed type of communication, and to whom it is addressed;
(d)	Whether the parties to whom the communication is addressed are appropriate recipients.

4. A professional accountant shall continue to comply with the principle of confidentiality even after the end of the relationship between the accountant and a client or employing organization. When changing employment or acquiring a new client, the accountant is entitled to use prior experience but shall not use or disclose any confidential information acquired or received as a result of a professional or employment relationship.

(e) Professional Behaviour- Subsection 115

1. A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any **conduct** that accountant knows or should know might discredit the profession.

Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

2. When promoting himself and his work, a professional accountant shall not bring the profession into disrepute. A professional Accountant is required to conduct his affairs in a manner that he remains outside the boundaries of professional and other misconduct. A professional accountant shall be honest and truthful and should not make:
- (a) Exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or
 - (b) Disparaging references or unsubstantiated comparisons to the work of others.
 - (c) Any direct or indirect measures to advertise any professional/other facts which are in violation of Advertisement Guidelines issued by the Council of the Institute from time to time.

The professional accountant should ensure that the contents of an advertisement are true to the best of his knowledge and belief, and are in conformity with the Advertisement Guidelines, and be aware that the Institute does not own any responsibility, whatsoever, for such contents or claims by him. However, if a professional accountant is in doubt about whether a form of proposed advertising is appropriate, the accountant is encouraged to consult with the Ethical Standards Board of ICAI.

A professional accountant shall comply with each of the fundamental principles.

The fundamental principles of ethics establish the standard of behaviour expected of a professional accountant.

The conceptual framework establishes the approach which an accountant is required to apply to assist in complying with those fundamental principles.

A professional accountant might face a situation in which complying with one fundamental principle conflicts with complying with one or more other fundamental principles. In such a situation, the accountant might consider consulting, with:



However, such consultation does not relieve the accountant from the responsibility to exercise professional judgment to resolve the conflict or, if necessary, and unless prohibited by law or regulation, disassociate from the matter creating the conflict.

The professional accountant is encouraged to document the substance of the issue, the details of any discussions, the decisions made and the rationale for those decisions.

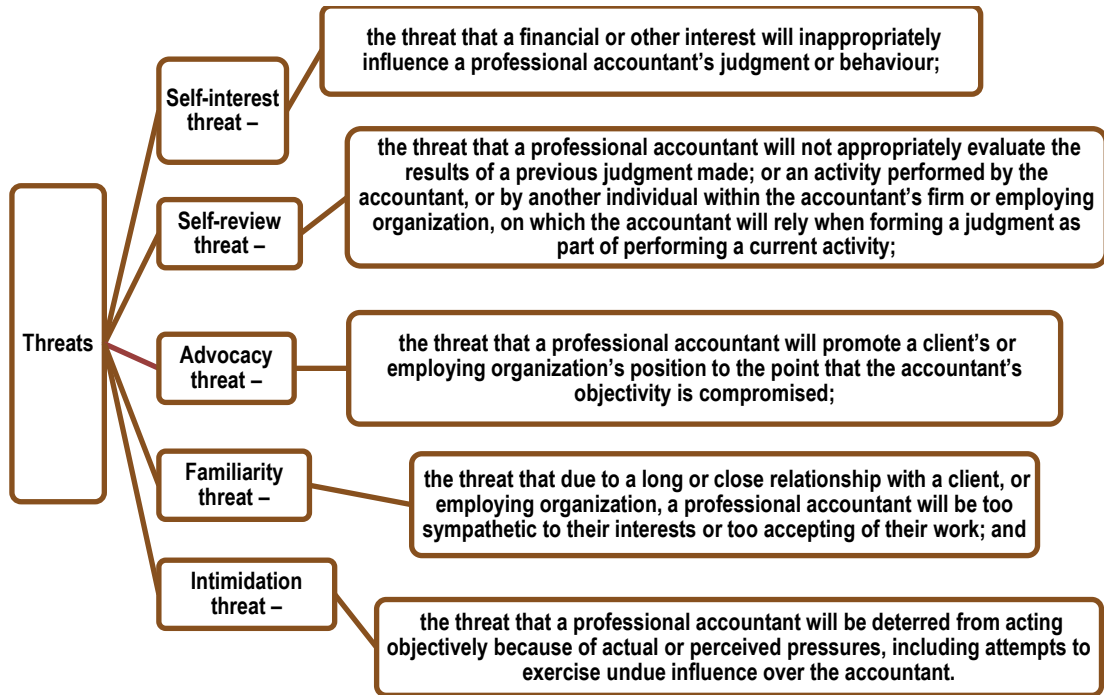
2.2 Threats, Evaluation of Threats and Safeguards

The conceptual framework specifies an approach for a professional accountant to:

- (i) Identify threats to compliance with the fundamental principles;
- (ii) Evaluate the threats identified; and
- (iii) Address the threats by eliminating or reducing them to an acceptable level.

A. Threats

Threats to compliance with the fundamental principles fall into one or more of the following categories:



A. The following are examples of facts and circumstances within each of those categories of threats that might create threats for a professional accountant when undertaking a professional service:



Self-interest Threats:

- A professional accountant having a direct financial interest in a client.
- A professional accountant quoting a low fee to obtain a new engagement and the fee is so low that it might be difficult to perform the professional service in accordance with applicable technical and professional standards for that price.
- A professional accountant having a close business relationship with a client.
- A professional accountant having access to confidential information that might be used for personal gain.
- A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the **accountant's firm**.

**Self-review Threats**

- A professional accountant issuing an assurance report on the effectiveness of the operation of financial systems after implementing the systems.
- A professional accountant having prepared the original data used to generate records that are the subject matter of the assurance engagement.

**Advocacy Threats**

- A professional accountant promoting the interests of, or shares in, a client.
- A professional accountant acting as an advocate on behalf of a client in litigation or disputes with third parties.
- A professional accountant lobbying in favor of legislation on behalf of a client.

**Familiarity Threats**

- A professional accountant having a close or immediate family member who is a director or officer of the client.
 - A director or officer of the client, or an employee in a position to exert significant influence over the subject matter of the engagement, having recently served as the engagement partner.
- An audit team member having a long association with the audit client.

**Intimidation Threats**

- A professional accountant being threatened with dismissal from a client engagement or the firm because of a disagreement about a professional matter.
- A professional accountant feeling pressured to agree with the judgment of a client because the client has more expertise on the matter in question.
- A professional accountant being informed that a planned promotion will not occur unless the accountant agrees with an inappropriate accounting treatment.
- A professional accountant having accepted a significant gift from a client and being threatened that acceptance of this gift will be made public.”.

B. The following are examples of facts and circumstances within each of those categories that might create threats for a professional accountant when undertaking a professional activity:



Self-interest Threats

- A professional accountant holding a financial interest in, or receiving a loan or guarantee from, the employing organization.
- A professional accountant participating in incentive compensation arrangements offered by the employing organization.
- A professional accountant having access to corporate assets for personal use.
- A professional accountant being offered a gift or special treatment from a supplier of the employing organization.



Self-review Threats

- A professional accountant determining the appropriate accounting treatment for a business combination after performing the feasibility study supporting the purchase decision.



Advocacy Threats

- A professional accountant having the opportunity to manipulate information in a prospectus in order to obtain favorable financing.



Familiarity Threats

- A professional accountant being responsible for the financial reporting of the employing organization when an immediate or close family member employed by the organization makes decisions that affect the financial reporting of the organization.
- A professional accountant having a long association with individuals influencing business decisions.



Intimidation Threats

- A professional accountant or immediate or close family member facing the threat of dismissal or replacement over a disagreement about:
 - The application of an accounting principle.
 - The way in which financial information is to be reported.
- An individual attempting to influence the decision-making process of the professional accountant, for example with regard to the awarding of contracts or the application of an accounting principle.

Specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats cannot be categorized. In either professional or business relationships, a professional accountant in public practice should always be on the alert for such circumstances and threats.

B. Evaluation of Threats:

The conditions, policies and procedures described above might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level.

- (i) **Acceptable level:** An acceptable level is a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.
- (ii) **Reasonable and Informed Third Party:** The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.

C. Addressing Threats

If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating them or reducing them to an acceptable level. The accountant shall do so by:

- (i) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (ii) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (iii) Declining or ending the specific professional activity.

Actions to Eliminate Threats: Depending on the facts and circumstances, a threat might be addressed by eliminating the circumstance creating the threat. However, there are some situations in which threats can only be addressed by declining or ending the specific professional activity. This is because the circumstances that created the threats cannot be eliminated and safeguards are not capable of being applied to reduce the threat to an acceptable level.

D. Safeguards:

Safeguards are actions individually or in combination that the accountant takes that effectively reduce threats to an acceptable level. Safeguards vary depending on the facts and circumstances.

Examples of actions that in certain circumstances might be safeguards to address threats include:



- Assigning additional time and qualified personnel to required tasks when an engagement has been accepted might address a self-interest threat.
- Having an appropriate reviewer, who was not a member of the team, review the work performed or advise as necessary might address a self-review threat.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review, advocacy or familiarity threats.
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy, familiarity or intimidation threats.
- Separating teams when dealing with matters of a confidential nature might address a self-interest threat.

2.3 Non-Compliance with Laws and Regulations (NOCLAR)

In the course of providing a professional service to a client or carrying out professional activities for an employer, a Professional accountant may come across an instance of non-compliance with laws and regulations (NOCLAR) or suspected NOCLAR committed or about to be committed **by the client or the employer**, or by those charged with governance, management or employees of the client or employer.

Non-compliance with laws and regulations (“non-compliance”) comprises of acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by:

- ☐ a client/professional accountant’s employing organisation;
- ☐ those charged with governance of a client or employing organisation;
- ☐ management of a client/ employing organisation; or
- ☐ other individuals working for or under the direction of a client/ employing organisation.

However, NOCLAR under Revised Code of Ethics does not address the personal misconduct unrelated to the business activities of the client/ employing organisation and non-compliance by parties other than listed out in the definition of NOCLAR.

As per IESBA, following examples would be covered in NOCLAR:-

Fraud, corruption and bribery	Money laundering, terrorist financing and proceeds of crime	Securities markets and trading	Banking and other financial products and services
Data protection	Environmental protection	Public health and safety	Tax and pension liabilities and payments

The objective of NOCLAR is that - turning a blind eye to potential NOCLAR is not an appropriate response from professional accountants, while placing renewed emphasis on the roles of management and those charged with governance in addressing the matter. Further, it increases awareness and understanding among Professional accountant of their legal and regulatory responsibilities when they face NOCLAR.

Some important facts about NOCLAR are given below:

During Course of Providing a Service: NOCLAR will be applicable if a professional accountant encounters, or is made aware of, non-compliance or suspected non-compliance in the course of providing a professional service to a client. He is not required to investigate, nor responsible for ensuring complete compliance.

Expertise of Laws not Required: A professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, he is not expected to have a level of knowledge of laws and regulations greater than that which is required to undertake the engagement. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

Certain Matters Expressly out of Purview: Matters that are clearly inconsequential, or relating to personal misconduct pertaining to business activities of the client not covered.

Disclosure, which is Contrary to Law not Required: As per IESBA Code, disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation.

2.3.1 Applicability of NOCLAR in India:

1. **Responding to Non-Compliance with Laws and Regulations (NOCLAR) applicable to Professional Accountants in service (Section 260):** Applicable to Senior Professional Accountants in service, being employees of listed entities.

Senior professional accountants in service ("senior professional accountants") are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources.

It is further explained that the senior professional accountants refer to key managerial personnel.

2. **Responding to Non-Compliance with Laws and Regulations (NOCLAR) applicable to Professional Accountants in public practice (Section 360) :** Applicable to Audit engagements of entities the shares of which are listed on recognized stock exchange(s) in India and have net worth of 250 crores of rupees or more.

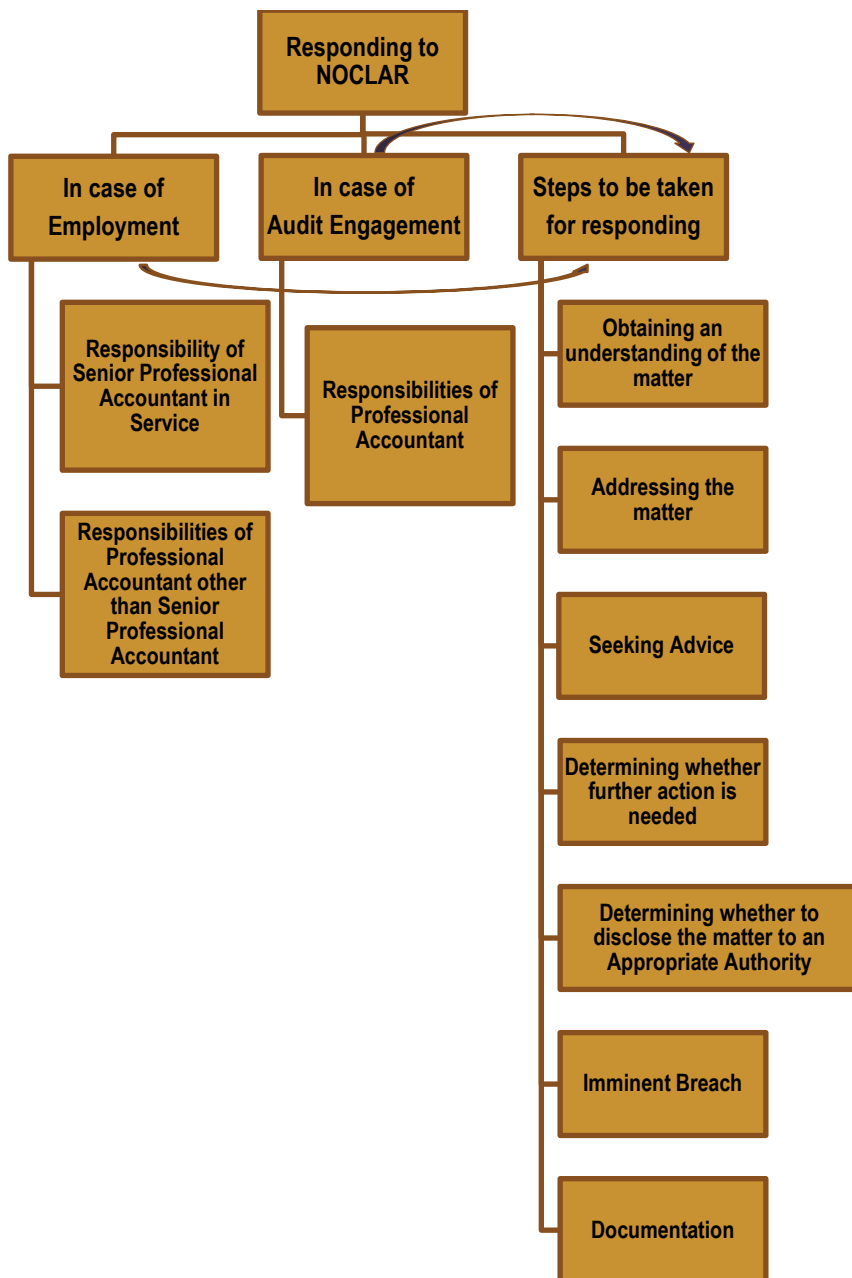
"For the purpose of Section-360 "Audit" or "Audit engagement" shall mean a reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements give a true and fair view in accordance with an applicable financial reporting framework".

2.3.2 NOCLAR vs. SA 250

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

the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted. This provision is not existent in SA 250.

2.3.2 Applicability of NOCLAR in India:



It may also be noted that in a situation where disclosure ought to be made by the Auditor, the “Appropriate authority” for the purpose of disclosure will depend on the nature of the matter. For example, the appropriate authority would be SEBI in the case of fraudulent financial reporting.

Appropriate alignment has been made in the Code with regard to requirements of Confidentiality, as required under Chartered Accountants Act, 1949.

2.3.3 Provisions of Confidentiality under Chartered Accountants Act, 1949

For Members in practice – Clause (1) of Part -I of Second schedule to The Chartered Accountants Act, 1949 : A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he 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;

For Members in service - Clause (2) of Part-II to the Second Schedule of the Chartered Accountants Act, 1949 : A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer;

Documentation Requirements in NOCLAR :

Revised Code over and above require the professional accountant to follow the additional documents requirements as under:

- How management / those charged with governance have responded to the matter.
- The course of action the accountant considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party test.
- How the accountant is satisfied that the responsibility of public interest has been fulfilled.

This documentation is in addition to complying with the documentation requirements under applicable auditing standards. SAs, for example, require a professional accountant performing an audit of financial statements to:

- Prepare documentation sufficient to enable an understanding of significant matters arising during the audit, the conclusions reached, and significant professional judgments made in reaching those conclusions;

- Document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place; and
- Document identified or suspected non-compliance, and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.



3. MEMBERSHIP OF THE INSTITUTE

On acceptance of application by the Council, the applicant's name shall be entered in the Register and a certificate of membership in the appropriate Form shall be issued to the applicant.

Particulars of the Register: Section 19 of the Chartered Accountants Act, 1949 provides the particulars to be included in the Register about every member of the Institute, namely-

Full name, date of birth, domicile, residential and professional address;	
Date of entry of name in the Register;	Qualifications;
Whether the member holds a COP; and	Any other prescribed particulars.

3.1 Disabilities for the Purpose of Membership

Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, as follows:

- If he has not attained the age of 21 years at the time of his application for the entry of his name in the Register of members; or
- If he is of unsound mind and stands so adjudged by a competent court; or
- If he is an undischarged insolvent; or
- If he, being a discharged insolvent, or has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part; or
- If he has been convicted by a competent Court whether within or without India, of an offence involving moral turpitude and punishable with imprisonment or of an offence, not of a technical nature, committed by him in his professional capacity unless in respect of the offence committed he has either been granted a pardon or, on an application made by him in this behalf, the Central Government has, by an order in writing, removed the disability; or

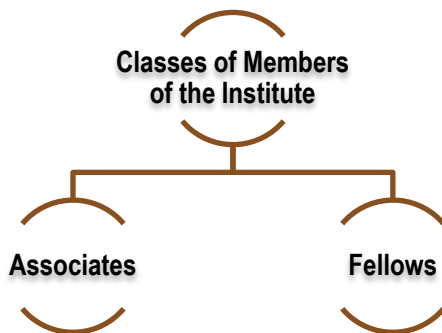
- (vi) If he has been removed from membership of the Institute on being found on inquiry to have been guilty of professional or other misconduct;

It may be noted that a person who has been removed from membership for a specified period, shall not be entitled to have his name entered in the Register until the expiry of such period.

In addition, failure on the part of a person to disclose the fact that he suffers from any one of the disabilities aforementioned would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities aforementioned, can be removed from the Register of Members by the Council.

3.2 Types of Members of the Institute

Section 5 of the Chartered Accountants Act, 1949 provides the division of members of the Institute. The members shall be divided into two classes designated as Associates and Fellows.



Associate Member: Any person, whose name has been entered in the Register of members, shall be deemed to have become an Associate of the Institute and shall also be entitled to use the letters A.C.A. after his name to indicate that he is an Associate Member of the Institute.

Fellow Member: The name of following types of members shall be entered into the Register of members as a Fellow of the Institute, on

payment of such fees along with the application made and granted in the prescribed manner-

- (i) An associate member who has been in continuous practice in India for at least 5 years,
- (ii) A member who has been an associate for a continuous period of not less than 5 years and who possesses such qualifications as may be prescribed by the Council with a view to ensuring that he has experience equivalent to the experience normally acquired as a result of continuous practice for a period of 5 years as a Chartered Accountant.

The abovementioned members shall be entitled to use the letters F.C.A. after his name to indicate that he is a Fellow Member of the Institute.

3.3 Removal of Name from the Register

As per section 20 of the Act, the Council may remove, from the Register, the name of any member of the Institute in the following cases-

- (i) who is dead; or
- (ii) from whom a request has been received to that effect; or
- (iii) who has not paid any prescribed fee required to be paid by him; or
- (iv) who is found to have been subject at the time when his name was entered in the Register of members, or who at any time thereafter has become subject, to any of the disabilities mentioned in Section 8, or who for any other reason has ceased to be entitled to have his name borne on the Register.

The Council shall remove the name of any member from the Register in respect of whom an order has been passed under this Act removing him from membership of the Institute.

If the name of any member has been removed from the Register for non-payment of prescribed fee as required to be paid by him, then, on receipt of an application, his name may be entered again in the Register of members on payment of the arrears of annual fee and entrance fee along with such additional fee, as may be determined by the Council.

3.4 Restoration of Membership

In addition to the provisions of the section 20 of the Chartered Accountants Act, 1949 (as discussed in above Para), Regulation 19 of the Chartered Accountants Regulations, 1988, states that the name of the member may be restored by the Council in the Register on an application, in the appropriate Form, received in this behalf whose name has been removed from the Register for non-payment of prescribed fee as required to be paid by him, if he is otherwise eligible to such membership, on his paying the arrears of annual membership fee, entrance fee and additional fee determined by the Council under the Act.

However, the effective date in case of restoration of cancelled membership, in different situations, shall be in the following manner:

Application for restoration and requisite fees are made within the same year of removal	• Restoration shall be with effect from the date on which it was removed from the Register.
Removal of name under the orders of the Board of Discipline or the Disciplinary Committee or the Appellate Authority or the High Court	• Restoration shall be in accordance with such orders.
In other cases	• Restoration shall be with effect from the date on which the application and fee are received.

3.5 Penalty for Falsely Claiming to be a Member etc.

Section 24 of the Chartered Accountants Act, 1949 provides that any person who-

- (i) not being a member of the Institute;
 - (a) represents that he is a member of the Institute; or
 - (b) uses the designation Chartered Accountant;
- (ii) being a member of the Institute, but not having a certificate of practice, represents that he is in practice or practices as a Chartered Accountant,

shall be punishable on first conviction with fine which may extend to ₹ 1000, and on any subsequent conviction with imprisonment which may extend to 6 months or with fine which may extend to ₹ 5,000, or with both.

The provision may be understood with a case, where, the Court of Additional Chief Judicial Magistrate had by its judgement found the accused guilty under Section 24(i)(a) & (b) of the Chartered Accountants Act, 1949 and Section 465 of the Indian Penal Code. The Court imposed a fine on the accused and in the event of his failure to pay the fine, sentenced to rigorous imprisonment for three months. (Case of Prem Batra decided on 18.7.1989)

4. CHARTERED ACCOUNTANTS IN PRACTICE

A practicing Chartered Accountant is a person who is a member of the Institute and is holding Certificate of Practice; and includes such members of the Institute who are deemed to be in Practice in accordance with the provisions of the Chartered Accountants Act, 1949.

4.1 Significance of the Certificate of Practice

Section 6 of the Chartered Accountants Act, 1949 provides that: -

- (1) No member of the Institute shall be entitled to practise whether in India or elsewhere unless he has obtained from the Council a certificate of practice:

It may be noted that this provision is not applicable to any person who, immediately before the commencement of this Act, has been in practice as a registered accountant or a holder of a restricted certificate until one month has elapsed from the date of the first meeting of the Council.

- (2) Every such member shall pay such annual fee for his certificate as may be determined, by notification, by the Council [...], and such fee shall be payable on or before the 1st day of April each year
- (3) The certificate of practice obtained under sub-section (1) may be cancelled by the Council under such circumstances as may be prescribed.

A member who is not in practice is precluded from accepting engagement to render services of any of the types normally prescribed for a Chartered Accountant, even though for doing so, he does not require special qualifications.

The Council of the institute is of view that-

- (i) Once the person concerned becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act and its Regulations. If and when he appears before the Income-tax Tribunal as an Income-tax representative after having become a member of the Institute, he could so appear only in his capacity as a Chartered Accountant and a member of the Institute. Having, as it were, brought himself within the jurisdiction of the Chartered Accountants Act and its Regulations, he could not set them at naught by contending that even though he continues to be a member of the Institute and has been punished by suspension from practice as a member, he would be entitled, in substance, to practice in some other capacity.
- (ii) A member of the Institute can have no other capacity in which he can take up such practice, separable from his capacity to practice as a member of the Institute."

Therefore, in nutshell, **a Chartered Accountant whose name has been removed from the membership for professional and/or other misconduct, during such period of removal, will not appear before the various tax authorities or other bodies before whom he could have appeared in his capacity as a member of this Institute.**

Illustration 1

A Chartered Accountant in practice has been suspended from practice for a period of 6 months and he had surrendered his Certificate of Practice for the said period. During the said period of suspension, though the member did not undertake any audit assignments, he undertook representation assignments for income tax whereby he would appear before the tax authorities in his capacity as a Chartered Accountant.

Solution

Undertaking Tax Representation Work: A chartered accountant not holding certificate of practice cannot take up any other work because it would be violation of the relevant provisions of the Chartered Accountants Act, 1949.

In case a member is suspended and is not holding Certificate of Practice, he cannot in any other capacity take up any practice separable from his capacity to practice as a member of the Institute. This is because once a person becomes a member of the Institute; he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations.

If he appears before the income tax authorities, he is only doing so in his capacity as a chartered accountant and a member of the Institute. Having bound himself by the said Act and its Regulations made there under, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity.

Conclusion: Thus, in the instant case, a chartered accountant would not be allowed to represent before the income tax authorities for the period he remains suspended. Accordingly, in the present case he is guilty of professional misconduct.

4.2 Cancellation and Restoration of Certificate of Practice

Regulation 10 provides that a Certificate of Practice (COP) shall be liable for cancellation, if:

(i)	the name of the holder of the certificate is removed from the Register; or
(ii)	the Council is satisfied, after giving an opportunity of being heard to the person concerned, that such certificate was issued on the basis of incorrect, misleading or false information, or by mistake or inadvertence; or
(iii)	a member has ceased to practise; or
(iv)	a member has not paid annual fee for certificate of practice till 30 th day of September of the relevant year.

Where a COP is cancelled, the holder shall surrender the same to the Secretary.

Further, Regulation 11 on restoration of COP states that, on an application made in the approved Form and on payment of such fee, the Council may restore the COP with effect from the date on which it was cancelled, to a member whose certificate has been cancelled due to non-payment of the annual fee for the COP and whose application, complete in all respects, together with the fee, is received by the Secretary before the expiry of the relevant year.

4.3 Members - deemed to be in Practice

Every member of the Institute is entitled to designate himself as a Chartered Accountant. There are two classes of members, those who are in practice and those who are otherwise occupied. In Section 2(2) of the Act, the term deemed “to be in practice” has been defined as follows:

“A member of the Institute shall be deemed “to be in practice” when individually or in partnership with Chartered Accountants in practice, or in partnership with members of such other recognised professions as may be prescribed, he, in consideration of remuneration received or to be received.

(i)	engages himself in the practice of accountancy; or
(ii)	offers to perform or performs service involving the auditing or verification of financial transactions, books, accounts or records, or the preparation, verification or certification of financial accounting and related statements or holds himself out to the public as an accountant; or
(iii)	renders professional services or assistance in or about matters of principle or detail relating to accounting procedure or the recording, presentation or certification of financial facts or data; or
(iv)	renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice;

and the words “to be in practice” with their grammatical variations and cognate expressions shall be construed accordingly.

Explanation – An associate or a fellow of the Institute who is a salaried employee of a Chartered Accountant in practice or a firm of such Chartered Accountants or firm consisting of one or more chartered accountants and members of any other professional body having prescribed qualifications shall, notwithstanding such employment, be deemed to be in practice for the limited purpose of the training of Articled Assistants”.

Pursuant to Section 2(2)(iv) above, the Council has passed a resolution permitting a Chartered Accountant in practice to render entire range of “Management Consultancy and other Services”.

The expression “Management Consultancy and other Services” shall not include the function of statutory or periodical audit, tax (both direct taxes and indirect taxes) representation or advice concerning tax matters or acting as liquidator, trustee, executor, administrator, arbitrator or receiver, but shall include the following-

(i)	Financial management planning and financial policy determination.*
(ii)	Capital structure planning and advice regarding raising finance.*
(iii)	Working capital management.*
(iv)	Preparing project reports and feasibility studies.*
(v)	Preparing cash budget, cash flow statements, profitability statements, statements of sources and application of funds etc.
(vi)	Budgeting including capital budgets and revenue budgets.
(vii)	Inventory management, material handling and storage.
(viii)	Market research and demand studies.
(ix)	Price-fixation and other management decision making.
(x)	Management accounting systems, cost control and value analysis.
(xi)	Control methods and management information and reporting.
(xii)	Personnel recruitment and selection.
(xiii)	Setting up executive incentive plans, wage incentive plans etc.
(xiv)	Management and operational audits.
(xv)	Valuation of shares and business and advice regarding amalgamation, merger and acquisition. Acting as Registered Valuer under the Companies Act, 2013 read with The Companies (Registered Valuers and Valuation) Rules, 2017. (incorporated pursuant to decision of Council at its 388 th Meeting)
(xvi)	Business Policy, corporate planning, organisation development, growth and diversification.
(xvii)	Organisation structure and behaviour, development of human resources including design and conduct of training programmes, work study, job-description, job evaluation and evaluation of workloads.
(xviii)	Systems analysis and design, and computer related services including selection of hardware and development of software in all areas of services which can otherwise be

* Consideration of “tax implications” while rendering the services at (i), (ii), (iii) and (iv) above will be considered as part of “Management Consultancy and other services”.

rendered by a Chartered Accountant in practice and also to carry out any other professional services relating to EDP.

- (xix) Acting as advisor or consultant to an issue, including such matters as:
 - (a) Drafting of prospectus and memorandum containing salient features of prospectus. Drafting and filing of listing agreement and completing formalities with Stock Exchanges, Registrar of Companies and SEBI.
 - (b) Preparation of publicity budget, advice regarding arrangements for selection of (i) ad-media, (ii) centres for holding conferences of brokers, investors, etc., (iii) bankers to issue, (iv) collection centres, (v) brokers to issue, (vi) underwriters and the underwriting arrangement, distribution of publicity and issue material including application form, prospectus and brochure and deciding on the quantum of issue material (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).
 - (c) Advice regarding selection of various agencies connected with issue, namely Registrars to Issue, printers and advertising agencies.
 - (d) Advice on the post issue activities, e.g., follow up steps which include listing of instruments and dispatch of certificates and refunds, with the various agencies connected with the work.

Explanation - For removal of doubts, it is hereby clarified that the activities of broking, underwriting and portfolio management are not permitted.
- (xx) Investment counselling in respect of securities [as defined in the Securities Contracts (Regulation) Act, 1956 and other financial instruments.] (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).
- (xxi) Acting as registrar to an issue and for transfer of shares/other securities. (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).
- (xxii) Quality Audit.
- (xxiii) Environment Audit.
- (xxiv) Energy Audit.
- (xxv) Acting as Recovery Consultant in the Banking Sector.
- (xxvi) Insurance Financial Advisory Services under the Insurance Regulatory & Development Authority Act, 1999, including Insurance Brokerage.
- (xxvii) Acting as Insolvency Professional in terms of Insolvency and Bankruptcy Code, 2016 (incorporated pursuant to decision of Council at its 362nd Meeting).
- (xxviii) Administrative Services. (incorporated pursuant to decision of Council at its 388th Meeting) Administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Such services require little to no professional judgment and are clerical in nature.

Examples of administrative services include:



- Word processing services.
- Preparing administrative or statutory forms for client approval.
- Submitting such forms as instructed by the client.
- Monitoring statutory filing dates, and advising an audit client of those dates.

For example, the functions of a GST practitioner as specified under Rule 83(8) of Central Goods and Services Tax Rules, 2017:-



- (a) furnish the details of outward and inward supplies;
- (b) furnish monthly, quarterly, annual or final return;
- (c) make deposit for credit into the electronic cash ledger;
- (d) file a claim for refund;
- (e) file an application for amendment or cancellation of registration;
- (f) furnish information for generation of e-way bill;
- (g) furnish details of challan in form GST ITC-04;
- (h) file an application for amendment or cancellation of enrolment under rule 58; and
- (i) file an intimation to pay tax under the composition scheme or withdraw from the said scheme.

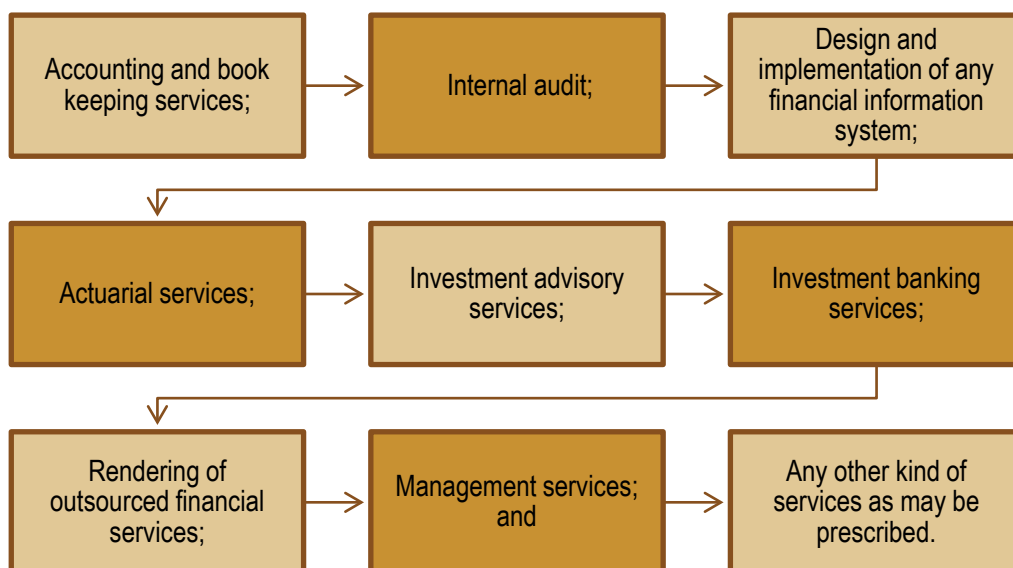
Pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949, read with Regulation 191 of Chartered Accountants Regulations, 1988 a member shall be deemed to be in practice if he, in his professional capacity and neither in his personal capacity nor in his capacity as an employee, acts as a liquidator, trustee, executor, administrator, arbitrator, receiver, adviser or representative for costing, financial or taxation matters or takes up an appointment made by the Central Government or a State Government or a court of law or any other legal authority or acts as a Secretary unless his employment is on a salary-cum-full-time basis.

It is necessary to note that a person is deemed to be in practice not only when he is actually engaged in the practice of accountancy but also when he offers to render accounting services whether or not he in fact does so. In other words, the act of setting up of an establishment offering to perform accounting services would tantamount to being in practice even though no client has been served.

It may also be noted that a member of the Institute is deemed to be in practice during the period he renders 'service with armed forces'.

The above provisions need to be correlated with the provisions of section 144 of the Companies Act, 2013 which prohibits an auditor of the company from rendering certain services directly or indirectly to the company or its holding company or its subsidiary company.

Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely (i) accounting and book-keeping services; (ii) internal audit; (iii) design and implementation of any financial information system; (iv) actuarial services; (v) investment advisory services; (vi) investment banking services; (vii) rendering of outsourced financial services; (viii) management services; and (ix) any other kind of services as may be prescribed.



Certain services not to be rendered by the Auditor as per section 144 of the Companies Act 2013.

Illustration 2

Mr. A, a practicing Chartered Accountant agreed to select and recruit personnel, conduct training programmes for and on behalf of a client where he is not providing any assurance service. Is this a professional misconduct?

Solution

Providing Management Consultancy and Other Services: Under Section 2(2)(iv) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed “to be in practice” when individually or in partnership with Chartered Accountants in practice, he, in consideration of remuneration received or to be received renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice. Pursuant to Section 2(2)(iv) above, the Council has passed a resolution permitting a Chartered Accountant in practice to render entire range of “Management Consultancy and other Services”.

The definition of the expression “Management Consultancy and other Services” includes Personnel recruitment and selection. Personnel Recruitment and selection includes, development of human resources including designing and conduct of training programmes, work study, job description, job evaluation and evaluations of workloads.

Conclusion: Therefore, Mr. A is not guilty of professional misconduct.

4.4 Companies not to Engage in Accountancy

Section 25 of the Chartered Accountants Act, 1949 provides that:

- (1) No company, whether incorporated in India or elsewhere, shall practise as chartered accountants.

Here, the term “company” shall include any limited liability partnership which has company as its partner for the purpose of this section.

- (2) If any company contravenes this provision then, without prejudice to any other proceedings which may be taken against the company, every director, manager, secretary and any other officer thereof who is knowingly a party to such contravention shall be punishable with fine which may extend on first conviction to ₹ 1,000 and on any subsequent conviction to ₹ 5,000.

In addition, as per section 141(2) of the Companies Act, 2013, where a firm (including a limited liability partnership) is appointed as an auditor of a company, then, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

Though the LLPs are allowed to be appointed as an auditor in accordance with the Companies Act, 2013, however, it cannot be engaged into practice, if it has company as its partner, as per the Chartered Accountants Act, 1949.

Therefore, it can be inferred that the LLP not having any company as its partner, can be engaged into practicing and thus take audit assignments.

4.5 Member in Practice Prohibited from using a Designation other than Chartered Accountant

- (i) Members of the Institute are now permitted to use the word 'CA' as prefix before their name irrespective of the fact that they are in practice or not.
- (ii) Under Section 7 of the Chartered Accountants Act, 1949 a member in practice cannot use any designation other than that of a Chartered Accountant, nor he can use any other description, whether in addition thereto or in substitution therefor, but a member who is not in practice and does not use the designation of a Chartered Accountant may use any other description. Nevertheless a member in practice may use any other letters or description indicating *shall be deemed to prohibit any such person from adding any other description or letters to his name, if entitled thereto, to membership of such other Institute of accountancy, whether in India or elsewhere, as may be recognised in this behalf by the Council, or any other qualification that he may possess, or to prohibit a firm, all the partners of which are members of the Institute and in practice, from being known by its firm name as Chartered Accountants.*

Merchant Banker / Advisor to an issue: The members may apply for and obtain registration as category IV Merchant Banker under the SEBI's rules and regulations and act as Advisor or Consultant to an issue. In client Companies' offer documents and advertisements regarding capital issue, name and address of the Chartered Accountant or firm of Chartered Accountants acting as Advisor or Consultant to the Issue could be indicated under the caption "Advisor/Consultant to the Issue". However, the name and address of such Chartered Accountant/firm of Chartered Accountants should not appear prominently.

Directors of Companies, Members of political parties, position in clubs, etc.: The members of the Institute who are also Directors in Companies, members of Political parties or Chartered Accountants Cells in the political parties, holding different positions in clubs or other organisations are not permitted to mention these positions as these would be violative of the provisions of Section 7 of the Act.

Members who are also Cost Accountants: Though a member cannot designate himself as a Cost Accountant, he can use the letters A.C.M.A (Associate) or F.C.M.A (Fellow) after his name, when he is a member of that Institute.

Permission to mention qualifications of certain Institutions: The members are permitted to mention membership of a foreign Institute of Accountancy, which has been recognized by the Council through a Memorandum of Understanding (MoU) / Mutual Recognition Agreement (MRA) with the said Institute.

Other Qualifications of the member

With regard to the other qualifications of a member, which he is permitted to mention, the following observations of the Supreme Court in *Institute of Chartered Financial Analyst of India (ICFAI) vs Council of the Institute of Chartered Accountants of India (ICAI)* dated 16th May, 2007 are relevant:

“The expression 'any other qualification that he may possess', therefore, must be read as qualification other than conferred upon the member by other Institutes of Accountancy. Such qualification of accountancy may be conferred even by other Institutes. But as noticed hereinbefore, an exemption had been granted by reason of a resolution of the Institute in relation to the Institute of Cost and Works Accountants. Furthermore, a degree conferred by any university also is subject to an exemption from the rigour of the provisions of Section 7 of the Act. There cannot, therefore, be any doubt whatsoever that 'the other qualification' would mean a qualification other than granted by an Institute of Accountancy, subject of course to recognition thereof by the Institute.”



3. For example, though a member cannot designate himself as a Cost Accountant, he can use the letters A.C.M.A. (Associate) or F.C.M.A. (fellow) after his name, when he is a member of that Institute.

It is improper for a Chartered Accountant to state on his professional documents that he is an Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant.

Members are allowed to appear before the various authorities including Company Law Board, Income Tax Appellate Tribunal, Sales Tax Tribunal where the law has permitted the same, so far as the designation “Corporate Lawyer” is concerned, the Council was of the view that as per the existing provisions of law, a Chartered Accountant in practice is not entitled to use the designation “Corporate Lawyer”.

Further, the members are not permitted to use the initials ‘CPA’ (standing for Certified Public Accountant) on their visiting cards.

Members of the Institute in practice who are otherwise eligible may also practice as Company Secretaries and/or Cost Accountants. Such members shall, however, not use designation/s of the aforesaid Institute/s simultaneously with the designation “Chartered Accountant”.

4.6 Maintenance of Branch Offices

In terms of Section 27 of the Act, if a Chartered Accountant in practice or a Firm of Chartered Accountants has more than one office in India, each one of such offices should be in the separate charge of a member of the Institute. Failure on the part of a member or a firm to have a member in

charge of its branch and a separate member in case of each of the branches, where there is more than one, would constitute professional misconduct.

However, exemption has been given to members practicing in hill areas subject to certain conditions. The conditions are:

(1)	Such members/firm be allowed to open temporary offices in a city in the plains for a limited period not exceeding 3 months in a year.
(2)	The regular office need not be closed during this period and all correspondence can continue to be made at the regular office.
(3)	The name board of the firm in the temporary office should not be displayed at times other than the period such office is permitted to function as above.
(4)	The temporary office should not be mentioned in the letterheads, visiting cards or any other documents as a place of business of the member/firm.
(5)	Before commencement of every winter it shall be obligatory on the member/firm to inform the Institute that he/it is opening the temporary office from a particular date and after the office is closed at the expiry of the period of permission, an intimation to that effect should also be sent to the office of the Institute by registered post.

Above conditions apply to any additional office situated at a place beyond 50 kms from the municipal limits in which any office is situated.

It is necessary to mention that the Chartered Accountant in-charge of the branch of another firm should be associated with him or with the firm either as a partner or as a paid assistant. If he is a paid assistant, he must be in whole time employment with him.

The requirement of Section 27 in regard to a member being in charge of an office of a Chartered Accountant in practice or a firm of such Chartered Accountants shall be satisfied only if the member is actively associated with such office. Such association shall be deemed to exist if the member resides in the place where the office is situated for a period of not less than 182 days in a year or if he attends the said office for a period of not less than 182 days in a year or in such other circumstances as, in the opinion of the Executive Committee, establish such active association.

However, a member can be in-charge of two offices if they are located in one and the same Accommodation. In this context some of the Council's decisions are as follows:

- (1) With regard to the use of the name-board, there will be no bar to the putting up of a name-board in the place of residence of a member with the designation of Chartered Accountant, provided it is a name-plate or a name-board of an individual member and not of the firm.

Illustration 3

Mr. X & Mr. Y, partners of a Chartered Accountant Firm, one in-charge of Head Office and another in-charge of Branch at a distance of 80 km. from the municipal limits, puts up a name-board of the firm in both premises and also in their respective residences.

Putting Name Board of the Firm at Residence: The council of the Institute has decided that with regard to the use of the name-board, there will be no bar to the putting up of a name-board in the place of residence of a member with the designation of chartered accountant, provided, it is a name-plate or board of an individual member and not of the firm.

In the given case, partners of XY & Co., put up a name board of the firm in both offices but not in their respective residences.

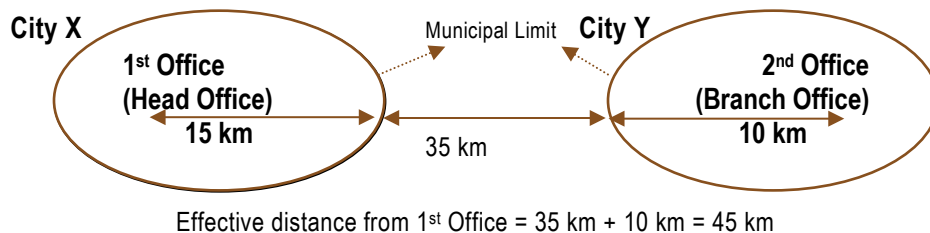
Conclusion: Thus, the chartered accountants are guilty of misconduct. Distance given in the question is not relevant for deciding.

- (2) The exemption may be granted to a member or a firm of Chartered Accountants in practice to have a second office without such second office being under the separate charge of a member of the Institute, provided-
- (a) the second office is located in the same premises, in which the first office is located or,
 - (b) the second office is located in the same city, in which the first office is located or,

City X



- (c) the second office is located within a distance of 50 km. from the municipal limits of a city, in which the first office is located.



A member having two offices of the type referred to above shall have to declare, which of the two offices is his main office, which would constitute his professional address.

Illustration 4

Mr. K, Chartered Accountant practicing as a sole proprietor has an office in the suburbs of Chennai. Due to increase in the income tax assessment work, he opens another office near the income tax office, which is within the city and at a distance of 30 km. from his office in the suburb. For running the new office, he has employed a retired Income Tax Commissioner who is not a Chartered Accountant.

Solution

Maintenance of Branch Office in the Same City: As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 km. from the municipal limits of a city, in which the first office is located.

In the given case, Mr. K, Chartered Accountant in practice as a sole proprietor at Chennai has an office in suburbs of Chennai, and due to increase in the work he opened another branch within the city near the income tax office. He also employed a retired income tax commissioner to run the new office and the second office is situated within a distance of 30 kilometers from his office in the suburb.

Conclusion: In view of above provisions, there will be no misconduct if Mr. K will be in-charge of both the offices. However, he is bound to declare which of the two offices is the main office.

4.7 KYC Norms for CA in Practice

The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice.

In light of this background, the Council of ICAI approved the following KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestation functions.

The KYC Norms approved by the Council of ICAI are given below:

1. Where Client is an Individual/ Proprietor

A. General Information

-  Name of the Individual
-  PAN No. or Aadhar Card No. of the Individual
-  Business Description
-  Copy of last Audited Financial Statement

B. Engagement Information

-  Type of Engagement

2. Where Client is a Corporate Entity

A. General Information

-  Name and Address of the Entity
-  Business Description
-  Name of the Parent Company in case of Subsidiary
-  Copy of last Audited Financial Statement

B. Engagement Information

-  Type of Engagement

C. Regulatory Information

-  Company PAN No.
-  Company Identification No.
-  Directors' Names & Addresses
-  Directors' Identification No.

3. Where Client is a Non-Corporate Entity**A. General Information**

-  Name and Address of the Entity
-  Copy of PAN No.
-  Business Description
-  Partner's Names & Addresses (with their PAN/Aadhar Card/DIN No.)
-  Copy of last Audited Financial Statement

B. Engagement Information

-  Type of Engagement

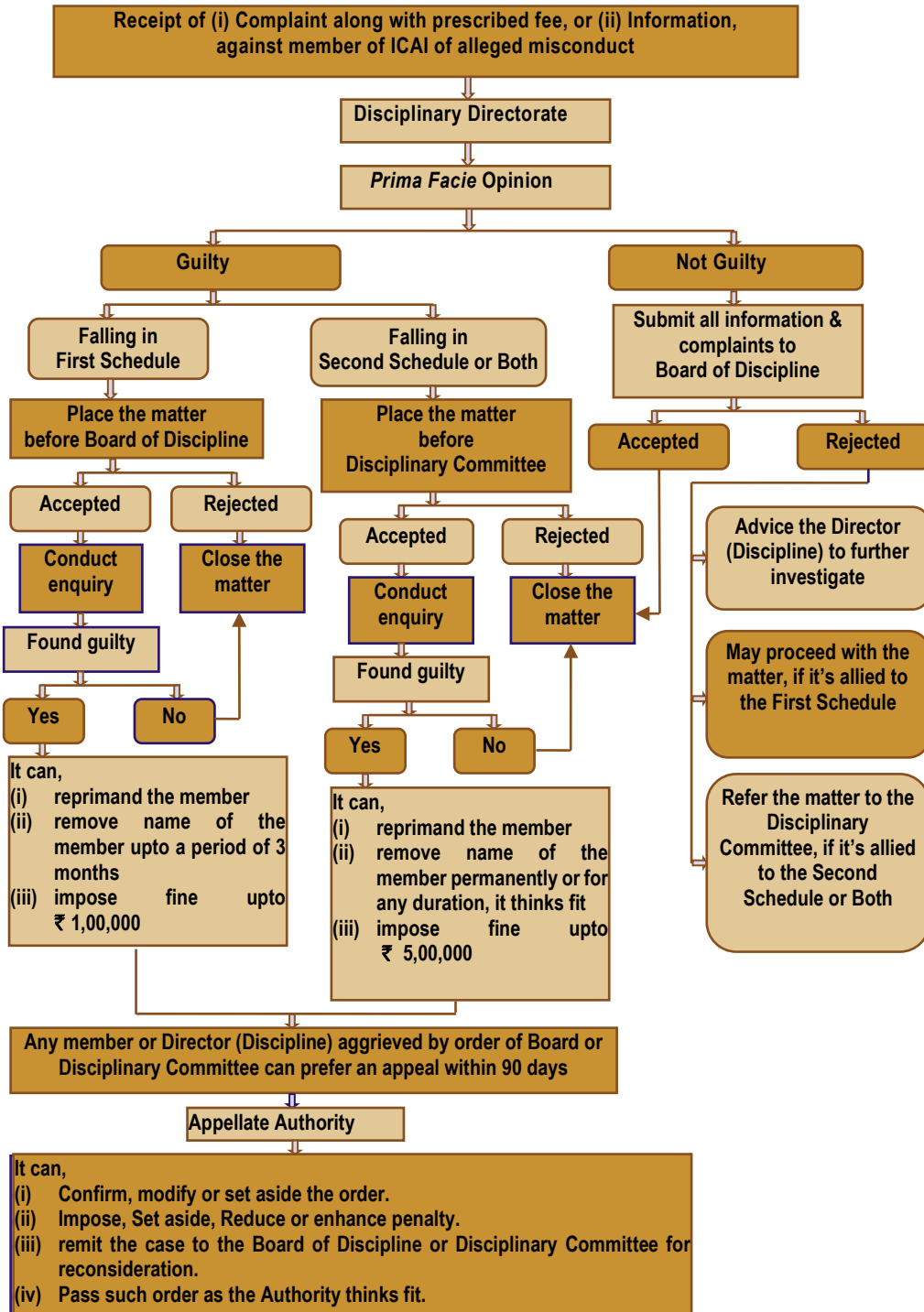
**5. CHARTERED ACCOUNTANTS IN SERVICE**

In accordance with the definitions provided under the Code of Ethics, a Professional Accountant in Service or Chartered Accountant in Service means a professional accountant employed or engaged in an executive or non-executive capacity in areas such as commerce, industry, service, the public sector, education, the not-for-profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.

**6 DISCIPLINARY PROCEDURE**

Sections 21, 21A, 21B, 21C, 22-A and 22-G of the Chartered Accountants Act read with The Chartered Accountants (Procedure of Investigations of Professional and Other Misconduct of Cases) Rules, 2007 have laid down the following procedure in regard to the investigation of misconduct of members which has been summarized as under:-

Flow Chart of Discipline Procedure Mechanism





7 TYPES OF MISCONDUCT: PROFESSIONAL OR OTHER MISCONDUCT

For the purposes of this Act, the expression “professional or other misconduct” shall be deemed to include any act or omission, on the part of any member of the Institute either in his individual capacity or as partner or owner of a firm, as mentioned in any of the Schedules, but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under sub-section (1) of section 21 to inquire into the conduct of such member or firm, under any other circumstances.’

A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any Professional or Other Misconduct.

7.1 Professional Misconduct

Professional misconduct has been defined in part I, II and III of the First Schedule; and part I and II of the Second Schedule. A member who is engaged in the profession of accountancy whether in practice or in service should conduct/restrict his actions in accordance with the provisions contained in the respective parts of the schedules. If the member is found guilty of any of the acts or omissions stated in any of the respective parts of the Schedule, he/she shall be deemed to be guilty of professional misconduct.

7.2 Other Misconduct

Other misconduct has been defined in part IV of the First Schedule and part III of the Second Schedule. These provisions empower the Council to inquire into any misconduct of a member even it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.



4. For example, a member who is found to have forged the will of a relative, would be liable to disciplinary action even though the forgery may not have been done in the course of his professional duty.

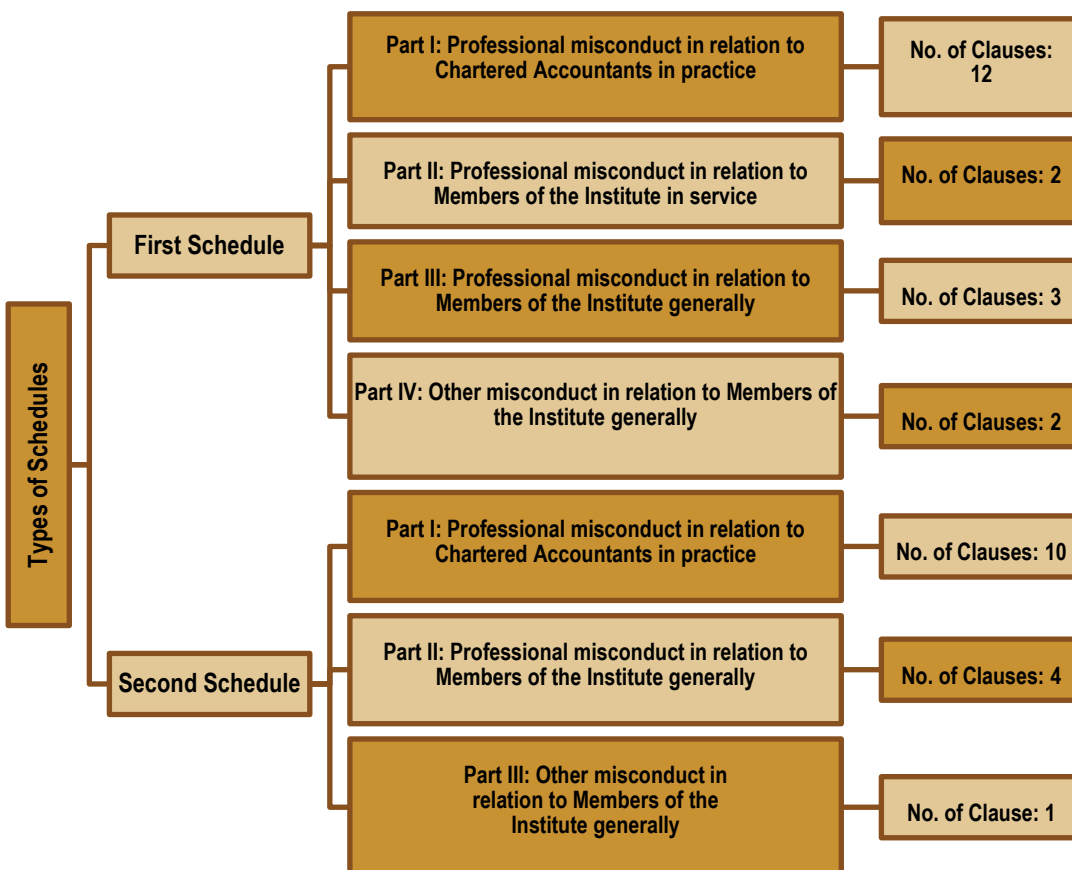
Other misconduct would also relate to conviction by a competent court for an offence involving moral turpitude punishable with transportation or imprisonment to an offence not of a technical nature committed by the member in his professional capacity. [See section 8(v) of the Act].



8. SCHEDULES TO THE ACT

Acts or omissions which comprise professional misconduct within the meaning of Section 22 of the Chartered Accountants Act are defined in two Schedules viz. the First Schedule and the Second Schedule. The First Schedule is divided into four parts, Part I of the First Schedule deals with the misconduct of a member in practice which would have the effect generally of compromising his position as an independent person. Part II deals with misconduct of members in services. Part III deals with the misconduct of members generally and Part IV deals with other misconduct in relation to members of the institute generally.

The Second Schedule is divided into three parts. Part I deals with misconduct in relation to a member in practice, Part II deals with misconduct of members generally and Part III deals with other misconduct in relation to members of the Institute generally.



The implications of the different clauses in the schedules are discussed below:

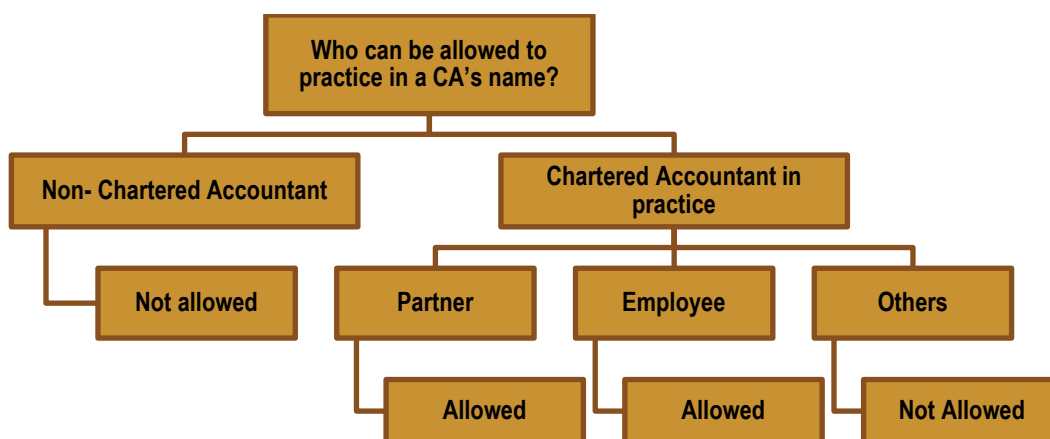
8.1 The First Schedule

Where the Director (Discipline) is of the opinion that member is guilty of any professional or other misconduct mentioned in the First Schedule; he shall place the matter before the Board of Discipline.

PART I - Professional Misconduct in relation to Chartered Accountants in Practice

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

Clause (1): allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.



The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner or his employee and would work under his control and supervision.

Illustration 5

Mr. C, Chartered Accountant, in practice allowed his brother-in-law Mr. P who is not a Chartered Accountant, to practice in the name of CA. C. He also allowed CA T who is employee in his firm to practice in the name. Whether Mr. C is correct in allowing his brother-in-law Mr. P and CA T employee of his firm to practice in his name.

Solution

Allowing to Practice in a Chartered Accountant's name: As per Clause (1) of Part I to the First Schedule to Chartered Accountants' Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows any person to practice in his name as a chartered

accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

In the given situation Mr. C, Chartered Accountant who is in practice allowed a non-Chartered Accountant his brother-in-law Mr. P to practice in the name of CA. C is not correct in view of Clause 1 of Part I to the First Schedule. However, he can allow CA T who is employee in his firm to practice in his name.

Conclusion: Thus, CA. C will be held guilty of professional misconduct for allowing Mr. P who is not a Chartered Accountant to practice in his name as a chartered accountant as per Clause (1) of Part I to the First Schedule.

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, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation - In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of item (4) of this Part.

It is in order for a member to share his fees or profits with another member of the Institute and/or a firm of Chartered Accountants. A practicing Member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as may be prescribed from time to time by the Council.

The Council has prescribed [**Regulation 53A (1)** of the Chartered Accountants Regulations, 1988] the professional bodies, which are as under: -

- (a) The Institute of Company Secretaries of India established under the Company Secretaries Act, 1980.
- (b) The Institute of Cost & Works Accountants of India established under the Cost & Works Accountants Act, 1959.
- (c) Bar Council of India established under the Advocates Act, 1961.
- (d) The Indian Institute of Architects established under the Architects Act, 1972.
- (e) The Institute of Actuaries of India established under the Actuaries Act, 2006.

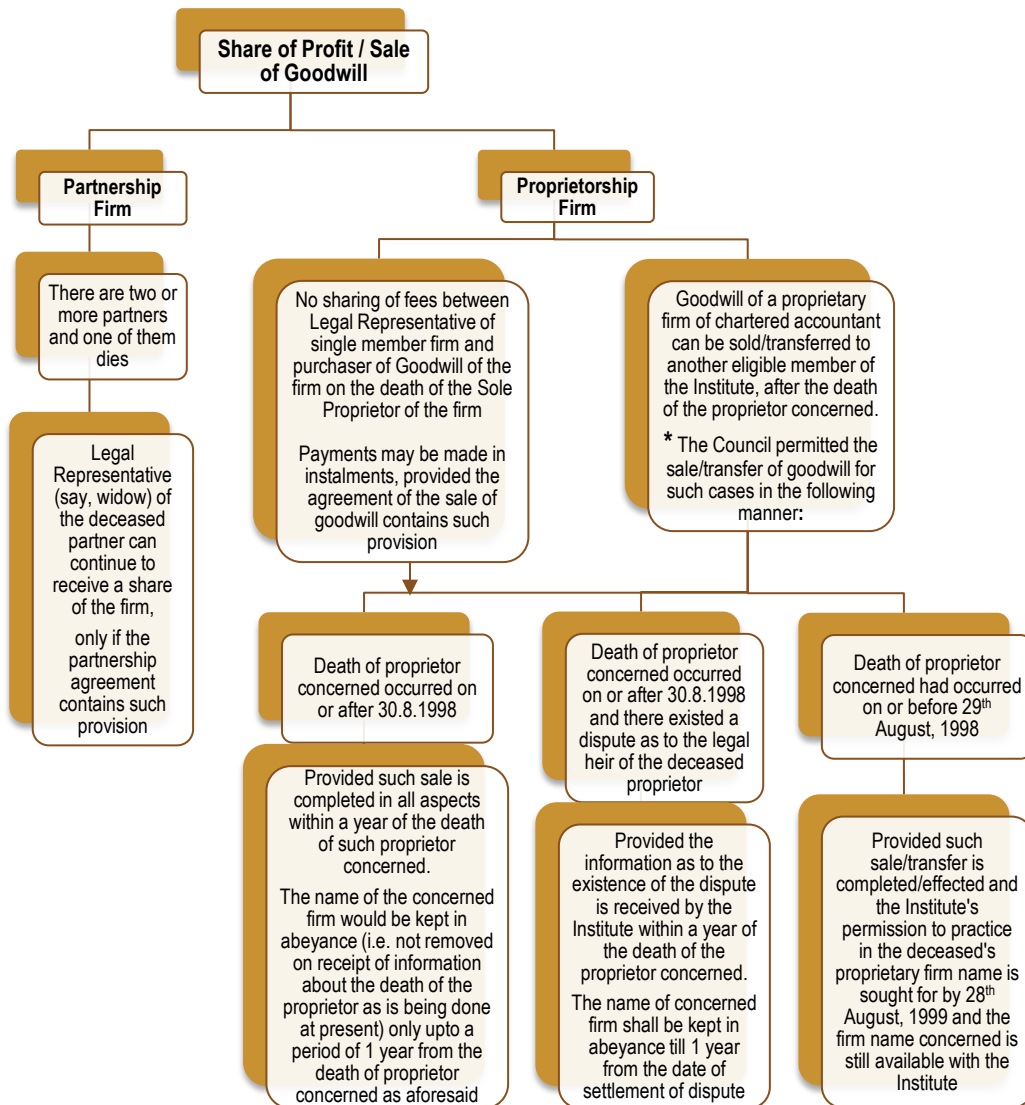
Further, the Council has also prescribed [Regulation 53A (3) of the Chartered Accountants Regulations, 1988] the persons qualified in India, which are as under:

- (i) Company Secretary within the meaning of the Company Secretaries Act, 1980;
- (ii) Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959;
- (iii) Actuary within the meaning of the Actuaries Act, 2006;
- (iv) Bachelor in Engineering from a University established by law or an Institution recognised by law;
- (v) Bachelor in Technology from a University established by law or an institution recognised by law;
- (vi) Bachelor in Architecture from a University established by law or an institution recognised by law;
- (vii) Bachelor in Law from a University established by law or an institution recognised by law;
- (viii) Master in Business Administration from Universities established by law or technical institutions recognised by All India Council for Technical Education.

The Institute came across certain Circulars/Orders issued by the Registrars of various State Co-operative Societies wherein it has been mentioned that certain amount of audit fee is payable to the concerned State Government and the auditor has to deposit a percentage of his audit fee in the state Treasury by a prescribed challan within a prescribed time of the receipt of Audit fee. The Council considered the issue and while noting that the Government is asking auditors to deposit such percentage of their audit fee for recovering the administrative and other expenses incurred in the process, the Council decided that as such there is no bar in the Code of Ethics to accept such assignment wherein a percentage of professional fee is deducted by the Government to meet the administrative and other expenditure.

Considering the case where a Chartered Accountant gave 50% of the audit fees received by him to the complainant, who was not a Chartered Accountant, under the nomenclature of office allowance and such an arrangement continued for a number of years, it was held by the Council that in substance the Chartered Accountant had shared his profits and, therefore, was guilty of professional misconduct under the clause. It is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into.

Treatment of Goodwill –



* In case of a partnership firm when all the partners die at the same time, the above Council decision would also be applicable.

Illustration 6

Mr. Qureshi, Chartered Accountant, in practice died in a road accident. His widow proposes to sell the practice of her husband to Mr. Pardeshi, Chartered Accountant, for ₹ 5 lakhs. The price also includes right to use the firm name - Qureshi and Associates. Can widow of Qureshi sell the practice and can Mr. Pardeshi continue to practice in that name as a proprietor?

Solution

Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

It lays down that the sale is permitted subject to certain conditions discussed in the above flowchart. It further resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.

Conclusion: Thus, in a given case, the widow of Mr. Qureshi, who has proposed to sell the practice for ₹ 5 lakhs is in effect proposing the sale of goodwill. Thus, the act of Mrs. Qureshi is permissible and Mr. Pardeshi can continue to practice in that name as a proprietor.

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 profit 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 item (2) of this part.

Just as a member cannot share his fees with a non-member, he is also not permitted to receive and share the fees of others except for sharing with Member of such professional body or other person having such qualification as may be prescribed (Regulation 53A of the Chartered Accountants Regulations, 1988) by the Council for the purpose of Clause (2), (3) and (5) of Part I of First Schedule. Such a restriction is necessary so that a Chartered Accountant who is often required to engage or to recommend for engagement by his clients, the services of the members of other professions, cannot share the fees received by other persons who are otherwise not permitted by the Council in terms of provision of this clause.

Referral fees amongst members: It is not prohibited for a member in practice to charge Referral Fees, being the fees obtained by a member in practice from another member in practice in relation to referring a client to him.

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 (1) of section 4 or whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships.

The Council has prescribed Regulation 53A (3) (as discussed under clause (2) of this part) and Regulation 53B of the Chartered Accountants Regulations, 1988 for the persons qualified and the professional bodies.

The Regulation 53B prescribes the membership of following professional bodies for entering into partnership:

- (a) Company Secretary, member, The Institute of Company Secretaries of India, established under the Company Secretaries Act, 1980;
- (b) Cost Accountant, member, The Institute of Cost and Works Accountants of India established under the Cost and Works Accountants Act, 1959;
- (c) Advocate, member, Bar Council of India established under the Advocates Act, 1961;
- (d) Engineer, member, The Institution of Engineers, or Engineering from a University established by law or an institution recognized by law.
- (e) Architect, member, The Indian Institute of Architects established under the Architects Act, 1972;
- (f) Actuary, member, The Institute of Actuaries of India, established under the Actuaries Act, 2006.

A Chartered Accountant in practice is not permitted to enter into partnership with any person other than a Chartered Accountant in practice or such other persons as may be prescribed by the Council from time to time. The members may however take note of the fact that they cannot form Multi-Disciplinary partnerships till such time that Regulators of such other professionals also permit partnership with chartered accountants, and guidelines in this regard are issued by the Council.

Clause (5) Secures either through the services of a person who is not an employee of such Chartered Accountant or who is not his partner or by means which are not open to a Chartered Accountant, any professional business.

Provided that nothing herein contained shall be construed as prohibiting any agreement permitted in terms of item (2), (3) and (4) of this part.

“A man must stand erect, and not to be kept erect by others”, is a dictum by Marcus Aurelius which though applicable for a man in every walk of life is more so in the case of a professional life. A

Chartered Accountant must seek work not through any agency, but by the respect, that he is able to command for his professional talent and skill and by the confidence he is able to inspire by his reputation. All forms of canvassing on that account are regarded unethical and are prohibited. The decision of the Council under this clause is given below:

A Chartered Accountant wrote various letters to officers of different Army Canteens giving details about him and his experience, his partner & office and the norms for charging audit fees. He was held guilty for violation of Clauses (5) & (6). (Jethanand Sharda vs. Deepak Mehta – Council's decision dated 1st to 4th July, 1998 – Page 61 of Volume VIII(2) of Disciplinary Cases).

It may further be noted that the acts of partners and employees of the Firm towards securing professional work are subject to the provisions of Clauses (6) and (7) of Part-I of First Schedule of Chartered Accountants Act, 1949.

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 -

- (i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or**
- (ii) A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.**

However, as per the guideline issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

Further, keeping in view the broad purview of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, an advertisement of Coaching /teaching activities by a member in practice may amount to indirect solicitation, as well as solicitation by any other means, and may therefore be violative of the provisions of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

In view of the above, such members are advised to abstain from advertising their association with Coaching / teaching activities through hoardings, posters, banners and by any other means, failing which they may be liable for disciplinary action, as per the provisions of Chartered Accountants Act, 1949 and Rules/Regulations framed thereunder. However, it may be noted that subject to the above prohibition, such members may put, outside their Coaching/teaching premises, sign board mentioning the name of Coaching/teaching Institute, contact details and subjects taught therein only. As regards the size and type of sign board, the Council Guidelines as applicable to Firms of Chartered Accountants would apply.

It is an elaboration of the principle propounded in the preceding clause enjoining that for securing professional work the help of others should not be sought. This clause further enjoins on a member not to solicit professional work by means of advertisement, circular, personal communication or interview or by any other means. The members should not adopt any indirect methods to adventure their professional practice with a view to gain publicity and thereby solicit clients or professional work. Such a restraint must be practiced so that members may maintain their independence of judgment and may be able to command the respect of their prospective clients.

The professional work cannot be secured either by advertisement or by circulars or by solicitation. It can only be obtained by a member gradually building confidence in his ability and integrity. The service tendered by an accountant is of a personal and intimate nature and its value can be appraised only by personal contact and experience. A public advertisement is likely to lead to an impression that the professional person is over anxious to win confidence, which however will have the opposite effect. The satisfaction of clients would be the best advertisement, which would lead to other clients. Unabashed advertisement would affect the public esteem in which the profession is held and would act to the disadvantage of its members. An advertisement is not a key to success in the profession. It is the quality service, which attracts and retains the clients.

Some forms of soliciting work which the Council has prohibited are discussed below:

- (a) **Advertisement and note in the press** – Members should not advertise for soliciting work or advertise in a manner which could be interpreted as soliciting or offering to undertake professional work. They are also not permitted to use the less open method of circulating letters to a small field of possible clients. Personal canvassing or canvassing for clients of previous employer through the help of the employees are also not permitted. The **exceptions** to the above rule are:
 - (i) A member may request another Chartered Accountant in practice for professional work.

- (ii) a member may advertise changes in partnerships or dissolution of a firm, or of any change in address of practice and telephone numbers. Such announcements should be limited to a bare statement of facts and consideration given to the appropriateness of the area of distribution of the newspaper or magazine and number of insertions.
 - (iii) a member is also permitted to issue a classified advertisement in the journal/newsletter of the Institute intended to give information for sharing professional work on assignment basis or for seeking partnership or salaried employment of an accountancy nature, provided it only contains the accountant's name, address or telephone number, fax number, e-mail address and address(es) of social Networking sites of members. However, mere factual position of experience and area of specialization, relevant to seek response to the advertisement, are permissible.
- (b) **Application for empanelment for allotment of audit and other professional work** – The Government departments, government companies/Corporations, courts, co-operative societies and banks and other similar institutions prepare panels of chartered accountants for allotment of audit and other professional work. Where the existence of such a panel is within the knowledge of a member, he is free to write to the concerned organization with a request to place his name on the panel. **However, it would not be proper for the Chartered Accountant to make roving enquiries by applying to any such organization for having his name included in any such panel.** It is permissible to quote fees on enquiries being received from such bodies, which maintain such panel.
- (c) **Responding to Tenders, Advertisements and Circulars:** It is not prohibited to the members to respond to tenders and requests made by users of professional work. This is however subject to conditions that may be issued by the Council from time to time.

The Council has issued Guidelines No. 1-CA(7)/03/2016 dated 7th April 2016 (see **Appendix 'J'**) which stipulate that a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for Chartered Accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants. *The "minimum fee" for this purpose should be such that it commensurates with size, value, volume, manpower requirement and nature of work.*

EMD/Security Deposit: The Council is of the view that while interference with the practices prevailing for requirement of EMD/Deposit is not required. However, on having received

complaint/ instance of exorbitant EMD/Deposit, the Ethical Standards Board may look into the matter on case to case basis.

A cost sheet be maintained by members of the Institute responding to tenders, incorporating details of the costs being incurred therein having regard to number of persons involved, hours to be spent, etc, so that the same may be called for by the Institute for perusal.

- (d) **Publication of Books, Articles or Presentation:** It is not permissible for a member to mention in a book or an article published by him, or a presentation made by him, any professional attainment(s), whether of the member or the firm of chartered accountants, with which he is associated. However, he may indicate in a book, article or presentation the designation "Chartered Accountant" as well as the name of the firm.
- (e) **Issue of Greeting Cards or Invitations:** The Council does not approve of the issue of greeting cards or personal invitations by members indicating their professional designation, status and qualifications etc. However, the Council is of the view that the designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards, invitations for marriages and religious ceremonies and any invitations for opening or inauguration of office of the members, change in office premises and change in telephone numbers, provided that such greeting cards or invitations etc. are sent only to clients, relatives and friends of the members concerned.
- (f) **Advertisement for Silver, Golden, Platinum or Centenary celebrations:** It is not permitted to advertise the events organised by a Firm of Chartered Accountants. However, considering the need of interpersonal socialization/relationship of the members through such get together occasions, the advertisement for Silver, Golden, Diamond, Platinum or Centenary celebrations of the Chartered Accountants Firms may be published in newspaper or newsletter.
- (g) **Sponsoring Activities**
 - (a) A member in practice or a Firm of Chartered Accountants is not permitted to sponsor an event. However, such member or Firm may sponsor an event conducted by a Programme Organizing Unit (PoU) of the ICAI, provided such event has the prior approval of Continuing Professional Education (CPE) Directorate of the ICAI.
 - (b) Members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, the mention of Firm name or CA Logo is not permitted.

- (h) **Advertisement of Teaching/Coaching activities by members:** The members engaged in teaching /coaching activities, while advertising such teaching /coaching activities, shall comply with the Regulation 190A of the Chartered Accountants Regulations, 1988(discussed in the Chapter in Clause 11).

Keeping in view the broad purview of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, an advertisement of Coaching /teaching activities by a member in practice may amount to indirect solicitation, as well as solicitation by any other means, and may therefore be violative of the provisions of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

In view of the above, such members are advised to abstain from advertising their association with Coaching /teaching activities through hoardings, posters, banners and by any other means, failing which they may be liable for disciplinary action, as per the provisions of Chartered Accountants Act, 1949 and Rules/Regulations framed thereunder.

Subject to the above prohibition, such members may put, outside their Coaching/ teaching premises, sign board mentioning the name of Coaching/teaching Institute, contact details and subjects taught therein only. As regards the size and type of sign board, the Council Guidelines as applicable to Firms of Chartered Accountants would apply.

- (i) **Sharing Firm Profile with prospective Client:** It is not permitted to share Firm profile with a prospective Client unless it is in response to a proposed client's specific query, and otherwise not prohibited to be used by the client.
- (j) **Television or Movie Credits:** While sharing name of the member or Firm of Chartered Accountants for inclusion in Television or Movie Credits, it must be taken care of that exhibition of name is not made differently as compared to other entries in the credits.
- (k) **Soliciting professional work by making roving enquiries:** It is not permissible for a member to address letters, emails or circulars specifically to persons who are likely to require services of a Chartered Accountant since it would tantamount to advertisement.
- (l) **Seeking work from Professional Colleagues:** The issue of an advertisement or a circular by a Chartered Accountant, seeking work from professional colleagues on any basis whatsoever except as provided above would be in violation of this clause.
- (m) **Scope of representation which an auditor is entitled to make under Section 225(3) of the Companies Act, 1956 (Section 140(4) of the Companies Act, 2013):** The right to make representation does not mean that an auditor has any prescriptive right or a lien to an audit. The wording of his representation should be such that, apart from the opportunity not being

abused to secure needless publicity, it does not tantamount directly or indirectly to canvassing or soliciting for his continuance as an auditor. The letter should merely set out in a dignified manner how he has been acting independently and conscientiously through the term of office and may, in addition, indicate if he so chooses, his willingness to continue as auditor if reappointed by the shareholders.

- (n) **Acceptance of original professional work by a member emanating from the client introduced to him by another member:** The Council has decided that a member should not accept the original professional work emanating from a client introduced to him by another member. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.
- (o) **Giving Public Interviews:** While giving any interview or otherwise furnishing details about themselves or their firms in public interviews or to the press or at any forum, the members should ensure that, it should not result in publicity. Due care should be taken to ensure that such interviews or details about the members or their firms are not given in a manner highlighting their professional attainments. Any detail which is given must, in addition to meeting the above requirements, be given only as a response to a specific question, and of factual nature only.
- (p) **Members and/or firms who publish advertisements under Box numbers:** Members/Firms are prohibited from inserting advertisements for soliciting clients or professional work under box numbers in the newspapers. This practice is in violation of this clause.
- (q) **Educational Videos:** While the videos of educational nature may be uploaded on the internet by members, no reference should be made to the Chartered Accountants Firm wherein the member is a partner/ proprietor. Further, it should not contain any contact details or website address.

Illustration 7

Mr. S, a Chartered Accountant published a book and gave his personal details as the author. These details also mentioned his professional experience.

Soliciting Professional Work: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means. Therefore, members should not adopt any indirect methods to advertise their professional practice with a view to gain publicity and thereby

solicit clients or professional work. Such a restraint must be practiced so that members may maintain their independence of judgement and may be able to command the respect of their prospective clients. While elaborating forms of soliciting work, the Council has specified that a member is not permitted to indicate in a book or an article, published by him, his association with any firm of chartered accountants. In this case, Mr. S, a Chartered Accountant published the book and mentioned his professional experience in detail in the same.

Conclusion: Mr. S being a chartered accountant in practice has committed the professional misconduct by mentioning his professional experience.

Illustration 8

M/s XYZ, a firm of Chartered Accountants created a website “www.xyzindia.com”. The website besides containing details of the firm and bio-data of the partners also contains the passport size photographs of all the partners of the firm.

Hosting Details on Website: As per detailed guidelines of the ICAI laid down in Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant of the firm can create its own website using any format subject to guidelines. However, the website should be so designed that it does not solicit clients or professional work and should not amount to direct or indirect advertisement. The guidelines of the ICAI to allow a firm to put up the details of the firm, bio-data of partners and display of a passport size photograph.

Conclusion: In the case of M/s XYZ, all the guidelines seem to have been complied and there appears to be no violation of the Chartered Accountants Act, 1949 and its Regulations.

Illustration 9

M/s LMN, a firm of Chartered Accountants responded to a tender from a State Government for computerization of land revenue records. For this purpose, the firm also paid ₹ 50,000 as earnest deposit as part of the terms of the tender.

Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. As per the guidelines if a matter relates to any services other than audit, members can respond to any tender. Further, in respect of a non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits. However, on having received complaint/ instance of exorbitant EMD/Deposit, the Ethical Standards Board may look into the matter on case to case basis.

Conclusion: In the instance case, since computerization of land revenue records does not fall within exclusive areas for chartered accountants, M/s LMN can respond to tender as well as deposit ₹ 50,000 as earnest deposit and shall not have committed any professional misconduct.

Illustration 10

Mr. Honest, a Chartered Accountant in practice, wrote two letters to M/s XY Chartered Accountants a firm of CAs; requesting them to allot him some professional work. As he did not have a significant practice or clients he also wrote a letter to M/s ABC, a firm of Chartered Accountants for securing professional work. Mr. Clever, another CA, informed ICAI regarding Mr. Honest's approach to secure the professional work. Is Mr. Honest wrong in soliciting professional work?

Securing Professional Work: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Provided that nothing herein contained shall be construed as preventing or prohibiting any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice.

Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Conclusion: In the given case, Mr. Honest wrote letters only to other Chartered Accountants, M/s XY and M/s ABC requesting them to allot some professional work to him, which is not prohibited under Clause (6) as explained above. Thus, Mr. Honest has not committed any professional misconduct by soliciting professional work.

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.

This clause prohibits advertising of professional attainments or services of a member. However, the services can be advertised in a restricted way through a write up subject to the Guidelines of the Council issued from time to time. Refer chapter 3 of the book. It also restrains a member from using

any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public.

Other Designations: It is improper for a Chartered Accountant in practice to state on his professional documents that he is an Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant.

While noting that it had already allowed its members to appear before the various authorities including Company Law Board, Income Tax Appellate Tribunal, Sales Tax Tribunal where the law has permitted the same, so far as the designation "Corporate Lawyer" is concerned, the Council was of the view that as per the existing provisions of law, a Chartered Accountant in practice is not entitled to use the designation "Corporate Lawyer".

A member must not use the designation such as 'Member of Parliament', 'Municipal Councilor' nor any other functionary in addition to that of Chartered Accountant.

A member empanelled as Insolvency Professional or Registered Valuer can mention "Insolvency Professional" or "Registered Valuer" respectively on his visiting card and letter head.

Permission to mention qualifications of certain Institutions: The members are permitted to mention a title on their visiting cards to indicate membership of a foreign Institute of Accountancy, which has been recognised by the Council e.g. South African Institute of Chartered Accountants (SAICA), Institute of Certified Public Accountants (CPA Ireland) and Institute of Chartered Accountants in England and Wales (ICAEW).

Date of setting-up practice: The date of setting up the practice by a member or the date of establishment of the firm on the letter heads and other professional documents etc. should not be mentioned.

Practice as Advocate: Members of the Institute in practice who are otherwise eligible may practise as advocates subject to the permission of the Bar Council but in such case, they should not use designation 'Chartered Accountant' in respect of the matters involving the practice as an advocate. In respect of other matters they should use the designation 'Chartered Accountant' **but they should not use the designation 'Chartered Accountant' and 'Advocate' simultaneously.**

Practice as Company Secretary/Cost Management Accountant: Members of the Institute in practice who are otherwise eligible may also practice as Company Secretaries and/or Cost Management Accountants. Such members shall, however, not use designation/s of the aforesaid Institute/s simultaneously with the designation "Chartered Accountant".

It is clarified that in the event of the permission being granted to a member in practice to also hold COP of sister Institute(s)/Bar Council, such a member be treated as a member in full-time practice.

Mention of Firm name except on Professional Documents: It is not proper for a Firm of Chartered Accountants to use the designation 'Chartered Accountant' except on professional documents, visiting cards, letter heads or sign boards and under the circumstances clarified under Clause (6). However, an individual member may use the prefix "CA" with his name.

Notice in the Press relating to the Success in an Examination: Notice in the press relating to the success in an examination of an individual candidate, should not contain any element of undesirable publicity either in relation to the article/audit assistant or an employee or the member or the firm with whom he was served.

It is usual for local papers to publish details of the examination success of local candidates. Some biographical information is often included. The rule aforementioned is not intended to discourage the printing of news of local interest but is intended to indicate the need for restraint. The candidate's name and address, school and local background, examination passed with details of any prize or place gained, the name of the principal, firm and town in which the principal practices may be published.

Reports and Certificates: The reports and certificates issued by a Chartered Accountant bring him to the notice of the public in a greater or lesser degree. It is therefore incumbent upon him to ensure that the extent and manner of publication of certificates are limited to what is necessary to enable the report or certificate to serve its proper purpose. The members may however note that they should use letterhead of their Firm for issuing reports and certificates.

Appearance of Chartered Accountants on Electronic Media (including Internet): Members may appear on television, films and Internet and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialised knowledge directly relevant to the subject matter of the programme may also be given. Firm name may also be mentioned, however, any exaggerated claim or any kind of comparison is not permissible. What he may say or write must not be promotional of him or his firm but must be an objective professional view of the topic under consideration.

Publicity is permitted for appointments to positions of local or national importance or for the views of members on matters of similar importance. Mention of the membership of the Institute is desirable in such cases. What should be aimed at is to achieve suitable publicity for the Institute and its members generally. Members giving talks or lectures or attending conference may describe

themselves as Chartered Accountants only when they are acting in their capacity as Chartered Accountants. However, reference to the professional firm of the member should not be given.

Organising Training Courses, Seminars etc. for his staff: A Chartered Accountant in practice holding training courses, seminars etc. for his staff may also invite the staff of other Chartered Accountants and clients to attend the same. However, undue prominence should not be given to the name of the Chartered Accountant in any booklet or document issued in connection therewith.

Writing Articles or Letters to the Press: Members writing articles or letters to the Press on subjects connected with the profession may give their names and use the description Chartered Accountants.

Size of Sign Board: With regard to the size of sign board for his office that a member can put up, it is a matter in which the members should exercise their own discretion and good taste while keeping in mind the appropriate visibility and illumination (limited to the sake of visibility). However, use of glow signs or lights on large-sized boards as is used by traders or shop-keepers is not permissible. A member can have a name board at the place of his residence with the designation of a Chartered Accountant, provided it is a name plate or name board of an individual member and not of the firm.

Public Announcements with details of Directors: The Council's attention has been drawn to the fact that more and more Companies are appointing Chartered Accountants as Directors on their Boards. The prospectus or public announcements issued by these Companies often publish descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field or add appellations or adjectives to their names. Attention of the members in this context is invited to the provisions of Clause (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act.

In order that the inclusion of the name of a member of the Institute in the prospectus or public announcements or other public communications issued by the Companies in which the member is a director does not contravene the above noted provisions, it is necessary that the members should take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the member. While it may be difficult to lay down a rigid rule in this respect, the members must use their good judgement, depending upon the facts and circumstances of each case to ensure that the above noted provisions are complied with both in letter and spirit.

It is advisable for a member that as soon as he is appointed as a director on the Board of a Company, he should specifically invite the attention of the management of the Company to the aforesaid

provisions and should request that before any such prospectus or public announcements or public communication mentioning the name of the member concerned, is issued, the material pertaining to the member concerned should, as far as practicable be got approved by him. The use of the expression 'Chartered Accountant' is permissible. However, the member must ensure that descriptions about his expertise, specialisation and knowledge in any particular field or other appellations or adjectives are not published with his name. Particulars about directorships held by the member in other Companies can, however, be given, but the name of the firm of Chartered Accountants in which the member is a partner, should not be given.

Network Firms and Networking Guidelines: *The Council has permitted Network amongst the Firms registered with the Institute. A member of the Network may advertise to the extent permitted by the Advertisement Guidelines issued by Institute.*

Note:

Students are required to refer Para 9 of this Chapter for Guidelines for Networking discussed in Chapter XV of Council General Guidelines 2008.

Advertisement Guidelines issued by Institute are being given in details in the Chapter

Use of Logo: For use of logos by Members on letter heads, visiting cards etc. the Council had decided that the logos unconnected with the first letter of the name of the firm or its partners or proprietors would not be permitted for use by members in practice/firms of Chartered Accountants on their letter heads, visiting cards etc. as the same would have amounted to advertisement or smacking of publicity. Subsequent to above, the Institute came across cases of registration of firm name in circumvention of the provisions contained in the Regulation 190 of the Chartered Accountants Regulations, 1988. The members/firms by themselves or through engineered name had been seeking to obtain firm name approval based on the name of the partner/s selected in the manner that logo of the firm would be identical to the firm name which would have not otherwise been permissible as firm name under Regulation 190.

In order to ensure compliance with the Regulations, the Council decided that the use of logo/monogram of any kind/form/ style/design/colour etc. whatsoever on any display material or media e.g. paper stationery, documents, visiting cards, magnetic devices, internet, sign board, by the members in practice and/or the firm of Chartered Accountants, be prohibited. Use/printing of member/firm name in any other manner tantamounting to logo/monogram was also prohibited.

Common CA Logo: To promote the brand of CA profession and responding to the long felt need to have a symbol of CA Profession in India, ICAI came up with a unique logo which could be used by all members, whether in practice or not. Encapsulating the current beliefs, attitudes and values of the profession, the CA Logo seeks to enhance the identity of the members. The logo consists of the

letters 'CA' with a tick mark (upside down) inside a rounded rectangle with white background. The letters 'CA' have been put in blue, the corporate colour which not only stands out on any background but also denotes creativity, innovativeness, knowledge, integrity, trust, truth, stability and depth. The upside down tick mark, typically used by the chartered accountants, has been included to symbolize the wisdom and value of the professional. The green colour in the tick mark signifies growth, prosperity, harmony and freshness. Members are encouraged to use this logo. The Council has decided that use of CA logo in the stamp is permissible, subject to CA logo guidelines.

[Students are advised to refer Chapter XVI on Logo Guidelines under Para no 9 Council Guidelines.]

Guidelines for elected Members of the Council/ office Bearers of the Regional Council in the context of use of designation etc. and manner of Printing of Letter-heads and visiting cards.

The guidelines/directions laid down by the Council as revised by the Council from time to time for use of designation etc. and manner of printing letter-heads and visiting cards of the President, Vice-President of the Institute, Members of the Council, Chairmen of various non-standing Committees of the Institute; Chairmen, other office bearers and Members of the Regional Councils; Chairmen, other office-bearers and Members of the Managing Committees of the Branches are appearing in **Appendix 'F'** to Code of Ethics publication.

Illustration 11

A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, as a Tax Consultant.

Tax Consultant: Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public.

Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Conclusion: Thus, it is improper to use designation "Tax Consultant" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a

recognised professional membership by the Central Government or the Council.

Illustration 12

B, a Chartered Accountant in practice is a partner in 3 firms. While printing his personal letter heads, B gave the names of all the firms in which he is a partner.

Advertisement of Professional Attainments: Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public. Even a member is not permitted to specify the date of setting up of practice or establishment of firm on letterheads. However, there is no prohibition for printing names of all the three firms on the personal letterheads in which a member holding Certificate of Practice is a partner.

Conclusion: Thus, B is not guilty of any misconduct under the Chartered Accountants Act, 1949.

Illustration 13

The offer document of a listed company in which Mr. D, a practising Chartered Accountant is a director mentions the name of Mr. D as a director along with his various professional attainments and spheres of specialisation.

Advertisement of Professional Attainments: The Council of the ICAI has in a communication to members stated that if a public company, in which a chartered accountant in practice is a director, issues a prospectus or gives any announcement that gives descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field, it shall constitute a misconduct under Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The Council has further stated that in such cases the member concerned has to take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the members.

Conclusion: Thus, in the instant case, Mr. D would be held to be guilty of professional misconduct and liable for disciplinary action.

Illustration 14

A Chartered Accountant in practice, empanelled as an Insolvency Professional (IP) has mentioned the same on his visiting cards, letter heads and other communications also. A person

residing in his neighbourhood, has filed a complaint for professional misconduct against the said member for such mention of IP.

Using Designation of Insolvency Professional: As per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than 'Chartered Accountant' on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.

Here, a Chartered Accountant empaneled as IP (Insolvency Professional) can mention "Insolvency Professional" on his visiting cards, letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause 7 of Part 1 of First Schedule to the Chartered Accountants Act, 1949.

Conclusion: Thus, complaint of neighbor is not enforceable/ valid.

Clause (8) accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

It must be pointed out that professional courtesy alone is not the major reason for requiring a member to communicate with the existing accountant who is a member of the Institute or a certified auditor. The underlying objective is that the member may have an opportunity to know the reasons for the change in order to be able to safeguard his own interest, the legitimate interest of the public and the independence of the existing accountant. It is not intended, in any way, to prevent or obstruct the change. When making the inquiry from the retiring auditor, the one proposed to be appointed or already appointed should primarily find out whether there are any professional or other reasons why he should not accept the appointment.

It is important to remember that every client has an inherent right to choose his accountant also that he may, subject to compliance, with the statutory requirements in the case of limited companies, make a change whenever he chooses, whether or not the reasons which had impelled him to do so are good and valid. The change normally occurs where there has been a change of venue of business and a local accountant is preferred or where the partner who has been dealing with the client's affairs retires or dies; or where temperaments clash or the client has some good reasons to

feel dissatisfied. In such cases, the retiring auditor should always accept the situation with good grace.

The existence of a dispute as regards the fees may be root cause of an auditor being changed. This would not constitute valid professional reasons on account of which an audit should not be accepted by the member to whom it is offered. However, in the case of an undisputed audit fees for carrying out the statutory audit under the Companies Act, 2013 or various other statutes having not been paid, the incoming auditor should not accept the appointment unless such fees are paid. In respect of other dues, the incoming auditor should in appropriate circumstances use his influence in favour of his predecessor to have the dispute as regards the fees settled. The professional reasons for not accepting an audit would be:

- (a) Non-compliance of the provisions of Sections 139 and 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The Chartered Accountants Act, 1949; and
- (b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; and
- (c) Issuance of a qualified report.

In the first two cases, an auditor who accepts the audit would be guilty of professional misconduct. In this connection, attention of members is invited to the Council General Guidelines, 2008 appearing in Chapter-4. In the said Guidelines, Council has explained that the *provision for audit fee in accounts signed by both the auditee and the auditor along with other expenses, if any, incurred by the auditor in connection with the audit, shall be considered as “undisputed audit fee” and “sick unit” shall mean a unit registered for not less than five years, which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.*

In the last case, however, he may accept the audit if he is satisfied that the attitude of the retiring auditor was not proper and justified. If, on the other hand, he feels that the retiring auditor had qualified the report for good and valid reasons, he should refuse to accept the audit. There is no rule, written or unwritten, which would prevent an auditor from accepting the appointment offered to him in these circumstances. However, before accepting the audit, he should ascertain the full facts of the case. For nothing will bring the profession to disrepute so much as the knowledge amongst the public that if an auditor is found to be “inconvenient” by the client, he could readily be replaced by another who would not displease the client and this point cannot be too over-emphasised.

Where the Previous Auditor is not available for accepting payment of undisputed audit fees, and it is not otherwise possible to transfer the payment to him electronically, the Incoming Auditor may

advise the client to purchase Demand Draft of the amount equivalent to undisputed Audit Fees of retiring auditor, and may accept the Audit assignment after verifying the same. It will be the duty of the Incoming auditor to ensure the payment of undisputed Audit Fees of the retiring auditor at the earliest possibility.

What should be the correct procedure to adopt when a prospective client tells you that he wants to change his auditor and wants you to take up his work? There being two persons involved, the Company and the old auditor, the former should be asked whether the retiring auditor had been informed of the intention to change. If the answer is in the affirmative, then a communication should be addressed to the retiring auditor. If, however, it is learnt that the old auditor has not been informed, and the client is not willing to make the first move, it would be necessary to ask him the reason for the proposed change. If there is no valid reason for a change, it would be healthy practice not to accept the audit. If he decides to accept the audit he should address a communication to the retiring auditor.

As stated earlier, the object of the incoming auditor, in communicating with the retiring auditor is to ascertain from him whether there are any circumstances which warrant him not to accept the appointment.



5. For example, whether the previous auditor has been changed on account of having qualified his report or he had expressed a wish not to continue on account of something inherently wrong with the administration of the business. The retiring auditor may even give out information regarding the condition of the accounts of the client or the reason that impelled him to qualify his report. In all these cases it would be essential for the incoming auditor to carefully consider the facts before deciding whether or not he should accept the audit, and should he do so, he must also take into account the information while discharging his duties and responsibilities.

Sometimes, the retiring auditor fails without justifiable cause except a feeling of hurt because of the change, to respond to the communication of the incoming auditor. So that it may not create a deadlock, the auditor appointed can act, after waiting for a reasonable time for a reply.

The Council has taken the view that a mere posting of a letter “under certificate of posting” is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person communicated with. A Chartered Accountant who relies solely upon a letter posted “under certificate of posting” therefore does so at his own risk.

The view taken by the Council has been confirmed in a decision by the Rajasthan High Court in J.S. Bhati v.s. The Council of the Institute of Chartered Accountants of India and another. The following observations of the Court are relevant in this context:

“Mere obtaining a certificate of posting in my opinion does not fulfil the requirements of Clause (8) of Schedule I as the presumption under Section 114 of the Evidence Act that the letter in due course reached the addressee cannot replace that positive degree of proof of the delivery of the letter to the addressee which the letters of the law in that case required. The expression ‘in ‘communication with’ when read in the light of the instructions contained in the booklet ‘Code of Conduct’ (now Code of Ethics) cannot be interpreted in any other manner but to mean that there should be positive evidence of the fact that the communication addressed to the outgoing auditor by the incoming auditor reached his hands. Certificate of posting of a letter cannot, in the circumstances, be taken as a positive proof of its delivery to the addressee”.

Members should therefore communicate with a retiring auditor in such a manner as to retain in their hands **positive evidence of the delivery** of the communication to the addressee. In the opinion of the Council, the following would in the normal course provide such evidence:-

- (a) Communication by a letter sent through “Registered Acknowledgement due”, or
- (b) By hand against a written acknowledgement, or
- (c) Acknowledgement of the communication from retiring auditor’s vide email address registered with the Institute or his last known official email address, or
- (d) Unique Identification Number (UDIN) generated on UDIN portal (subject to separate guidelines to be issued by the Council in this regard)

Premises found Locked: The communication received back by the Incoming Auditor with “**Office found Locked**” written on the Acknowledgement Due shall be deemed as having been delivered to the retiring auditor.

Firm not found at the given Registered address : If the Communication sent by the Incoming auditor is received back with remarks “No such office exists at this address”, and the address of communication is the same as registered with the Institute on the date of dispatch, the letter will be deemed to be delivered, unless the retiring auditor proves that it was not really served and that he was not responsible for such non-service.

As a matter of professional courtesy and professional obligation it is necessary for the new auditor appointed to act jointly with the earlier auditor and to communicate with such earlier auditor.

Special Audit under Income Tax Act, 1961: It would be a healthy practice if a Tax Auditor appointed for conducting special audit under the Income Tax Act, 1961 communicates with the member who has conducted the Statutory Audit.

The Council has also laid down the detailed guidelines on the subject as under:-

Communication required for all kinds of audit: The requirement for communicating with the previous auditor being a Chartered Accountant in practice would apply to all types of Audit viz., Statutory Audit, Tax Audit, GST Audit, Internal Audit, Concurrent Audit or any other kind of audit.

Communication in case of Assignments done by other professionals: A Communication is mandatorily required for all types of Audit/Report where the previous auditor is a Chartered Accountant. In case of assignments done by other professionals not being Chartered Accountants, it would also be a healthy practice to communicate.

Lack of time in acceptance of Government Audits: Although the mandatory requirement of communication with previous auditor being Chartered Accountant applies, in uniform manner, to audits of both government and Non-Government entities, yet in the case of audit of government Companies/ banks or their branches, if the appointment is made well in time to enable the obligation cast under this clause to be fulfilled, such obligation must be complied with before accepting the audit. However, in case the time schedule given for the assignment is such that there is no time to wait for the reply from the outgoing auditor, the incoming auditor may give a conditional acceptance of the appointment and commence the work which needs to be attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. In his acceptance letter, he should make clear to the client that his acceptance of appointment is subject to professional objections, if any, from the previous auditors and that he will decide about his final acceptance after taking into account the information received from the previous auditor.

Illustration 15

Mr. X, a Chartered Accountant accepted his appointment as tax auditor of a firm under Section 44AB, of the Income-tax Act, and commenced the tax audit within two days of his appointment since the client was in a hurry to file Return of Income before the due date. After commencing the audit, Mr. X realised his mistake of accepting this tax audit without sending any communication to the previous tax auditor. In order to rectify his mistake, before signing the tax audit report, he sent a registered post to the previous auditor and obtained the postal acknowledgement. Will Mr. X be held guilty under the Chartered Accountants Act?

Communication with the Previous Auditor: As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, Mr. X will be held guilty since he has accepted the tax audit, without first communicating with the previous auditor in writing. The object of the incoming auditor communicating in writing with the retiring auditor is to ascertain whether there are any circumstances which warrant him not to accept the appointment, for example, whether the previous auditor has been changed on account of having qualified the report or he had expressed a wish not to continue on account of something inherently wrong with the

administration of the business. The retiring auditor may even give out information regarding the condition of the accounts of the client or the reason that impelled him to qualify his report. Under all circumstances, it would be essential for the incoming auditor to carefully consider the facts before deciding whether or not he should accept the audit. As a matter of professional courtesy and professional obligation it is necessary for the new auditor appointed to communicate with such earlier auditor.

Conclusion: Therefore, Mr. X will be held guilty of professional misconduct.

Illustration 16

W, a Chartered Accountant had sent letters under certificate of posting to the previous auditor informing him his appointment as an auditor before the commencement of audit by him.

Communication with the Previous Auditor: Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 requires communication by the incoming auditor with the previous auditor before accepting a position by him. The Council of the Institute has taken the view that a mere posting of a letter “under certificate of posting” is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person communicated with. A Chartered Accountant who relies solely upon a letter posted “under certificate of posting” therefore does so at his own risk. Since the letters were sent by “W” to the previous auditor informing him of his appointment as an auditor before the commencement of audit by him under Certificate of Posting is not sufficient to prove communication with the retiring auditor. In the opinion of the Council, communication by a letter sent “Registered Acknowledgement Due” or by hand against a written acknowledgement would in the normal course provide positive evidence.

Conclusion: Hence “W” was guilty of professional misconduct under Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949

Clause (9) accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (1 of 1956), in respect of such appointment have been duly complied with;

The Companies Act, 2013 provides for the requirements which an auditor appointed in respect of a Company should satisfy himself about, before he accepts the appointment. The relevant provisions are contained in Section 139 and 140 of Companies Act, 2013 Act (erstwhile Section 225 of Companies Act, 1956) and the Council has notified that the provisions to be complied with under Clause (9) are those contained in Sections 139 and 140 of the Act. Section 139 contains several provisions in the matter of appointment of auditors in different circumstances and situations whereas

Section 140 lays down the procedure which must be followed whenever a Company desires to change its auditors. In order that the validity of the appointment of an auditor is not challenged or objected to by shareholders or the retiring auditors at a later date, it has been made obligatory on the Incoming Auditor to ascertain from the Company that the appropriate procedure in the matter of appointment has been faithfully followed.

The following guidelines have been issued by the Council for this purpose:-

Clause (9) of Part I of the First Schedule to Chartered Accountants Act, 1949 provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a Company without first ascertaining from it whether the requirements of Sections 139 and 140 of the Companies Act, 2013, in respect of such appointment have been duly complied with. Under this clause it is obligatory on the incoming auditor to ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.

The steps to be taken by an Auditor of a Company who is appointed in the following circumstances are indicated in the paragraphs below:

- (a) When the auditor appointed is the First Auditor of the Company.
- (b) When the auditor is appointed in place of an existing auditor who has resigned or has been removed or has ceased to hold office for any other reason.
- (c) When the auditor or auditors appointed by the Company were holding this office jointly with others and one or more of such joint auditors are not reappointed.
- (d) When one or more of the auditors appointed by the Company was/were not holding this office earlier.

Note : Students are advised to refer Intermediate level Paper 2 Corporate and Other Law for more details regarding Section 139 and 140, Section 139 of the Companies Act, 2013 laid down the procedure to be followed by a Company for appointment of an auditor and Section 140 of the Companies Act, 2013 lays down the procedure for appointment of auditor other than the retiring auditor and for removal of existing auditor.

The procedure to be followed by the Company is given below:-

- If a member of the Company wants that the retiring auditor should not be reappointed or that an auditor other than the retiring auditor should be appointed, he has to give a special notice

u/s 140(4) of Companies Act, 2013 to the Company for a resolution at the Annual General Meeting for this purpose.

- Such special notice is also required to be given if a member of the Company wants to remove the auditor before the expiry of his term of office. The special notice should be given before the date of the General Meeting when the question of appointment or reappointment of the auditor is to be considered.
- On receipt of the special notice of such a resolution, the Company has to send a copy of the same to the retiring auditor forthwith, as required u/s 140(4) of Companies Act, 2013.
- The Company is also required to send the special notice to the members of the Company at least seven days before the Meeting as per the provisions of Section 115 read with Section 20 of the Companies Act, 2013. According to these provisions, a document may be served on a company or an officer thereof by sending it to the company or the officer at the registered office of the company by registered post or by speed post or by courier service or by leaving it at its registered office or by means of such electronic or other mode as may be prescribed.
- After receipt of the above notice, the retiring auditor can submit his representation to the members of the Company. Such representation, on receipt by the Company, is required to be sent to its members as required under Section 140(4) of the Companies Act.
- The representation received from the retiring auditor will have to be considered at the General Meeting of the Company before the resolution proposed by the concerned member is passed. The resolution proposed by the concerned member can be passed only in accordance with the provisions of Section 114 of the Companies Act, 2013.
- Under Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, the incoming auditor has to ascertain whether the Company has complied with the provisions of the above sections. The word "ascertain" means "to find out for certain". This would mean that the incoming auditor should find out for certain as to whether the Company has complied with the provisions of Sections 139 and, 140 of the Companies Act, 2013. In this respect, it would not be sufficient for the incoming auditor to accept a certificate from the management of the Company that the provisions of the above sections have been complied with. It is necessary for the incoming auditor to verify the relevant records of the Company and ascertain as to whether the Company has, in fact, complied with the provisions of the above sections. If the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor should not accept the audit assignment.

It is suggested that the incoming auditor should verify the following records of the Company:-

If the appointment of the auditor is being made for the first time after incorporation of the Company, the auditor should verify as to whether the Board of Directors have passed the resolution for his appointment within thirty days of the date of registration of the Company.

If the Board of Directors have not appointed the first auditor but the appointment is being made by a general meeting of the Company, the auditor should verify as to whether a proper notice convening the general meeting has been issued by the Company and whether the resolution has been validly passed at the general meeting of the Company.

If the appointment is being made to fill a casual vacancy, the incoming auditor should verify as to whether the Board of Directors have powers to fill the casual vacancy and whether the Board of Directors have passed the resolution filling the casual vacancy.

If the vacancy has arisen due to resignation of the auditor, the incoming auditor should see as to whether a proper resolution filling the vacancy has been passed at the General Meeting of the Company.

If the vacancy has arisen as a result of removal of the auditor before the expiry of his term of office, the incoming auditor should see that special resolution has been passed at the General Meeting of the Company and that the previous approval of the Central Government has been obtained by the Company.

Where the auditor other than the retiring auditor is proposed to be appointed, the incoming auditor should ascertain whether the provisions of Sections 139 and 140 have been complied with. These provisions equally apply where an auditor who was jointly holding office with another auditor or auditors and any one or more of such joint auditors has not been reappointed.

For the purpose of ascertaining whether the Company has complied with the provisions of Section 140 of the Companies Act the incoming auditor should verify the records of the Company in respect of the following matters:-

- a. Whether a member of the Company has given special notice of the resolution as required under Section 140 (4) of the Companies Act, 2013. The notice shall be sent by members to the company not earlier than three months but at least fourteen days before the date of the meeting at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting. A true copy of this notice should be obtained by the incoming auditor.

- b. Whether this special notice has been sent to all the members, of the Company as required under Section 115 of Companies Act, 2013 at least 7 days before the date of the General Meeting.
- c. Whether this special notice has been sent to the retiring auditor forthwith as required under Section 140 (4).
- d. Whether the representation received from the retiring auditor has been sent to the members of the Company as required under Section 140 (4) .
- e. Whether the representation received from the retiring auditor has been considered at the general meeting and the resolution proposed by the special notice has been properly passed at the general meeting.

As regards the mode of sending the notice of the resolution to the members of the Company as provided in Sections 139 and 140 and section 20 to be followed for service of documents, which is as under:-

- (A) A document may be served on a company or an officer thereof by sending it to the company or the officer at the registered office of the company by registered post or by speed post or by courier service or by leaving it at its registered office or by means of such electronic or other mode as may be prescribed.
- (B) As regards the mode of sending the notice of the resolution to the retiring auditor as provided in Sections 224 & 225 of Companies act, 1956 (equivalent Sections being Section 139 & 140 of Companies 2013), attention is invited to the Department of Company Affairs circular dated 17.10.1981 issued to all Chambers of Commerce, which is reproduced below:-

“I am directed to say that it has been reported by the Institute of Chartered Accountants of India that difficulties are being experienced by retiring Auditors in the operation of the provisions of Section 225 of the Companies Act, 1956 whenever any appointment of a new auditor takes place. Such difficulties arise because of the fact that the copy of the special notice required to be served u/s 225(2) of the Act on the retiring auditors are not effectively served and proof of such service is not available. To obviate such difficulties; therefore, it is advisable that the copy of the special notice u/s 225(2) of the Act should be sent to the retiring auditors by Registered A/D post.”

- (C) Accordingly, it is necessary for the incoming auditor to satisfy himself that the notice provided for in Sections 139 & 140 of Companies Act, 2013 has been effectively served on the outgoing auditor (e.g. by seeing that the notice has been duly served through hand delivery or by Regd. Post with A.D.). Production of a certificate of posting by the Company would not be adequate

for the purpose of the incoming auditor satisfying himself about compliance with Sections 139/140. Acknowledgement received from the outgoing auditor would be one of the forms in which such satisfaction can be obtained.

A copy of the relevant minutes of the general meeting where the above resolution is passed duly verified by the Chairman of the meeting should also be obtained by the incoming auditor for his records.

Sometimes the annual general meeting is adjourned without conducting any business or after conducting business in respect of some of the items on the agenda. The items in respect of which the business is conducted may or may not include the item relating to appointment of auditors. Under Section 139(1) the retiring auditor holds office till the conclusion of every sixth annual general meeting. Therefore, when the annual general meeting is adjourned in the circumstances stated above, the retiring auditor will continue to hold the office of auditor till the adjourned meeting is held and the business listed in the agenda of the meeting is concluded. In case a new auditor is appointed at the original meeting (which is adjourned) such auditor can assume office only after the conclusion of such adjourned meeting.

If any annual general meeting is adjourned without appointing an auditor, no special notice for removal or replacement of the retiring auditor received after the adjournment can be taken note of and acted upon by the Company, since in terms of Section 115 of the Companies Act, special notice should be given to the Company at least fourteen clear days before the meeting in which the subject matter of the notice is to be considered. The meeting contemplated in Section 115 undoubtedly is the original meeting. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company mentioned in Section 139.

If the incoming auditor is satisfied that the Company has complied with the provisions of Sections 139 and 140 of the Companies Act, he should first communicate with the outgoing auditor in writing as provided in Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 before accepting the audit assignment.

Unjustified removal of auditors: In order to examine various ethical issues and safeguard the independence of the Auditors, the Council has set up a Ethical Standards Board (ESB). This Board examines various issues concerning professional ethics governing the members of the Institute which are either raised by the members or are taken up based on their importance. The recommendations of the Board are forwarded to the Council for its consideration. This Board is also charged with the responsibility of looking into the cases of removal and resignation of auditors and making an appropriate report to the Council.

The following guidelines have been issued for the Board for looking into the cases of Removal of Auditors:

A. Where an auditor resigns his appointment as an auditor of a Company or does not offer himself for reappointment as auditor of such Company, he shall send a communication, in writing, to the Board of Directors of the Company giving reasons therefor, if he considers that there are professional reasons connected with his resignation or not offering himself for re-appointment which, in his opinion, should be brought to the notice of the Board of Directors, and shall send a copy of such communication to the Institute. It shall be obligatory on the incoming auditor, before accepting appointment, to obtain a copy of such communication from the Board of Directors and consider the same before accepting the appointment.

B. Where an auditor, though willing for re-appointment has not been reappointed, he shall file with the Institute a copy of the statement which he may have sent to the management of the Company for circulation among the shareholders. It shall be obligatory on the incoming auditor before accepting the appointment, to obtain a copy of such a communication from the Company and consider it, before accepting the appointment.

C. The Ethical Standards Board, on a review of the communications referred to in paras (A) and (B), may call for such further information as it may require from the incoming auditor, the outgoing auditor and the Company and make a report to the Council in cases where it considers necessary.

D. The above procedure is also followed in the case of removal of auditors by the government and other statutory authorities.

[Note: Students are advised to refer Appendix 'G' For the Mission Statement, Terms of Reference and Procedure to be followed by the Board for dealing with the cases of Unjustified Removal of Auditors.]

Illustration 17

CA Raja was appointed as the Auditor of Castle Ltd. for the year 2022-23. Since he declined to accept the appointment, the Board of Directors appointed CA Rani as the auditor in the place of CA Raja, which was also accepted by CA Rani.

Appointment of Auditor by Board: Board can appoint the auditor in the case of casual vacancy under section 139(8) of the Companies Act, 2013. The non-acceptance of appointment by CA. Raja does not constitute a casual vacancy to be filled by the Board. In this case, it will be deemed that no auditor was appointed in the AGM.

Further, as per Section 139(10) of the Companies Act, 2013 when at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. The appointment of the auditor by the Board is defective in law.

Clause (9) of Part I of First Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant is deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956 (now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013), in respect of such appointment have been fully complied with.

Conclusion: Hence, CA. Rani is guilty of professional misconduct since she accepted the appointment without verification of statutory requirements.

Illustration 18

Mr. X is a Chartered Accountant accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor before accepting the audit. He also failed to ascertain the compliance of requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.

Communication by incoming auditor with previous auditor: Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 requires communication by the incoming auditor with the previous auditor before accepting a position by him.

Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (now Section 139 and 140 of the Companies Act, 2013), in respect of such appointment have been duly complied with.

Under this clause it is obligatory on the incoming auditor to communicate with previous auditor and ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.

In this case Mr. X accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor. Further, he accepted the appointment without first ascertaining whether the requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.

Conclusion: Therefore, Mr. X is liable for misconduct under clause 8 and Clause 9 since he accepted the appointment without communicating with previous auditor as well as for not verifying the compliance of statutory requirements.

Clause (10) Charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

What distinguishes a profession from a business is that professional services are not rendered with the sole purpose of a profit motive. Personal gain is one but not the main or the only objective. Professional opinion, therefore frowns upon methods where payment is made to depend on the basis of results. It is obvious that a person who is to receive payment in direct proportion to the benefit received by his client, may be tempted to exaggerate the advantage of his service or may adopt means that are not ethical. It will have the effect of undermining his integrity and impairing his independence. Therefore, members are prohibited from charging or accepting any remuneration based on a percentage of the profits or on the happening of a particular contingency such as, the successful outcome of an appeal in revenue proceedings.

Professional services should not be offered or rendered under an arrangement whereby no fee will be charged unless a specified finding or result is obtained or where the fee is otherwise contingent upon the findings or results of such services. However, fees should not be regarded as being contingent if fixed by a court or other public authority.

The Council of the Institute has however framed Regulation 192 which exempts members from the operation of this clause in certain professional services. The said Regulation 192 is reproduced -

192. Restriction on fees - No Chartered Accountant in practice shall charge or offer to charge, accept or offer to accept, in respect of any professional work, fees which are based on a percentage of profits, or which are contingent upon the findings or results of such work, provided that:

- (a) "In the case of a receiver or a liquidator, the fees may be based on a percentage of the realization or disbursement of the assets;
- (b) In the case of an auditor of a co-operative society, the fees may be based on a percentage of the paid up capital or the working capital or the gross or net income or profits;
- (c) In the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of property valued;

- (d) in the case of certain management consultancy services as may be decided by the resolution of the Council from time to time, the fees may be based on percentage basis which may be contingent upon the findings, or results of such work;
- (e) in the case of certain fund raising services, the fees may be based on a percentage of the fund raised;
- (f) in the case of debt recovery services, the fees may be based on a percentage of the debt recovered;
- (g) in the case of services related to cost optimisation, the fees may be based on a percentage of the benefit derived; and
- (h) any other service or audit as may be decided by the Council. **[Following activities have been decided by the Council under “h” above :-(i) Acting as Insolvency Professional;(ii) Non-Assurance Services to Non-Audit Clients]**

Illustration 19

Mr. P a practicing chartered accountant acting as liquidator of AB & Co. charged his professional fees on percentage of the realization of assets.

Restriction on fees based on a Percentage: According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, CA Regulation allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of a receiver or a liquidator, and the fees may be based on a percentage of the realization or disbursement of the assets.

In the given case, Mr. P, a practicing Chartered Accountant, has acted as liquidator of AB & Co. and charged his professional fees on percentage of the realisation of assets.

Conclusion: Therefore, Mr. P shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the realisation of assets being a liquidator.

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 chartered accountant 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.

This is a provision introduced to restrain a member in practice from engaging himself in any business or occupation other than that of chartered accountant except when permitted by the Council to be so engaged. The objective is to restrain members from carrying on any other business in conjunction with the profession of accountancy and combining such work with any business, which is not in keeping with the dignity of the profession. Another reason for the introduction of such prohibition is that a chartered accountant, if permitted to enter into all kinds of business, would be able to advertise for his other business and thereby secure an unfair advantage in his professional practice.

The Council, on a very careful consideration of the matter, has formulated Regulation, 190A and 191 which are reproduced below, specifying the activities with which a member in practice can associate himself with or without the permission of the Council.

190A. Chartered Accountant in practice not to engage in any other business or occupation.

“A chartered accountant in practice not to engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council”.

191. Part-time employment a Chartered Accountant in practice may accept.

“Notwithstanding anything contained in Regulation 190A but subject to the control of the Council, a Chartered Accountant in practice may act as a liquidator, trustee, executor, administrator, arbitrator, receiver, adviser or representative for costing, financial or taxation matter, or may take up an appointment that may be made by the Central Government or a State Government or a court of law or any other legal authority or may act as a Secretary in his professional capacity, provided his employment is not on a salary-cum-full-time basis”.

Appendix 9 C.A. Regulations, 1988

The General and specific Resolutions passed by the Council under the power vested in it under Regulation 190A as included in Appendix 9 of C.A. Regulations, 1988 are also reproduced below for information.

General Resolution

Permission granted generally - Members of the Institute in practice be generally permitted to engage in the following categories of occupations, for which no specific permission from the Council would be necessary in individual cases:

- (1) Employment under Chartered Accountants in practice or firms of such chartered accountants.
- (2) Private tutorship.
- (3) Authorship of books and articles.
- (4) Holding of Life Insurance Agency License for the limited purpose of getting renewal commission.
- (5) Attending classes and appearing for any examination.
- (6) Holding of public elective offices such as M.P., M.L.A. and M.L.C.
- (7) Honorary office leadership of charitable-educational or other non-commercial organisations.
- (8) Acting as Notary Public, Justice of the Peace, Special Executive Magistrate and the like.
- (9) Part-time tutorship under the coaching organisation of the Institute.
- (10) Valuation of papers, acting as paper-setter, head-examiner or a moderator, for any examination.
- (11) Editorship of professional journals.
- (12) Acting as Surveyor and Loss Assessor under the Insurance Act, 1938 provided they are otherwise eligible.
- (13) Acting as recovery consultant in the banking sector
- (14) Owning agricultural land and carrying out agricultural activity (w.e.f. August 9th, 2008).

Specific Resolution - Members of the Institute in practice may engage in the following categories of business or occupations, after obtaining the specific and prior approval of the Council in each case:

- (1) Full-time or part-time employment in business concerns provided that the member and/or his relatives do not hold "substantial interest" in such concerns.
- (2) Full-time or part-time employment in non-business concern.

- (3) Office of managing director or a whole-time director of a body corporate within the meaning of the Companies Act, 1956 (now Companies Act, 2013) provided that the member and/or any of his relatives do not hold substantial interest in such concern.
- (4) Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken.
- (5) Interest in an educational institution.
- (6) Part-time or full-time lectureship for courses other than those relating to the Institute's examinations conducted under the auspices of the Institute or the Regional councils or their branches.
- (7) Part-time or full-time tutorship under any educational institution other than the coaching organization of the Institute.
- (8) Editorship of journals other than professional journals.
- (9) Any other business or occupation for which the Executive Committee considers that permission may be granted.

However, it is open to the Council to refuse permission in individual cases though covered under any of the above categories. For the purpose of the above resolution:

- (i) the expression "relative", in relation to a member, means the husband, wife, brother or sister or any lineal ascendant or descendant of that member;
- (ii) a member shall be deemed to have a "substantial interest" in a concern -
 - (i) in a case where the concern is a Company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of voting power at any time, during the relevant years are owned beneficially by such member or by any one or more of the following persons or partly by such member and partly by one or more of the following persons:
 - (a) One or more relatives of the member;
 - (b) Any concerns in which any of the persons referred to above has a substantial interest;
 - (ii) in the case of any other concern, if such member is entitled or the other persons referred to above or such member and one or more of the other persons referred to

above are entitled in the aggregate, at any time during the relevant years to not less than twenty percent of the profits of such concern.

Attention of the members is also invited to para 3 of the above Resolution relating to the holding of office of a managing director or a whole-time director in a company. In such cases, a member can accept the office of a managing director or a whole-time director only after obtaining, the specific and prior approval of the Council. Attention of the members is also invited to the provisions of Section 2(26) of the Companies Act, 1956 (now Section 2(54) of the Companies Act, 2013) under which even where a person is not designated as a managing director or a whole-time director, he can be deemed to be a managing director or a whole-time director if he is entrusted with the whole or substantially the whole of the management of the affairs of the company. It may be pointed out that a member cannot accept and hold the office of a managing director or a whole-time director in a company if the member and/or his partners and relatives hold substantial interest in such a company.

The Council has considered the question of permitting members in practice to become a Director, Managing Director, full time/Executive Director etc. and related issues and the following decisions have been taken.

As regards the question of permitting member in practice to be a Director, Promoter/Promoter-Director, Subscriber to the Memorandum and Articles of Association of any company including a board managed company, it was decided that -

(a) Director of a Company

- (i) The expression "Director Simplicitor" means an ordinary / simple Director who is not a Managing Director or Whole time Director and is required only in the Board Meetings of the company and not paid any remuneration except for attending such meetings.
- (ii) A member in practice is permitted generally to be a Director Simplicitor in any Company including a board-managed Company and as such he is not required to obtain any specific permission of the Council in this behalf unless he or any of his partners is interested in such Company as an auditor, irrespective of whether he and/or his relatives hold substantial interest in that Company.

A question arises, whether the auditor of a Subsidiary Company can be a Director of its Holding Company-

The Ethical Standard Board (ESB) noted that, in terms of Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 a Chartered Accountant in practice cannot engage (unless permitted by the Council so to engage) in any business or occupation other than the profession of Chartered Accountant but he can be a director of a Company (not being a managing director or

whole-time director) wherein he or any of his partners is not interested in such company as an auditor. The Board further noted that Public conscience is expected to be ahead of the law. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence. In view of the above, the Board, via a clarification, decided that the auditor of a Subsidiary Company can't be a Director of its Holding Company, as it will affect the independence of an auditor.

(b) Promoter/Promoter Director - There is no bar for a member to be a promoter / signatory to the Memorandum and Articles of Association of any company. There is also no bar for such a promoter / signatory to be a Director Simplicitor of that company irrespective of whether the object of the company include areas which fall within the scope of the profession of Chartered Accountants. Therefore, members are not required to obtain specific permission of the Council in such cases. It must be clarified that under Section 25 of the Chartered Accountants Act, no Company can practise as a Chartered Accountant.

(c) Member in practice in a HUF doing business - "A member of the Institute can acquire interest in family business in any of the following manner:

- (i) as a proprietary firm
- (ii) as a partnership firm
- (iii) in the name and style of Hindu Undivided Family as its Karta or a member.

It would be necessary for the members to provide evidence that interest in the family business concern devolved on him as a result of inheritance/succession/partition of the family business. It is also necessary for the member to show that he was not actively engaged in carrying on the said business and that the family business concern in question was not created by himself.

To establish his case, the member should furnish a declaration in the prescribed format and the documents evidencing above for consideration to the concerned Decentralized Office."

A member in practice engaged as Karta of a HUF doing family business, will be within the limit prescribed by Council if he makes investments from the funds pertaining to HUF only, provided, he is not actively engaged in the management of the said business.

Students may also note that as per decision taken by appropriate authority in Council, Regulation 190A of the Chartered Accountants Regulations, 1988 provides that a chartered accountant in practice shall not engage in any business or occupation other than the profession of accountancy, except with the permission granted in accordance with a resolution of the Council. The Council has

passed a Resolution under Regulation 190A granting general permission (for private tutorship, and part-time tutorship under Coaching organization of the Institute) and specific permission (for part-time or full-time tutorship under any educational institution other than Coaching organization of the Institute). Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should not exceed 25 hours a week in order to be able to undertake attest functions.

Illustration 20

A chartered accountant holding certificate of practice and having four articled clerks registered under him accepts appointment as a full-time lecturer in a college. Also, he becomes a partner with his brother in a business. Examine his conduct in the light of Chartered Accountants Act, 1949 and the regulations thereunder.

Specific Permission to be Obtained: Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. This clause, in effect, has empowered the Council of the Institute to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper. Accordingly, the Council had formulated Regulations 190A and 191 to the Chartered Accountants Regulations, 1988 to provide a basis for considering applications of chartered accountants seeking permission to engage in other business or occupation. A member can accept full-time lecturer-ship in a college only after obtaining the specific and prior approval of the Council as also becoming a partner in a business with his brother would require specific permission.

Conclusion: Thus, the chartered accountant is liable for professional misconduct since he failed to obtain specific and prior approval of the Council in each case.

Illustration 21

Mr. A, a practicing Chartered Accountant, took over as the executive chairman of Software Company on 1.4.2023. On 10.4.2023 he applied to the Council for permission.

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

In the instant case, Mr. A took over as the executive chairman on 01.04.2023 and applied for

permission on 10.04.2023. On the basis of these facts, he was engaged in other occupation between the period 01.04.2023 and 10.04.2023, without the permission of the Council.
Conclusion: Therefore, Mr. A is guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Illustration 22

CA. Prabhu is a leading income tax practitioner and consultant for derivative products. He resides in Mumbai near to the ABC commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 50% of his time to settle the commodity transactions. Is C.A. Prabhu liable for professional misconduct?

Engaging into a Business: 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.

In this case, CA. Prabhu is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

Conclusion: Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.

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.

The above clause prohibits a member from allowing another member who is not his partner to sign any balance sheet, profit and loss account or financial statements on his behalf or on behalf of his firm.

This clause is to be read in conjunction with Section 26 of the Chartered Accountants Act, 1949 which stipulates that 'No person other than a member of the Institute shall sign any document on behalf of a Chartered Accountant in practice or a firm of Chartered Accountants in his or its professional capacity'.

The term 'financial statement' for the purposes of this clause would cover an examination of the accounts or of financial statements given under a statutory enactment or otherwise. A report, however, may cover a wider range of documents but in the context in which it is used in this clause, it would mean only a report arising out of a professional assignment undertaken by him or his firm and submitted by him or his firm to the client(s) or where so required, to an outsider on behalf of himself or on behalf of the firm. The subject matter of report should be the expression of a professional opinion whether, financial or non-financial. The financial statements and the reports referred to in this clause obviously means the financial statements and reports as ultimately finalized and submitted to the outside authorities.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

- (i) Issue of audit queries during the course of audit.
- (ii) Asking for information or issue of questionnaire.
- (iii) Letter forwarding draft observations/financial statements.
- (iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
- (v) Acknowledging and carrying on routine correspondence with clients.
- (vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
- (vii) Issuing acknowledgements for records produced.
- (viii) Raising of bills and issuing acknowledgements for money receipts.
- (ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
- (x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

It is also clarified that where the authority to sign documents given above is delegated by a chartered accountant or by a firm of chartered accountants the fact that the documents have not been signed by a chartered accountant is not a defence to him or to the firm in an enquiry relating to professional misconduct.

However, the Council has decided that where a Chartered Accountant while signing a report or, a financial statement or any other document is statutorily required to disclose his name, the member should disclose his name while appending his signature on the report or document. Where there is no such statutory requirement, the member may sign in the name of the firm. It may be noted that the revised SA 700 mandates mentioning of Membership No. and Firm Registration No. Members' attention is also drawn towards UDIN Guidelines of the Institute in 2018.

Illustration 23

S, a practicing chartered accountant gives power of attorney to an employee chartered accountant to sign reports and financial statements on his behalf.

Power of Signing Reports and Financial Statements: Under Clause (12) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

This clause read in conjunction with Section 26 of the Chartered Accountants Act, 1949 stipulates that no person other than the member of the institute shall sign any document on behalf of a Chartered Accountant in practice or a firm of Chartered Accountants in his or its professional capacity.

The term 'Financial Statement' for this purpose would cover an examination of the accounts or financial statements given under a statutory enactment or otherwise.

Further, Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

Conclusion: Accordingly, S is guilty of professional misconduct under Clause (12) of Part I of First Schedule and also under Clause (1) of Part II of Second Schedule for contravening Section 26.

Illustration 24

CA. Smart, a practicing Chartered Accountant was on Europe tour between 15-9-23 and 25-9-23. On 18-9-23 a message was received from one of his clients requesting for a stock certificate to be produced to the bank on or before 20-9-23. Due to urgency, CA. Smart directed his assistant, who is also a Chartered Accountant, to sign and issue the stock certificate after due verification, on his behalf.

Allowing a Member Not Being a Partner to Sign Certificate: As per Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case, CA. Smart allowed his assistant who is not a partner but a member of the Institute of Chartered Accountants of India to sign stock certificate on his behalf and thereby commits misconduct.

Conclusion: Thus, CA. Smart is guilty of professional misconduct under Clause (12) of Part I of First Schedule to the Chartered Accountants Act, 1949.

PART II - Professional misconduct in relation to members of the Institute 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.

A member of the Institute in service is deemed to be guilty of professional misconduct, if he is an employee of any company, firm or person and during that course whatever emoluments he receives, if he either pays or allows to pay or agree to pay any part or share thereof whether directly or indirectly. However, this clause does not restrict such sharing or commitments among relatives, dependents, friends etc., if there is no relationship in procuring or retaining the job and payment is not a consideration for job procurement or retainership.

The clear verdict of this clause is that job must be procured and retained with own professional capabilities and not by any financial deal impairing professional dignity.

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 or agent or customer of such company, firm or person by way of commission or gratification.

This clause restricts to accept or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification. The objective is that when a member is in employment, he must maintain high level of ethics and should not accept any other amount from anyone for which he is not entitled from employer under contractual agreement of service.

[Note: A member in the foregoing circumstances would be guilty of misconduct regardless of the fact that he was in whole-time or part-time employment or that he was holding Certificate of Practice along with his employment.]

Illustration 25

Mr. 'C', a Chartered Accountant holds a certificate of practice while in employment also, recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from employer paid a particular sum as referral fee to Mr. 'C'.

Referral Fee from Lawyer: According to Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949, a member of the Institute (other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

In the present case, Mr. C who beside holding a certificate of practice, is also an employee and by referring a lawyer to the company in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.

Conclusion: Therefore, Mr. C is guilty of professional misconduct by virtue of Clause (2) of Part II of First schedule.

PART III - Professional misconduct in relation to members of the Institute 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 Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.

Clause (11) of Part I and Clauses (1) and (3) of Part III where a Chartered Accountant had not disclosed to the Institute at any time about his engagement as a proprietor of a non-chartered accountant's firm while holding certificate of practice and had not furnished particulars of his engagement as Director of a company despite various letters of the institute which remained

unreplied. Held that he was guilty under Clause (11) of Part I and Clauses (1) and (3) of Part III of the First Schedule.

Where a Chartered Accountant had continued to train an articled clerk though his name was removed from the membership of the Institute and he had failed to send any reply to the Institute asking him to send his explanation as to how he was training as his articled clerk when he was not a member of the Institute. Held that he was guilty under Clause (2) of Part III of the First Schedule.

Illustration 26

Mr. 'G', while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business.

Disclosure of Information: As per Clause (2) of Part III of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant, in practice or not, does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

In the given case, Mr. "G", a Chartered Accountant while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business. Details of engagement in business need to be disclosed while applying for the certificate of practice as it was the information called for in the application, by the Institute.

Conclusion: Thus, Mr. G will be held guilty for professional misconduct under the Clause (2) of Part III of First Schedule of the Chartered Accountants Act, 1949.

Illustration 27

Mr. X, a Chartered Accountant, employed as a paid Assistant with a Chartered Accountant firm, leaves the services of the firm on 31st December, 2023. Despite many reminders from ICAI he fails to reply regarding the date of leaving the services of the firm.

Failed to Supply Information Called For: As per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Conclusion: Thus, in the given case, Mr. X has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant. Therefore, he is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

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 I of this Schedule, gives information knowing it to be false.

Any member of the Institute, in the course of procurement of professional work from another Chartered Accountant or from any other source provides or renders any information which he knows to be false through any documents, or acts (like tenders, enquiries, response to advertisement, CV type write ups etc.), he would be deemed guilty of professional misconduct under Clause (3), Part III of First Schedule.

PART IV- Other misconduct in relation to members of the Institute 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.

Illustration 28

YKS & Co., a proprietary firm of Chartered Accountants was appointed as a concurrent auditor of a bank. YKS, the proprietor, used his influence to get a loan and thereafter failed to repay the loan.

Disrepute to the Profession: This is a case which is covered under the expression in other misconduct of the Chartered Accountants Act, 1949. As per Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work. Here the Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards calls for

disciplinary action.

In the present case, YKS & Co, being a concurrent auditor used his position to obtain the funds and failed to repay the same to the bank. This brings disrepute to the profession of a Chartered Accountant. This act of YKS & Co is not pardonable.

Conclusion: Therefore, YKS & Co will be held guilty of other misconduct under Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949.

These Clauses (1) & (2) are self-explanatory and any of the member of the Institute is found guilty by any civil or criminal court and prosecuted for an imprisonment in an offence involving moral turpitude or his acts bring disrepute to the profession or the Institute, irrespective of the fact whether such acts are related to profession or not, such member will be deemed to be guilty of other misconduct in Part IV of First Schedule.

The important point to note is that if imprisonment tenure exceeds six months, this case will be covered in the Clause of Part III of Second Schedule.

8.2 The Second Schedule

Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the second schedule or in both the Schedule, he shall place the matter before the Disciplinary Committee.

Part I - Professional Misconduct in relation to Chartered Accountants in Practice

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he-

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.

An accountant in public practice has access to a great deal of information of his client, which is of a highly confidential character. It is important for the work of an accountant and for maintaining the dignity and status of the profession that he should treat such information as having been provided to him, only to facilitate the performance of his professional duties for which his services have been engaged. To divulge such information would be a breach of professional confidence, which may give rise to the most serious consequences, even to an action by the client for the loss suffered by him through such a breach. The accountant's duty not to disclose continues even after the completion of his assignment.

If disclosure is required as a part of performance of professional duty by a practicing member in relation to a client, the fact that such performance is required by the client would itself amount to the client consenting to such disclosure. Thus, a member in practice submitting information to, say, exchange control authorities, while performing his professional duties cannot be considered to have made disclosure without the aforesaid consent. But, in all cases, the request or the initiative that the members does prefer the service, which would entail such disclosure, must come from the client in relation to whose affairs the disclosure would be entailed.

If disclosure is required in other cases, it would be necessary to ensure that the consent of the client is given by a person who is competent to accord such consent. Thus, in the case of a sole proprietary concern, the consent may be given by the proprietor or his constituted attorney who is legally empowered to give such consent. In the case of partnership firm, since in turn, every partner has the authority to bind the firm by his acts, the consent may be given by any partner. In the case of a company, by virtue of section 179 of the Companies Act, 2013, the Board of Directors is empowered to do all that the company in a general meeting may do unless a resolution by the company in general meeting is required by the Act or by the Memorandum or Articles of the company. Hence, the consent may be sought from the Managing Director if the powers of the Board of Directors are delegated to him comprehensively enough to include the power to give such consent, but if the powers of the Board of Directors are not so delegated, the consent should be obtained by means of resolution of the Board of Directors of the Company.

An auditor is not required to provide the client or other auditors of the same enterprise or its related enterprise such as a parent or a subsidiary, **access to his audit working papers**. The main auditors of an enterprise do not have right of access to the audit working papers of the branch auditors. In the case of a company, the statutory auditor has to consider the report of the branch auditor and has a right to seek clarifications and/or to visit the branch if he deems it necessary to do so for the performance of the duties as auditor. An auditor can rely on the work of another auditor, without having any right of access to the audit working papers of the other auditor. For this purpose, the term 'auditor' includes 'internal auditor'.

However, the auditor may, at his discretion, in cases considered appropriate by him, make portions of or extracts from his working papers available to the client.

There is a difference between sharing of working papers and sharing of information. So far as the information is concerned, he can provide the same to the client or to a Regulatory body after obtaining the consent of the client.

It is not possible to set out all the circumstances under which disclosure of information may be required by law. If under any legal compulsion and if it is not legally permissible to claim privilege

under the Evidence Act, 1872 (Section 126), the disclosure made by a member of such information may not be considered as misconduct. However, such matters involve niceties of law and expert legal advice may be sought prior to such disclosure.

The only circumstance in which this duty of confidence may give rise to a difficulty is where the accountant has reason to believe that the client has been guilty of some unlawful act or default. This matter is of special significance in the case where the client is guilty of tax evasion.

Further, students may note that as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.

Illustration 29

Mr. P, a Chartered Accountant was invited by the Chamber of Commerce to present a paper in a symposium on the issues facing Indian Leather Industry. During the course of his presentation, he shared some of the vital information of his client's business under the impression that it will help the Nation to compete with other countries at international level.

Disclosure of Client's Information: Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 deals with the professional misconduct relating to the disclosure of information by a chartered accountant in practice relating to the business of his clients to any person other than his client without the consent of his client or otherwise than as required by any law for the time being in force would amount to breach of conduct. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. The Chartered Accountant may however, disclose the information in case it is required as a part of performance of his professional duties. In the given case, Mr. Ph has disclosed vital information of his client's business without the consent of the client under the impression that it will help the nation to compete with other countries at International level.

Conclusion: Thus, it is a professional misconduct covered by Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Clause (2) Certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice.

The above clause restrains a member from subscribing to the report on a financial statement so long as it has not been examined by him or by a partner or an employee of his firm or by another chartered accountant in practice. It has been introduced to ensure that the work entrusted to him has been carried out by the member either directly or under his supervision before he renders his report.

An exception however has been made in respect of an examination carried out by another chartered accountant in practice. This enables two or more members to accept a joint assignment or enables a member also to carry out the examination of financial statements by or with the assistance of all or either any chartered accountant in practice.

Where the joint auditors are appointed, the work is normally divided among themselves in terms of identifiable units or areas, or with reference to the items of liabilities, or income or expenditure or to the period of time etc. Such division should be adequately documented and communicated to the auditee.

In the course of his work, where a joint auditor comes across matters requiring discussion with or application of judgement by the joint auditors, he must communicate to the other joint auditors before submission of the report.

In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible in accordance with SA 299 "Joint Audit of Financial Statements":

Each joint auditor should decide for himself the appropriateness of using test checks or sampling, the nature, timing and extent of audit procedures to be applied in relation to the work allotted to him.

Obtaining and evaluating the information and explanations from the management is the joint responsibility of the joint auditors unless they agree upon a specific pattern of distribution of this responsibility. In case of distribution of the responsibility, the liability of the joint auditors is limited to the area allotted to that auditor.

Clause (3) Permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in manner which may lead to the belief that he vouches for the accuracy of the forecast.

As per the opinion of the Council while finalising the Guidance Note on Accountant's Report on Profit Forecasts and/or Financial Forecasts at its 100th meeting held on 22nd through 24th July 1982, a chartered accountant can participate in the preparation of profit or financial forecasts 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 and so long as he does not vouch

for the accuracy of the forecasts. The Council has further opined that the same opinion would also apply to projections made on the basis of hypothetical assumptions about future events and management actions which are not necessarily expected to take place so long as the auditor does not vouch for the accuracy of the projection.

Further, the attention of the members is drawn to “**Guidance Note on Reports in Company Prospectuses (Revised 2019)**” issued by the Council in January 2019. This Guidance Note provides guidance on compliance with the provisions of the Companies Act, 2013 and the **Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations 2018** relating to the reports required to be issued by chartered accountants in prospectus issued by the companies for the offerings made in India.

A Chartered Accountant issued 97 Projection Statements for certain Individuals without verifying the basic documents and on the basis of which the Bank had extended the loan amount. Afterwards, the Bank revealed that persons for whom the Respondent had issued Financial Statements did not have any business/source for repayment of loan. Accordingly, Chartered Accountant will be held, guilty of professional misconduct falling within the meaning of Clauses (3), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Clause (4) Expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

- (i) If the opinions of auditors are to command respect and the confidence of the public, it is essential that it must be free of any interest which is likely to affect their independence. Since financial interest in the business can be a substantial interest and one of the important factors which may disturb independence, the existence of such an interest direct or indirect affects the opinion of the auditors. As per this clause, an auditor should not express his opinion on financial statements of any business or enterprise wherein he has a substantial interest. This is intended to assure the public as regards the faith and confidences that could be reposed on the independent opinion expressed by the auditors.
- (ii) For the purpose of this Clause, the expression “Substantial Interest” shall have meaning as is assigned thereto, under Appendix (9) of the Chartered Accountants Regulations, 1988. **(see Clause 11 of Part I of First Schedule).**
- (iii) The words “financial statements” used in this clause would cover both reports and certificates usually given after an examination of the accounts or the financial statement or any attest function under any statutory enactment or for purposes of income-tax assessments. This would not, however, apply to cases where such statements are prepared by members in

employment purely for the information of their respective employers in the normal course of their duties and not meant to be submitted to any outside authority.

- (iv) Public conscience is expected to be ahead of the law. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence.
- (v) Member must take care to see that they do not land themselves in situations where there could be conflict of interest and duty.



6. For example, where a Chartered Accountant is appointed the Liquidator of a Company, he should not qua a Chartered Accountant himself, audit the Statement of Accounts to be filed under Section 348(1) of the Companies Act, 2013. The audit in such circumstances should be done by a Chartered Accountant other than the one who is the Liquidator of the Company.

- (vi) In this connection, the Council has decided not to permit a Chartered Accountant in employment to certify the financial statements of the concern in which he is employed, or of a concern under the same management as the concern in which he is employed, even though he holds certificate of practice and that such certification can be done by any Chartered Accountant in practice. This restriction would not however apply where the certification is permitted by any law. The Council has also decided that a Chartered Accountant should not by himself or in his firm name:-
 - a. accept the Auditorship of a college, if he is working as a part-time lecturer in the college.
 - b. accept the Auditorship of a Trust where his partner is either an employee or a trustee of the Trust.

The Council has, in this connection, issued the following guidelines:

Requirements of Clause applicable to all Attest Functions

- (vii) Many new areas of professional work have been added, e.g., Tax Audit, GST 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. The Council wishes to emphasize that the aforesaid requirement of Clause (4) are equally applicable while performing all types of attest functions by the members.

(viii) Some of the situations which may arise in the applicability of Clause (4) read with the definition of "Substantial Interest" (see **Clause 11 of Part I of First Schedule**) and other statutory prohibitions are discussed below for the guidance of members:-

1. Where the member, his firm or his partner or his relative has substantial interest in the business or enterprise (not being a company).

The independence of mind is a fundamental concept of audit and/or expression of opinion on the financial statements in any form and, therefore, must always be maintained. Nothing can substitute for the essential and fundamental requirements of independence. Therefore, the Council's views are clarified in the following circumstances.

- (a) An enterprise/concern of which a member is either an owner or a partner

The holding of interest in the business or enterprise (not being a company) by a member himself whether as sole-proprietor or partner in a firm, in the opinion of the Council, would affect his independence of mind in the performance of professional duties in conducting the audit and/or expressing an opinion on financial statements of such enterprise. Therefore, a member shall not audit financial statements of such business or enterprise.

- (b) Where the partner or relative of a member has substantial interest

The holding of substantial interest by the partner or relative of the member in the business or enterprise (not being a company) of which the audit is to be carried out and opinion is to be expressed on the financial statement, may also affect the independence of mind of the member, in the opinion of Council, in the performance of professional duties. Therefore, the member may, for the same reasons as not to compromise his independence, desist from undertaking the audit of financial statements of such business or enterprise.

2. Where the member or his partner or relative is a director or in the employment of an Officer or an Employee of the Company.

- (a) Where the member is holding a position in the Company as Director, officer or employee

Section 141(3)(b) of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a Company in which he is an officer or employee of the Company, or in the employment of an officer or an employee of the

Company (irrespective of the question of substantial interest).

Moreover, in case the member who is Director *Simplicitor* (general permission) in a Company, the Council has prohibited such member from auditing the accounts of a Company, whether or not he holds substantial interest in the Company.

In case the member seeks specific permission of the Council to be Whole Time or Managing Director in a Company, he would, on grant of such permission, not be entitled either to engage in attest functions (which includes audit), or to hold substantial interest in the Company. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. Tax Audit, yet the underlying principle of independence of mind is equally applicable in those situations also.

- (b) Where the member is not holding a position in the Company, but holding any security or interest

Section 141(3) (d)(i) of Companies Act, 2013 disqualifies a person from being Auditor of a Company, if he holds any security or interest in the Company, or its subsidiary, or holding or associate company or a subsidiary of such holding Company.

- (c) Where the partner of the member is an officer or employee of a company

Section 141(3)(c) of Companies Act, 2013 disqualifies a member from being the auditor of a Company, where the partner of such member is an officer or employee of the Company.

- (d) Where the partner of the member is holding any security or interest in the Company

Section 141(3) (d)(i) of Companies Act, 2013 bars a person from being auditor of a Company, if his partner holds any security or interest in the Company, or its subsidiary, or holding or associate company or a subsidiary of such holding Company.

- (e) Where the relative of the member is a director or is in the employment of the Company as a director or key managerial person

Section 141 (3) (f) of Companies Act, 2013 bars a person from accepting audit of a Company where the relative of the member is director or is in the

employment of the Company as a director or key managerial person.

- (f) Where the relative of the member is holding any security or interest in the Company

Section 141(3)(d) (i) of Companies Act, 2013, read with Rule 10 of Companies (Audit and Auditors) Rules, 2014 bars a person from being auditor of a Company, if his relative holds security or interest in the Company, or its subsidiary, or holding or associate company or a subsidiary of such holding Company of face value exceeding Rupees One Lakh.

- (ix) It is not permissible for a member to undertake the assignment of certification, wherein the client is relative of the member. The "relative" for this purpose would refer to the definition mentioned in Accounting Standard (AS)-18.
- (x) An accountant is expected to be no less independent in the discharge of his duties as a tax consultant or as a financial adviser than as auditor. In fact, it is necessary that he should bear the same degree of integrity and independence of mind in all spheres of his work. Unless this is done, the accounts of entities audited by Chartered Accountants or statements made by them during the course of assessment proceedings would not be relied upon as correct by the authorities.
- (xi) **Members not to write Books of Account for auditee clients:** The Council has clarified that the members are not permitted to write the books of account of their auditee clients.
- (xii) **Statutory auditor not to be the Internal Auditor simultaneously:** An Auditor appointed by an entity under the Companies Act or any other statute shall not be the Internal Auditor of the same entity.
- (xiii) **Internal auditor not to be the Tax auditor simultaneously:** An Internal Auditor of an assessee, whether working with the organization or an independently practicing Chartered Accountant irrespective of being an individual Chartered Accountant or a firm of Chartered Accountants cannot be appointed as its Tax Auditor.
- (xiv) **Internal Auditor not to be the GST Auditor simultaneously:** The Internal Auditor of an entity cannot undertake GST Audit of the same entity.
- (xv) **Cooling off period after completion of tenure as Director:** A member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

- (xvi) **Members to satisfy whether appointment is as per the statute:** A member should satisfy himself before accepting an appointment as an auditor of an entity that his appointment is in accordance with the statute governing the entity. In case the entity is constituted under a trust deed/instrument, the member should satisfy whether his appointment is valid according to the instrument constituting the entity and rules and regulations made thereunder.
- (xvii) In case the appointment is to be authorised by the regulatory authorities such as in the case of co-operative societies, trusts etc. then the member must satisfy whether such regulatory authorities have authorised the managing committee of the society/trust for appointment of the auditors. In a case where any entity is being managed by a Managing Committee or Board of Trustees or Board of Governors by whatever name called he should ensure that his appointment is duly made by a resolution passed of such Managing Committee or Board of Trustees or Board of Governors. Even in case of partnership or sole proprietary concerns, the member must ensure that a letter of appointment/engagement is given by the firm/sole proprietor before he accepts the appointment/ engagement.
- (xviii) Section 288 of Income Tax Act, 1961 describe the disqualifications for the purpose of Tax Audit.

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 where he is concerned with that financial statement in a professional capacity.

It may be observed that this clause refers to failure to disclose a material fact, which is known to him, in a financial statement reported on by the auditor. It is obvious, that before a member could be held guilty of misconduct, materiality has to be established. The determination of materiality has been provided in SA 320, "Materiality in Planning and Performing an Audit".

It should be borne in mind that there may be cases where an item may not be material from the point of view of the balance sheet, but may have material significance in relation to the profit and loss account for that year and vice-versa. It is therefore essential that care should be taken to ensure that the aspect of materiality should be judged in relation to both the balance sheet and the profit and loss account.

The word "financial statements" used in this clause would cover both reports and certificate usually given after an examination of the accounts or of financial statements under any statutory enactment, or/for purposes of income tax assessments. This would not however, apply to cases where such statements are prepared by members in employment purely for the information of their respective

employers in the normal course of their duties and not meant to be submitted to any outside authority.

Illustration 30

Mr. J, a Chartered Accountant during the course of audit of M/s XYZ Ltd. came to know that the company has taken a loan of ₹ 10 lakhs from Employees Provident Fund. The said loan was not reflected in the books of account. However, the auditor ignored this information in his report.

Failure to Disclose Material Facts: As per Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading. In this case, Mr. J has come across information that a loan of ₹ 10 lakhs has been taken by the company from Employees Provident Fund. This is contravention of Rules and the said loan has not been reflected in the books of accounts. Further, this material fact has also to be disclosed in the financial statements. The very fact that Mr. J has failed to disclose this fact in his report, he is attracted by the provisions of professional misconduct under Clause (5).

Conclusion: Mr. J will be liable of professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

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.

This clause refers to failure on the part of a member to point out in his report a material misstatement appearing in a financial statement and he has knowledge of the same. Here also, it is obvious, that before a member could be held guilty of misconduct, materiality has to be established and the observations made under the preceding Clause (5), in this connection, will equally apply to this clause.

Illustration 31

A practicing Chartered Accountant was appointed to represent a company before the tax authorities. He submitted certain information and explanations to the authorities on behalf of his clients, which were found to be false and misleading.

Submitting Information as Authorised Representative: As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949, if a member in practice fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that

financial statement in a professional capacity, he will be held guilty under Clause (5). As per Clause (6) of Part I of Second Schedule if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity, he will be held guilty under Clause (6).

In given case, the Chartered Accountant had submitted the statements before the taxation authorities. These statements are based on the data provided by the management of the company. Although the statements prepared were based on incorrect facts and misleading, the Chartered Accountant had only submitted them acting on the instructions of his client as his authorized representative.

Conclusion: Hence the Chartered Accountant would not be held liable for professional misconduct.

Clause (7) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Though very simply worded, it is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence. The meaning and significance of this clause is well contained in the following passage quoted from the Judgement of the Karnataka High Court in a disciplinary case which came before it in 1977:

“It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watchdog but not a bloodhound. If there is anything calculated to excite suspicion he should probe it to the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful.”

Professional misconduct is a term of fairly wide import but generally speaking, it implies fairly serious cases of misconduct of gross negligence. Negligence per se would not amount to gross negligence in the case of minor errors and lapses, which do not constitute professional misconduct and which, therefore, don't require a reference to the Disciplinary Committee, the Council would nevertheless bring the matter to the attention of its members so that greater care may be taken in the future in avoiding errors and lapses of a similar type.

Illustration 32

CA C who conducted statutory audit of a Haryana daily 'New Era' certified the circulation figures based on Management Information System Report (M.I.S Report) without examining the books of Account.

Failed to exercise Due Diligence: According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he “does not exercise due diligence or is grossly negligent in the conduct of his professional duties”.

In the instant case, CA C did not exercise due diligence and is grossly negligent in the conduct of his professional duties since he certified the circulation figures without examining the books of accounts.

To ascertain the number of paid copies verification of remittances from the agents, credit allowed to the agents for unsold copies returned, examination of books of account is essential. Further certification of circulation figures based on statistical information without cross verification with financial records amounts to gross negligence and failure to exercise due diligence.

Conclusion: Hence, CA C is guilty of professional misconduct as per Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949.

Illustration 33

Mr. D, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements.

Not Exercising Due Diligence: According to Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard. He was guilty of professional misconduct under Clause (7).

Since Mr. D has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements.

Conclusion: Therefore, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Clause (8): Fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

It is expected of a Chartered Accountant to express his opinion on the truth and fairness of statements of accounts after examining their authenticity with reference to information and explanations given to him. A Chartered Accountant must determine the extent of information, which, should be obtained by him before he expresses an opinion on the financial statements submitted to him for report.

The chartered accountant should not express an opinion before obtaining the required data and information. The latter part of the clause enjoins that where due to inadequacy of information or data the report has to be circumscribed to an extent that it would cease to be of any expression of a categorical opinion, the auditor should clearly express his disclaimer in no uncertain terms.



7. For example, if the auditor has not seen any evidence of the existence and/or valuation of the investment which constitute the only asset of a company, he should not say that:

“Subject to the verification of the existence and value of the investments the balance sheet shows a true and fair view etc.”

For manner of auditor's reporting in such situations, reference may be made to SA 705(Revised), “Modifications to the Opinion in the Independent Auditor's Report”.

Where a Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e. by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printers bills and by not caring to ascertain how many copies were sold and paid for. Held he was guilty under Clause (8). [*Registrar of Newspapers for India vs K. Rajinder Singh (1971)*]

“a certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.” A Chartered Accountant is required to clearly state his limitations/assumptions in his certificates, while in the said matter, the Respondent in none of the 12 certificates either mentioned his limitation or assumptions. Though, in his written

statements he submitted that his job was not to verify the assets physically or verification of original bills or whether promoters contribution have come in actually in the Bank account etc. If his assignment did not include the same, he ought to have disclosed or mentioned in the certificates that while issuing the certificate he had relied upon the following documents, so as not to mislead the users of the said certificate(s). In the instant matter, the Respondent did not disclose any assumptions/limitations whatsoever while issuing the certificates. Moreover, the Respondent in none of the certificates issued by him had mentioned the basis/papers relied upon by him. Consequently, the same misled the IDBI Bank in approving the loan based on such certificates which did not mention the basis of issuance.

The Respondent while issuing the Certificates ought to have exercised diligence but he failed to do so. Accordingly, the Committee is of the view that the Respondent was grossly negligent in conduct of his professional duties and also failed to obtain sufficient information while issuing the aforesaid certificates. Thus, he was guilty under clause (7) and (8).

The Committee noted that since the transaction of land took place between the Shivdarshan Firm i.e., a partnership firm and Siddheshwari Developers, the same should have been reflected in the books of Shivdarshan Firm and not in the books of Shivdarshan Construction which was a proprietary concern. The Respondent being the auditor of Shivdarshan Construction failed to report the said discrepancy in his audit report. Since, the amount of loan was material and the Respondent failed to submit any evidence based on which he had chosen not to qualify the appearance of housing loan from Navsarjan Industrial Co. Op. Bank Ltd in the financial statements, hence, the Committee is of the view that the Respondent is guilty of professional misconduct falling within the meaning of Clauses (6), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 [*Shri Mukesh M. Kelawala vs. CA. Sukhdev Manilal Soni (2013)*]

Where the Respondent had failed to report on the Bank Account which was opened by the client in the capacity as a proprietor which included lot of variations, i.e., Account Number was different and the capacity in which Account was opened was also different. As a Professional, the Respondent ought to have copies of Bank Account which could easily establish the fact that the Bank Account was opened and operated proprietary name but he could not do that. Hence, it was observed that the Respondent was not only negligent in his duties in respect of auditing of bank transactions but also, failed to obtain sufficient information for expressing an opinion. The Respondent was held guilty of professional misconduct falling within the meaning of Clauses (7) & (8) of Part I of the Second Schedule to the Chartered Accountants Act 1949. [*P. Arun vs. N. Raja Ganesh, (2014)*]

Illustration 34

Mr. A, a Chartered Accountant was the auditor of 'A Limited'. During the financial year 2022-23, the investment appeared in the Balance Sheet of the company of ₹ 12 lakh 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 inflated for the purpose of obtaining higher amount of Bank loan.

Grossly Negligent in Conduct of Duties: As per Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice, under Clause (2); does not exercise due diligence, or is grossly negligent in the conduct of his professional duties, under Clause (7); or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, under Clause (8).

The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation.

In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty.

Conclusion: Accordingly, Mr. A, will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Clause (9) Fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available in general

terms from the various pronouncements of the Institute is issued by way of Engagement and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers. (ref.)

Audit of Listed Companies: Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI.

FRN and Membership No.: The members are required to mention the Membership number and Firm registration number to all reports issued pursuant to any attestation engagements, including certificates, issued by them as proprietor or/ partner in the said firm.

Unique Document Identification Number (UDIN): The members may note that UDIN is mandatory from 1st July, 2019 on all Corporate/ Non- Corporate Audit, Attest and Assurance Functions. Thus, a member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him.

An auditor of a company is appointed by the shareholders to perform certain statutory functions and duties and it is expected of him that he will in fact, perform these functions and duties. The failure to perform a statutory duty in the manner required is not excused merely by giving a qualification or reservation in auditor's report.



8. For example, if an auditor fails to verify the cash balance in circumstances where such verification was necessary, feasible and material, it is not sufficient for him merely to state in his report that he did not verify the cash balance in circumstances when giving any reservations or qualifications in the auditor's report as required under this clause, a member would be well advised to indicate clearly the reasons why he was unable to perform the audit in accordance with generally accepted procedures and standards.

It is not possible to exhaustively deal with instances or accepted procedure of audit applicable to special cases. **Two instances** of an audit requiring a special procedure are given below:

Certifying figures of circulation of Newspapers etc.: Very often members are required to certify the figures of circulation of newspapers, magazines etc. by their clients on behalf of the Audit Bureau of Circulations Ltd. Members are normally supplied by the ABC with the Rules and Regulations under which the certification of circulation is to be carried out. Members are also asked to give their acceptance in writing that they will observe the rules of procedure envisaged to report upon any lapse of such special requirements, even of an insignificant nature.

Verification on behalf of Banks: Similarly, in the case of verification on behalf of banks, the rules or procedure for conducting such audit are different from the normal rules applicable to audits under the Companies Act. Members are required to be very familiar with the special procedure required in these matters and act accordingly.

Clause (10) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilize such funds only in accordance with the instructions of the client or for the purposes intended by the client. In this connection the Council has considered some practical difficulties of the members and the following suggestions have been made to remove these difficulties:

- (i) An advance received by a Chartered Accountant against services to be rendered does not fall under Clause (10) of Part I of the Second Schedule.
- (ii) Moneys received for expenses to be incurred, for example, payment of prescribed statutory fees, purchase of stamp paper etc., which are intended to be spent within a reasonably short time need not be put in a separate bank account. For this purpose, the expression; “reasonably **short** time”, would depend upon the circumstances of each case.
- (iii) Moneys received for expenses to be incurred which are not intended to be spent within a reasonably short time as aforesaid, should be put in a separate bank account immediately.
- (iv) Moneys received by a Chartered Accountant, in his capacity as trustee, executor liquidator, etc. must be put in a separate bank account immediately.

Illustration 35

A charitable institution entrusted ₹ 10 lakhs with its auditors M/s R & Co., a Chartered Accountant firm, to invest in a specified securities. The auditors deposited it in their Savings bank account and no investment was made in the next three months.

Failure to Keep Money in Separate Bank Account: If a Chartered Accountant in practice fails to keep moneys of his clients in a separate bank account or fails to use such moneys for purposes for which they are intended then his action would amount to professional misconduct under Clause (10) of Part I of Second Schedule to the Chartered Accountants Act, 1949. In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate

banking account, and to utilise such funds only in accordance with the instructions of the client or for the purposes intended by the client.

Conclusion: In the given case by depositing the client's money by M/s R & Co., a firm of Chartered Accountants, in their own savings bank account, the auditors have committed a professional misconduct. Hence in the given case, M/s R & Co. will be held guilty of professional misconduct.

PART II - Professional misconduct in relation to members of the Institute generally

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

Clause (1) contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

This clause is very important. It requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations and Guidelines made by Council thereunder. Any violation either of these Guidelines or the Act or the Regulations by a member would amount to misconduct under this part.

The Regulations under which cases of contravention have generally come to the notice of the Council are the following:

Regulation 43	Engagement of Articled Assistant
Regulation 46	Registration of Articled Assistant
Regulation 47	Premium from Articled Assistant
Regulation 48	Stipend to Articled Assistant
Regulation 56	Termination or assignment of Articles
Regulation 65	Articled Assistant not to engage in any other occupation
Regulation 67	Complaint against the employer (from Articled Assistant)
Regulation 68 to 80	Audit Assistant
Regulation 190	Register of offices and firms
Regulation 190-A	Chartered Accountants not to engage in any other business or occupation
Regulation 191	Part time employment's a Chartered Accountant may accept
Regulation 192	Restriction on fees

Clause (2) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer.

This is an adaptation of the well-accepted principle of the law of agency. A member in the forthcoming circumstance would be guilty of misconduct regardless of the fact that he was in whole time or part-time employment or that he was carrying on practice of accountancy along with his employment. Since as employee, a member may have access to a confidential information, hence for maintaining the status and dignity of the profession in general, he should treat such information as having been provided to him only to facilitate the performance of his duties as an employee. In order to keep the confidence of the people, Chartered Accountants, should take special care not to divulge such information.

Clause (3) Includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline. Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

If a Chartered Accountant includes in any information, statement, return or form to be submitted to the Institute Council etc. any particular knowing it to be false, he will be held guilty of misconduct.

Where a Chartered Accountant who was employed as a manager of a firm of Registered Accountants, applied for admission as Fellow of the Institute stating that he was a partner, while he was not. Held that the Chartered Accountant was guilty of misconduct as he had made the statement that he was a partner knowing it to be false. [*J.R. Chatrath, (1952)*]

A Member had during the course of the hearing before Disciplinary Committee given a wrong statement duly verified and also a statement on oath knowing it to be false. He was found guilty in terms of this clause. [*K.S. Dugar, (1987)*]

In spite of repeated reminders a Chartered Accountant failed to reply to the letters of the Institute asking him to confirm the date of leaving the services by the Paid Assistant. Held, the Chartered Accountant was guilty of professional misconduct under the Clause. [*A. Umanath Rao, (1965)*]

Clause (4) Defalcates or embezzles money received in his professional capacity.

Defalcation and embezzlement of moneys received in professional capacity amounts to fraud (Covered in SA-240) and such member will be deemed to be guilty of professional misconduct under this clause.

Part III - Other misconduct in relation to members of the Institute generally

A member 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.

Imprisonment awarded for a term exceeding six months in any civil/criminal matter treated as a major offence under 'other misconduct' is included in this Schedule.

 9 COUNCIL GUIDELINES

The relevant extracts of the **Council General Guidelines, 2008** (*issued under Clause (1) of Part-II of Second Schedule to The Chartered Accountants Act, 1949*) are given below:

Chapter I**Preliminary****1.0 Short title, commencement, etc.**

- (a) These Guidelines have been issued by the Council of the Institute of Chartered Accountants of India under the provisions of The Chartered Accountants Act, 1949, as amended by The Chartered Accountants (Amendment) Act 2006, These Guidelines be called the 'Council General Guidelines, 2008'.
- (b) These guidelines shall be applicable to all the Members of the Institute whether in practice or not wherever the context so requires.

Chapter II**Conduct of a Member being an employee**

A member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

Chapter III**Appointment of a Member as Cost auditor**

This Chapter is being omitted.

Chapter IV**Opinion on financial statements when there is substantial interest**

This Chapter is being omitted.

Chapter V

Maintenance of books of account

A member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his / its professional practice, proper books of account including the following-

- (i) a Cash Book;
- (ii) a Ledger.

Illustration 36

L, a chartered accountant did not maintain books of account for his professional earnings on the ground that his income is less than the limits prescribed u/s 44AA of the Income Tax Act, 1961.

Maintenance of Books of Account: As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct. Accordingly, it does not matter whether section 44AA of the Income Tax Act, 1961 applies or not.

Conclusion: Hence, Mr. L is guilty of professional misconduct.

Chapter VI

Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961

A member of the Institute in practice shall not accept, in a financial year, more than the “specified number of tax audit assignments” under Section 44AB of the Income-tax Act, 1961.

Provided that in the case of a firm of Chartered Accountants in practice, the “specified number of tax audit assignments” shall be construed as the specified number of tax audit assignments for every partner of the firm.

Provided further that where any partner of the firm is also a partner of any other firm or firms of Chartered Accountants in practice, the number of tax audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the “specified number of tax audit assignments” in the aggregate.

Provided further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which

may be accepted by him shall not exceed the “specified number of tax audit assignments” in the aggregate.

Provided also that the audits conducted under Section 44AD, 44ADA¹ and 44AE of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the “specified number of tax audit assignments”.

Explanation:

For the above purpose, “the specified number of tax audit assignments” means -

- (a) in the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, **60 tax audit assignments, in a financial year, whether in respect of corporate or non-corporate assesses.
- (b) in the case of firm of Chartered Accountants in practice, **60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

According to a clarification on Tax Audit Assignments by Committee on Ethical Standards Board) of the Institute, if there are 10 partners in a firm of Chartered Accountants in practice, then all the partners of the firm can collectively sign 600 tax audit reports. This maximum limit of 600 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 600 tax audit reports in case remaining 9 partners are not signing any tax audit report.

In computing the “specified number of tax audit assignments” each year’s audit would be taken as a separate assignment.

In computing the “specified number of tax audit assignments”, the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.

The audit of the head office and branch offices of a concern shall be regarded as one tax audit assignment.

¹ As inserted by the Council pursuant to decision at its 368th Meeting held on 10th to 12th Aug., 2017 (Section 44AF, earlier appearing, was repealed).

The audit of one or more branches of the same concern by one Chartered Accountant in practice shall be construed as only one tax audit assignment.

A Chartered Accountant being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the tax audit assignments of the firm.

A Chartered Accountant in practice shall maintain a record of the tax audit assignments accepted by him in each **assessment** year in the format as may be prescribed by the Council.

The limit on number of tax audit assignments per partner in a CA Firm may be distributed between the partners in any manner whatsoever. However, it should be in accordance with the Standard on Quality Control (SQC) 1: Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

Illustration 37

A member of the institute shall not accept in a year more than the specified number of tax audits under section 44AB of the Income Tax Act.

Mr. G is a partner in M/s. XYZ & Co., a firm of Chartered Accountants with 6 partners.

During the assessment year 2022-23, Mr. G alone had signed 290 tax audit reports consisting of both corporate and non-corporate assesses.

Ceiling limit for signing the Tax Audit Reports: As per Council General Guidelines 2008, a member of the Institute in practice shall not accept, in a financial year, more than the “specified number of tax audit assignments” under Section 44AB of the Income-tax Act, 1961. It is also provided further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the “specified number of tax audit assignments” in the aggregate.

In the case of firm of Chartered Accountants in practice “the specified number of tax audit assignments” means, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

Further, as per clarification issued by the Institute on Tax Audit Assignments, tax audit reports may be signed by the partners in any manner whosoever in accordance with specified audit limits. Thus, one partner can individually sign all the tax audit reports subject to specified tax audit assignment limits on behalf of all the partners in the firm of Chartered Accountants in practice or all the partners of the firm can collectively sign the tax audit reports.

In the instant case, there are 6 partners in M/s XYZ & Co., a Chartered Accountants firm, accordingly, specified ceiling limit for the firm will be (60 tax audit assignments per partner X 6

partners) = 360. Therefore, all the 6 partners of the firm can collectively sign 360 tax audit reports. This maximum limit of 360 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 360 tax audit reports in case remaining 5 partners are not signing any tax audit report.

Assuming Mr. G has signed 290 tax audit reports consisting of both corporate and non-corporate assessee on behalf of firm and remaining partners are signing audit reports within the specified number of tax audit assignments u/s 44AB i.e. upto 70.

Conclusion: Hence, Mr. G shall not be deemed to guilty of professional misconduct provided total number of tax audit reports on behalf of firm do not exceeds 360.

Chapter VII

Appointment of an Auditor in case of non-payment of undisputed fees

A member of the Institute in practice shall not accept the appointment as auditor of an entity in case the undisputed audit fee of another Chartered Accountant for carrying out the statutory audit under the Companies Act, 2013 or various other statutes has not been paid:

Provided that in the case of sick unit, the above prohibition of acceptance shall not apply.

Explanation 1: For this purpose, the provision for audit fee in accounts signed by both - the auditee and the auditor **along with other expenses, if any, incurred by the auditor in connection with the audit, shall be considered as “undisputed audit fees”**.

Explanation 2: For this purpose, “sick unit” shall mean a unit registered for not less than five years, which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

Illustration 38

Mr. C accepted the statutory audit of M/s PSU Ltd., whose net worth is negative for the year 2021-22. The audit was to be conducted for the year 2022-23. The audited accounts for the year 2022-23 showed liability for payment of tax audit fees of ₹ 15,000 in favour of Mr. E, the previous auditor.

Accepting Appointment as an Auditor: As per Chapter 7 of Council General Guidelines 2008, a member of the Institute of Chartered Accountants of India in practice shall be deemed to be guilty of professional misconduct if he accepts appointment as auditor of an entity in case the undisputed audit fee of another chartered accountant for carrying out the statutory audit under Companies Act or various other statutes has not been paid.

As per the proviso, such prohibition shall not apply in case of a sick unit where a sick unit is defined to mean “where the net worth is negative”.

Conclusion: In the instant case, though the undisputed fees are unpaid, Mr. C would still not be guilty of professional misconduct since the M/s PSU Ltd. is a sick unit having negative net worth for the year 2021-22.

Chapter VIII

Specified number of audit assignments

A member of the Institute in practice shall not hold at any time appointment of more than the “specified number of audit assignments” of Companies under Section 141 of the Companies Act 2013.

Provided that in the case of a firm of Chartered Accountants in practice, the “specified number of audit assignments” shall be construed as the specific number of audit assignments for every partner of the firm.

Provided further that where any partner of the firm of Chartered Accountants in practice is also a partner of any other firm or firms of Chartered Accountants in practice, the number of audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the “specified number of audit assignments” in the aggregate.

Provided further where any partner of a firm or firms of Chartered Accountants in practice accepts one or more audit of Companies in his individual capacity, or in the name of his proprietary firm, the total number of such assignments which may be accepted by all firms in relation to such Chartered Accountant and by him shall not exceed the “specified number of audit assignments” in the aggregate.

Explanation:

1. For the above purpose, the “specified number of audit assignments” means –
 - (a) in the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, 30 audit assignments whether in respect of private Companies or other Companies, with the exception of one person Companies and dormant companies.

- (b) in the case of Chartered Accountants in practice, 30 audit assignments per partner in the firm, whether in respect of private Companies or other Companies, with the exception of One person Companies and dormant companies².
2. In computing the “specified number of audit assignments”-
- (a) the number of audit of such Companies, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.
 - (b) the audit of the head office and branch offices of a Company by one Chartered Accountant or firm of such Chartered Accountants in practice shall be regarded as one audit assignment.
 - (c) the audit of one or more branches of the same Company by one Chartered Accountant in practice or by firm of Chartered Accountants in practice in which he is a partner shall be construed as one audit assignment only.
 - (d) the number of partners of a firm on the date of acceptance of audit assignment shall be taken into account.

A Chartered Accountant in practice, whether in full-time or part time employment elsewhere, shall not be counted for the purpose of determination of “specified number of audit of Companies” by firms of Chartered Accountants.

A Chartered Accountant being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the audit assignments of the firm.

A Chartered Accountant in practice as well as firm of Chartered Accountants in practice shall maintain a record of the audit assignments accepted by him or by the firm of Chartered Accountants, or by any of the partners of the firm in his individual name or as a partner of any other firm, as far as possible in the prescribed format.

Chapter IX

Appointment as Statutory auditor

A member of the Institute in practice shall not accept the appointment as statutory auditor of Public Sector Undertaking(s)/ Government Company(ies)/Listed Company(ies) and other Public Company(ies) having turnover of ₹ 50 crores or more in a year where he accepts any other work(s) or assignment(s) or service(s) in regard to the same Undertaking(s)/ Company(ies) on a

² As incorporated pursuant to decision of Council at its 388th Meeting held on 6th and 7th Feb., 2020.

remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same Undertaking/company.

Provided that in case appointing authority(ies)/regulatory body(ies) specify(ies) more stringent condition(s)/restriction(s), the same shall apply instead of the conditions/restrictions specified under these Guidelines.

The above restrictions shall apply in respect of fees for other work(s) or service(s) or assignment(s) payable to the statutory auditors and their associate concern(s) put together.

For the above purpose,

- (i) the term “other work(s)” or “service(s)” or “assignment(s)” shall include Management Consultancy and all other professional services permitted by the Council pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 but shall not include:-
 - (a) audit under any other statute;
 - (b) certification work required to be done by the statutory auditors; and
 - (c) any representation before an authority;
- (ii) the term “associate concern” means any corporate body or partnership firm which renders the Management Consultancy and all other professional services permitted by the Council wherein the proprietor and/or partner(s) of the statutory auditor firm and/or their “relative(s)” is/are Director/s or partner/s and/or jointly or severally hold “substantial interest” in the said corporate body or partnership;
- (iii) the terms “relative” and “substantial interest” shall have the same meaning as are assigned thereto under Appendix (9) to the Chartered Accountants Regulations, 1988.

In regard to taking up other work(s) or service(s) or assignment(s) of the undertaking/company referred to above, it shall be open to such associate concern or corporate body to render such work(s) or service(s) or assignment(s) so long as aggregate remuneration for such other work(s) or service(s) or assignment(s) payable to the statutory auditor/s together with fees payable to its associate concern(s) or corporate body(ies) do/does not exceed the aggregate of fee payable for carrying out the statutory audit.

Illustration 39

A is the auditor of Z Ltd., which has a turnover of ₹ 200 crore. The audit fee for the year is fixed at ₹ 50 lakhs. During the year, the company offers A an assignment of management consultancy within the meaning of Section 2(2)(iv) of the CA Act, 1949 for a remuneration of ₹ 1 crore. A seeks your advice on accepting the assignment.

Appointment as a Statutory Auditor of a PSUs'/Govt Company(ies)/Listed Company(ies) and Other Public Company(ies): As per the Council General Guidelines 2008, under Chapter IX on appointment as statutory auditor a member of the Institute in practice shall not accept the appointment as a statutory auditor of a PSUs'/Govt company(ies)/Listed company(ies) and other public company(ies) having a turnover of ₹ 50 crores or more in a year and where he accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking. For this purpose, the other work/services include Management Consultancy and all other professional services permitted by Council excluding audit under any other statute, Certification work required to be done by the statutory auditor and any representation before an authority.

Conclusion: In view of the above position it would be a misconduct on A's part if he accepts the management consultancy assignment for a fee of ₹ 1 crore.

Chapter X

Appointment of an auditor when he is indebted to a concern

A member of the Institute in practice or a partner of a firm in practice or a firm or a relative of such member or partner 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 ₹ 100,000/-.

Illustration 40

D, who conducts the tax audit u/s 44AB of the Income Tax Act, 1961 of M/s ABC, a partnership firm, has received the audit fees of ₹ 2,50,000 on progressive basis in respect of the tax audit for the year ended 31.3.2023. The audit report was, however, signed on 25.5.2023.

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

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

Conclusion: In the instant case, Mr. D is appointed to conduct a tax audit u/s 44AB of the Income Tax Act, 1961. He has received the audit fees of ₹ 2,50,000 in respect of the tax audit for the year ended 31.3.2023 which is on progressive basis. Therefore, Mr. D will not be held guilty for misconduct.

Chapter XI

Directions in case of unjustified removal of auditors

A member of the Institute in practice shall follow the direction given, by the Council or an appropriate Committee or on behalf of any of them, to him being the incoming auditor(s) not to accept the appointment as auditor(s), in the case of unjustified removal of the earlier auditor(s).

Chapter XIII

Guidelines on Tenders

A member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

Chapter XIV

Unique Document Identification Number (UDIN) Guidelines

Whereas, to curb the malpractice of false certification/attestation by the unauthorized persons & to eradicate the practice of bogus certificates and to save various regulators, banks, stakeholders etc. from being misled, the Council of the Institute decided to implement an innovative concept to generate Unique Document Identification Number (UDIN) mandatorily for all kinds of the certificates/GST and Tax Audit Reports and other attest function in phased manner, for which members of the ICAI were notified through the various announcements published on the website of ICAI www.icaai.org at the relevant times.

A member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him which made mandatory from the following dates through announcements published on the website of the ICAI www.icaai.org at the relevant time: -

- For all Certificates w.e.f. 1st February, 2019.
- For all GST and Tax Audit Reports w.e.f. 1st April, 2019.
- For all other Audit, Assurance and Attestation functions w.e.f. 1st July, 2019.

Chapter XV

Guidelines for Networking

Concept: To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct.

For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is deemed to be a network.

The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.

Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is deemed to be a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.

Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is deemed to be a network. This could be achieved by contract or other means.

Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is deemed to be a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.

Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is deemed to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision.

Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a network. A common brand name includes common initials or a common name. A firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.

Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such memberships, a perception may be created that the firm belongs to a network.

Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is deemed to be a network. **Professional resources include:**

- Common systems that enable firms to exchange information such as client data, billing and time records;
- Partners and staff;
- Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;
- Audit methodology or audit manuals; and
- Training courses and facilities.

The determination of whether the professional resources shared are significant, and therefore the firms are network firms, shall be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

Forms of the Network :

The different forms of Network can be as under:-

A network can be constituted as a mutual entity which will act as a facilitator for the constituents of the Network. In such a case the Network itself will not carry out any professional practice.

A network can be constituted as a partnership firm subject to the condition that the total number of partners does not exceed twenty.

A network can be constituted as a Limited Liability Partnership subject to the provision of the Chartered Accountant Act and Rules and such other laws as may be applicable.

A network can be constituted as company subject to the guidelines prescribed by Institute for corporate form of practice and formation of management consultancy services company.

Network Firms shall consist of sole Practitioner/proprietor, partnership or any such entity of professional accountants as may be permitted by the Act.

A firm is allowed to join only one network.

Firms having common partners shall join only one Network.

Approval of Name of Network amongst firms registered with Institute:

1. The Network may have distinct name which should be approved by the Institute. To distinguish a "Network" from a "firm" of Chartered Accountants, the words "& Affiliates" shall be used after the name of the network and the words "& Co." / "& Associates" shall not be used. The prescribed format of application for approval of Name for Network is at Form 'A' (enclosed). The names of the network may be as mentioned in Appendix II.
2. Provisions of Regulation 190 of the Chartered Accountants Regulations, 1988 shall be applicable to the name of Network. However, even if a name is approved and subsequently it is found that the same is undesirable then, the said name may be withdrawn at any time by the Institute. The Institute shall reject any undesirable name and the provisions in respect of names of companies as prescribed in the Companies Act, 1956 shall be applicable in spirit.
3. The Institute shall approve or reject the name of the Network and intimate the same to the Network at its address mentioned in Form 'A' within a period which shall not be later than 30

days from the date of receipt of the said Form.

4. Mere approval of the name of the Network shall not entitle the Network to carry on practice in its own name.

Registration of Network with entities in India

1. After the name of a Network is approved as per provision under Guideline 5, the Institute same shall reserve such name for a period of three (3) months from the date of approval.
2. The Network shall get itself registered with the Institute by applying in Form B within the period of 3 months, failing which the name assigned shall stand cancelled on the expiry of the said period.
3. Registration of Network with Institute is mandatory.
4. If different Indian firms are networked with a common Multinational Accounting Firm, they shall be considered as a part of network.

Listing of Network with entities outside India

1. The duly authorized representative(s) of the Indian Member firm (s)/Member constituting the Network with entities outside India shall file a declaration with the Institute in Form 'D' for Listing of such Network within 30 days from the date of entering into the Network arrangement.
2. Proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members as may be permitted by the Act, shall be permitted to join such network with entities outside India provided that the proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members are allowed to join only one network and firms having common partners shall join only one such network.

Change in constitution of registered Network:

In case of change in the constitution of registered Network on account of any entry into or exit from the Network, the network shall communicate the same to the Institute by filing Form 'C' within a period of thirty (30) days from the date of change in the constitution.

Ethical Compliance:

Once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular: -

1. If one firm of the network is the statutory auditor of an entity then the associate [including the networked firm(s)] or the said firm directly/indirectly shall not accept the internal audit or book-keeping or such other professional assignments which are prohibited for the statutory auditor firm.
2. The guidelines of ceiling on Non-audit fees is applicable in relation to a Network as follows: -
 - i) For a Network firm who is doing statutory audit (including its associate concern and/or firm(s) having common partnership), it shall be the same as mentioned in the said notification; and
 - ii) For other firms of the same Network collectively, it shall be 3 times of the fee payable for carrying out the statutory audit of the same undertaking/ company.
3. In those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.
4. The Network may advertise the Network to the extent permitted by the Advertisement Guidelines issued by Institute. The firms constituting the network are permitted to use the words "Network Firms" on their professional stationery.
5. The constituent member firms of a Network and the Network shall comply with all the Ethical Standards prescribed by the Council from time to time.

Consent of Client:

The effect of registration of network with Institute will be deemed to be a public notice of the network and therefore consent of client will be deemed to be obtained.

Framework of Internal Byelaws of Network:

To streamline the networking, a network shall formulate operational bye-laws. Bye-laws may contain the following clauses on which the affiliates of the network may enter into a written agreement among themselves:

- (i) Appointment of a Managing Committee, from among the managing partners of the member firms of the network and the terms and conditions under which it should function. The minimum and maximum number of members of the Managing Committee shall also be agreed upon.
- (ii) Administration of the network
- (iii) Contribution of membership fees to meet the cost of the administration of the network.
- (iv) Identifying a partner of any of the member firms of the network to be responsible for the assignment (engagement partner)
- (v) Dispute settlement procedures through arbitration and conciliation
- (vi) Development of training materials for members of the network
- (vii) Issue of News-letters for staff and clients
- (viii) Development of software for different types of assignments
- (ix) Development and maintenance of data bases relevant for different types of assignments
- (x) Library
- (xi) Appointment of a technical director to whom references can be made
- (xii) Determining the methodology for drawing resources from each member firm
- (xiii) Determining compensation to member firms for resources to be drawn from them
- (xiv) Peer review of the member firms

These clauses are illustrative.



9. Illustrative examples of names of Network: -

(a) If the Network is a Mutual Entity or Partnership Firm:

AB & Affiliates

(b) If the Network is a LLP:

AB Affiliates LLP

(c) If the Network is a Limited Company:

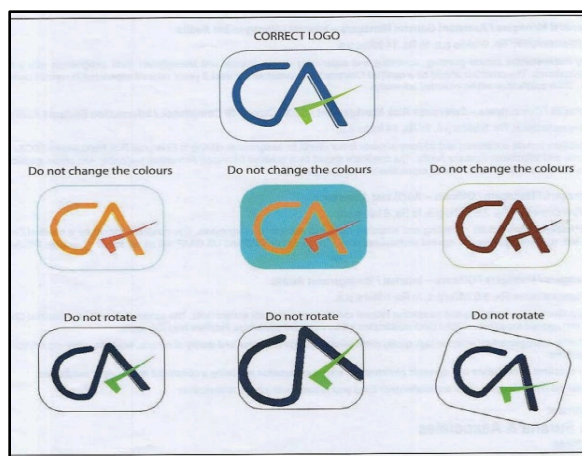
AB Affiliates P. Ltd/Limited

Chapter XVI

Logo Guidelines

The logo consists of letter 'CA' with a tick mark inside a rounded rectangle with white background. The letters CA have been put in blue, the corporate colour which not only stands out on the background but also denotes creativity, innovativeness, knowledge, integrity, trust, truth, stability and depth. The upside down tick mark typically used by Chartered Accountants, has been used to symbolize the wisdom and value of the professional. The green colour in the tick mark signifies growth, prosperity, harmony and freshness.

Members are encouraged to use the new logo, as published here as it is. Do not change the design and colours, including the white background. Refrain from rotating or tilting the logo. The correct and incorrect usage of the logo is explained as under:



Chapter XVII

Guidelines for Corporate Form of Practice

The Council decided to allow members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate within the meaning of the Companies Act provided that the body corporate is engaged exclusively in rendering Management Consultancy and Other Services permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard.

The members can retain full time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company. There will be no restriction on the quantum of the equity holding of the members, either individually and/ or along with the relatives, in such Company. Such members shall be regarded as being in full- time practice and

therefore can continue to do attest function either in individual capacity or in Proprietorship/Partnership firm in which capacity they practice and wherein they are also entitled to train articled/audit assistants.

The name of the Management Consultancy Company is required to be approved by the Institute and such Company has to be registered with the Institute. The guidelines alongwith the prescribed application forms for approval of name and registration, provisions of ethical compliance and other details have been issued and the same will come into force w.e.f. 1.10.2006.

On abundant caution, it may be clarified that no audit practice can be done in Corporate Form. The consultancy practice hitherto done in Individual or Firm Status alone is now intended to be permitted in Corporate Form also.

Ethical Compliance: (i) Once the Management Consultancy Company is Registered with the Institute as per the Guidelines, it will be necessary for such a Company to comply with the following requirements: -

- (a) If the individual practitioner/sole-proprietorship firm/partnership firm is the statutory auditor of an entity then the Management Consultancy Company should not accept the internal audit or book-keeping or such other professional assignments, which are prohibited for the statutory auditor firm.
 - (b) The Notification No. 1-CA(7)/60/2002 dated 8th March, 2002 (enclosed) in respect of ceiling on Non-audit fees is applicable in relation to a Management Consultancy Company.
 - (c) The Management Consultancy Company shall comply with clauses (6) & (7) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.
- (ii) The Management Consultancy Company shall give an undertaking that it shall comply with clauses (6) & (7) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.

Object of Management Consultancy Company: The Management Consultancy Company shall engage itself only in Management Consultancy & Other Services. The Management Consultancy Company shall give an undertaking that it shall render only Management Consultancy & Other Services prescribed by the Council pursuant to powers under section 2 (2)(iv) of the Chartered Accountants Act, 1949.

Note: Students are advised to refer Appendix 'D' of the Code for more details.

9.1 Council Guidelines for Advertisement, 2008

1. Write up -

The Members may advertise through a write up setting out their particulars or of their firms and services provided by them subject to the following Guidelines and must be presented in such a manner as to maintain the profession's good reputation, dignity and its ability to serve the public interest.

The Member(s)/Firm(s) should ensure that the contents of the Write up are true to the best of their knowledge and belief and are in conformity with these Guidelines and be aware that the Institute of Chartered Accountants of India will neither approve a propose write-up, nor owns any responsibility whatsoever for such contents or claims by the writer Member(s)/ Firm(s).

The write-up shall comply with the following conditions:-

- A. It shall be honest and truthful.
- B. There shall be no exaggerated claims for the services offered by the member or the Firm, or the qualifications or experience of the member or any of the partners or any other person associated with the Firm.
- C. It must not make any disparaging references or unsubstantiated comparisons to the work of others.
- D. It should not be of a nature that may bring the profession into disrepute.
- E. It should not contain testimonials or endorsements concerning Member(s) or names of clients (both the past and present) or the fees charged.
- F. It should not contain any information about achievements /awards (except the awards given by the Central or State Governments or Regulatory bodies) or any other position held, or accreditation(s) granted by any organisation.
- G. Monogram of any kind or use of any kind of catch words is not permissible.
- H. The Membership No./FRN (as may be applicable) is mandatory to be mentioned in the write-up.
- I. It should not be of font size exceeding 14.
- J. It must not be violative of any provisions of Chartered Accountants Act, 1949, Chartered Accountants Regulations, 1988, Code of Ethics, 2020 or any Guideline of the Council

The Institute of Chartered Accountants of India may issue a reasoned directive for removal or withdrawal of the whole write-up or of any part(s) thereof.

Advertisement through write-up

While advertising the services or details of Firms, the write-up may include only the following information:

(A) For Members

- (i) CA.....Name
- (ii) Membership No. with Institute
- (iii) Age
- (iv) Date of becoming ACA
- (v) Date of becoming FCA
- (vi) Date from which COP held
- (vii) Recognized qualifications
- (viii) Languages known
- (ix) Telephone/Mobile/Fax No.
- (x) Professional Address
- (xi) Website
- (xii) E-mail
- (xiii) CA Logo
- (xiv) Passport style³ photograph
- (xv) Details of Employees (Nos. -)
 - (a) Chartered Accountants -
 - (b) Other Professionals –
 - (c) Articles/Audit Assistants
 - (d) Other Employees

3 As amended by Council at its 388th Meeting held on 6th and 7th Feb., 2020.

- (xvi) Names of the employees and their particulars on the lines allowed for a member as stated above.
- (xvii) Services provided
 - (a)
 - (b)
 - (c)
- (xviii) Position held as Director or Managing Director in a Management Consultancy Company registered with the Institute⁴.

(B) For Firms

- (i) Name of the Firm Chartered Accountants
- (ii) Firm Registration No. with Institute
- (iii) Year of establishment.
- (iv) Professional Address(s) registered with the Institute (both Head Office and Branches)
- (v) Working Hours
- (vi) Tel. No(s)/Mobile No./Fax No(s)
- (vii) E-mail
- (viii) No. of partners
- (ix) Name of the proprietor/partners and their particulars on the lines allowed for a member as stated above including passport style⁵ photograph.
- (x) CA Logo
- (xi) Details of Employees (Nos. -)
 - (a) Chartered Accountants -
 - (b) Other professionals –
 - (c) Articles/Audit Assistants
 - (d) Other employees

⁴ As incorporated pursuant to decision of Council at its 388th Meeting held on 6th and 7th Feb., 2020.

⁵ As amended by Council at its 388th Meeting held on 6th and 7th Feb., 2020.

(xii) Names of the employees of the firm and their particulars on the lines allowed for a member as stated above.

(xiii) Services provided:

(a)

(b)

(c)

(xiv) Affiliation with a Network registered with the Institute⁶

The write-up may have the Signature, Name of the Member/ Name of the Partner signing on behalf of the firm, Place and Date.

2. Website of the CA Firms⁷

The Council has approved the detailed guidelines for posting the particulars on Website by Chartered Accountant(s) in practice and firm(s) of Chartered Accountants in practice :-

1. The Chartered Accountants and/or Chartered Accountants' Firms would be free to create their own Website. The following stipulations will be applicable on such websites:-
2. The actual format of the Website is not being prescribed nor any standard format of the Website is being given to provide independence to the Members.
3. The Chartered Accountants and/or Chartered Accountants' Firms would ensure that their Websites are run on a "pull" model and not a "push" model of the technology to ensure that any person who wishes to locate the Chartered Accountants or Chartered Accountants' firms would only have access to the information and the information should be provided only on the basis of specific "pull" request.
4. The Chartered Accountants and/or Chartered Accountants' Firms should ensure that none of the information contained in the Website be circulated on their own or through E-mail or by any other mode or technique except on a specific "pull" request.
5. The Chartered Accountants would also not issue any circular or any other advertisement or any other material of any kind whatsoever by virtue of which they solicit people to visit their

⁶ As incorporated pursuant to decision of Council at its 388th Meeting held on 6th and 7th Feb. 2020.

⁷ As amended and included under Guidelines for Advertisement pursuant to decision of Council at its 388th Meeting held on 6th and 7th Feb., 2020.

Website. The Chartered Accountants would, however, be permitted to mention their Website address on their professional stationery and email.

6. The following information may be allowed to be displayed on the Firms/Members' Websites:

- (i) Member/Trade/Firm name.
- (ii) Year of establishment.
- (iii) Member/Firm's Address (both Head Office and Branches)

Tel. No(s)

Fax No(s)

E-mail ID(s)

- (iv) Nature of services rendered (to be displayable only on specific "pull" request)

- (v) Partners

Partners Name	Year of Qualification	Other Qualification(s)	Tel.. Off.- Direct Res. Mobile E-mail address	Area of Experience (to be displayable only on specific "pull" request)

- (vi) Details of Employees -

Professional	Others	Name	Designation	Area of experience (to be displayable only on specific "pull" request)

- (vii) Job vacancies for the Chartered Accountant/firm of Chartered Accountants (including articleship).
- (viii) No. of articulated assistants. (to be displayable only on specific "pull" request).
- (ix) Nature of assignments handled (to be displayable only on specific "pull" request).
Names of clients and fee charged cannot be given. While the mention of names of clients is not permissible, members may take note of the following with regard to website of the Firm:-

Note: Disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the

regulator and is made only till such period that the member works under the purview of such Regulator/ such requirements of the Regulator are in force. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that “This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/ area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].

7. Display of Passport style photograph is permitted.
8. The members may include articles, professional information, bulletin boards, professional updation and other matters of larger importance or of professional interest on the website. Educational videos on topics of professional relevance are permissible.
9. The chat rooms can be provided which permit chatting amongst members of the ICAI and between Firms and its clients. The confidentiality protocol would have to be observed. The Firms can provide document management facility with distinct log in and password facility to the clients to access copies of their documents on the Firm website.
10. The Firm can provide link of its page on Social Networking site. However, the members should not solicit people to visit or like their respective page(s) on such social Networking site.
11. The members/firms can provide on line advice to their clients who specifically request for the advice whether free of charge or on payment.
12. The details in the Website should be so designed that it does not amount to soliciting client or professional work. In case any content or technical feature of Website is against the professional Code of Conduct and Ethics as well as the restrictions contained in the schedules to the Chartered Accountants Act, 1949 or against the guidelines or directions issued by ICAI from time to time, appropriate action will be initiated by the ICAI in terms of its disciplinary mechanism either suo moto or on complaint as provided under the Chartered Accountants Act, 1949.
13. The Website should ensure adequate secrecy of the matters of the clients handled through Website.
14. No Advertisement in the nature of banner or any other nature will be permitted on the Website.
15. The Website should be befitting the profession of Chartered Accountants and should not contain any information or material which is unbecoming of a Chartered Accountant.

16. The Website may provide a link to the Website of ICAI, its Regional Councils and Branches and also the Website of Govt./Govt. Departments/Regulatory authorities/other Professional Bodies.
17. The Website address should be as near as possible to the individual name/trade name, firm name of the Chartered Accountant in practice or firm of Chartered Accountants in practice. But it should not amount to soliciting clients or professional work or advertisement of professional attainments or services. The Ethical Standards Board (ESB) of ICAI will decide in case there is any difficulty.
18. The Website should mention the information which is not at material variance from the information as per the ICAI's records.

3 Online Third Party Platforms

A number of non-Chartered Accountants' firms, corporates including banks, finance Companies and newspapers have set up their own Websites providing advisory services on taxation and other areas where Chartered Accountants are rendering professional service. Some of such Websites may request Chartered Accountants or Chartered Accountants' firms to provide consultation and advice through their Websites. No other service, besides consultancy and advice can be rendered through such websites, This would be permitted subject to the condition that on the Website, contact address of the Chartered Accountant concerned is not provided nor such Website will contain any material which advertises professional achievements or status of such Chartered Accountant except making a statement that they are Chartered Accountants. The name of Chartered Accountants' firm with suffix "Chartered Accountants" would not be permitted.

4. Publication of Name or Firm Name by Chartered Accountants in the Telephone or other Directories published by Telephone Authorities or Private Bodies

The Chartered Accountants and Chartered Accountants Firms may have entries made in a Telephone Directory (in printed and electronic form) either by making a special request or by means of an additional payment. The Council has also considered the question of permitting entries in respect of Chartered Accountants and their firms under specified groups in telephone/trade directories subject to the following additional restrictions :-

- (i) The entry should not appear in any other section/category except that of 'Chartered Accountants'.
- (ii) The member/firm should belong to the town/city in respect of which the directory is being published.

- (iii) The order of the entries should not be in any manner other than alphabetical.
- (iv) The entry should not be made in a differential or prominent manner giving the impression of publicity/advertisement.
- (v) The entries should not be restricted and should be open to all the Chartered Accountants/firms of Chartered Accountants in the particular city/town in respect whereof the directory is published.
- (vi) The members can also include their names in trade/ social directories.

6. Application based Service provider Aggregators

It is not permissible for members to list themselves with online Application based service provider Aggregators, wherein other categories like businessmen, technicians, maintenance workers, event organizers etc. are also listed.

7. Specialised Directories for limited circulation

The name, description and address of member (or firm) may appear in any directory or list of members of a particular body in which the names are listed alphabetically. For a specialised directory or a publication such as a "Who's Who" (including those compiled on purely local basis), a member should use his discretion in supplying information, bearing in mind the nature and purpose of the publications. In addition to his name, description and address and those of his firm, a member may give where appropriate, directorships held and reasonable personal details and may state his outside interests. He should not, however, give the names of any of his clients.

8 Exemptions

1 A special exemption has been made as regards publication of the name and address of a member or that of his firm, with the description Chartered Accountant(s), in an advertisement appearing in the press in the following circumstances, provided that the advertisement is not displayed more prominently than is usual for such advertisements or the name of the member or that of his firm with the designation Chartered Accountant(s) appears in type not bolder than the substance of the advertisement:-

- (a) Advertisement for recruiting staff in the member's own office.
- (b) Advertisement inserted on behalf of clients requiring staff or wishing to acquire or dispose of business or property.

- (c) Advertisement for the sale of a business or property by a member acting in a professional capacity as trustee, liquidator or receiver.
- 2 When advertising for staff, it is desirable that members should avoid the expression such as “a well-known firm”, since this would savour of advertisement. Similar considerations apply to advertisements for articled assistants. The advertisements should not contain any promotional element nor should there be any suggestion that the services offered by the Chartered Accountant or his firm are superior to those offered by other accountants.

10 RECOMMENDED SELF-REGULATORY MEASURES

As the members are aware, the Council has decided upon certain self-regulatory measures in order to ensure a healthy growth of the profession and an equitable flow of professional work among the members. These measures are reviewed from time to time and are published in the Journal of the Institute for observance by the members. The self-regulatory measures are recommendatory. However, considering the spirit underlying these measures, the Council expects that each and every member will effectively implement them. The Council earnestly believes that implementation of these measures would go a long way in ensuring equitable flow of work among the members and would also further enhance the prestige of the profession in the society.

The more important of these recommendations are as under:

10.1 Branch Audits

The branch audits of a company should not be conducted by its statutory auditors consisting of ten or more members, but should be conducted by the local firms of auditors consisting of less than ten members. This should not be understood to mean any restriction on the right of the statutory auditors to have access over branch accounts conferred under the Companies Act, 2013. This restriction may not apply in the following cases.

- (i) where the accounting records of the branches are maintained at the head office of the respective companies, and
- (ii) where significant operations of an undertaking or a company are carried out at its branch office.

10.2 Joint Audit

In the case of large companies, the practice of associating a practicing firm with less than five members as Joint auditors should be encouraged. Where a client desires to appoint such a firm as joint auditor, the senior firm should not object to the same.

10.3 Ratio Between Qualified and Unqualified Staff

In the Council's view, a practicing firm of Chartered Accountants engaged in audit work should have at least one member for every five non-qualified members of the staff, excluding articled and audit **assistants**, typists, peons and other persons not engaged directly in such professional work.

10.4 Disclosure of Interest by Auditors in other Firms

The Council has decided that as a good and healthy practice, auditors should make a disclosure of the payments received by them for other services through the medium of a different firm or firms in which the said auditor may be either a partner or proprietor.

10.5 *Recommended Minimum Scale of Fees

The Institute has issued revised Minimum scale of Fees for the professional assignments of the members of ICAI. The recommended scale of Fees is to be charged as per the work performed for various professional assignments. The Fees has been recommended separately for Class-A, B and C cities.

10.5.1 Fees - Relative Size:

Differentiated disclosure requirements for non public interest entities and public interest entities are following:-

- 1. For non Public Interest Entities (PIE)**-Disclosure is required where for two consecutive years, the gross annual professional fees from an audit client represent more than 40% of the total fees of the firm.
- 2. For public interest entities**- Disclosure is required where for two consecutive years, the gross annual professional fees from an audit client represent more than 20% of the total fees of the firm.

Exemption from applicability of the above provision will be in case where total Fees received by Firm does not exceed 20 lacs of rupees.

In addition, exemption from applicability of the above provision is also given in the case of audit of government Companies, public undertakings, nationalised banks, public financial institutions, regulators or where appointments of auditors are made by the Government.

Case Scenario

Synopsis: The case scenario underscores ethical and quality requirements to be complied with by statutory auditor of a listed company. Failure to perform audit of financial statements in accordance with Standards on Auditing can result in breakdown of trust of investors and public at large. The case involves issue of non-adherence to requirements of SA 501, SA 550 and SA 505 by statutory auditor of a listed company.

Only major lapses have been considered for developing this case scenario for the sake of brevity.

The case scenario is presented in the following manner: -

- I. Relevant provisions of Companies Act, 2013 and requirements of relevant Standards on Auditing
- II. Relevant Clauses of Part I of Second Schedule to Chartered Accountants Act, 1949
- III. Facts of the case
- IV. Major lapses pointed out by NFRA, engagement partner's submissions and NFRA's contentions/findings
- V. Conclusion including its basis
- I. Relevant provisions of Companies Act, 2013 and requirements of relevant Standards on Auditing

[1] Section 132(4) of Companies Act, 2013

NFRA has power to investigate into matters of professional or other misconduct committed by any member or firm of chartered accountants registered under Chartered Accountants Act, 1949 for certain classes of bodies corporate. By virtue of this section, it has also got power to impose penalty on erring members and debarring members of firm from undertaking audit work.

[2] Relevant requirements of Standards on Auditing

- SA 501 requires that when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting *unless impracticable*.

It further requires that if attendance at physical inventory counting is *impracticable*, the auditor shall perform *alternative audit procedures* to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall *modify the opinion* in the auditor's report in accordance with SA 705.

- SA 550 requires auditor to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately *identified, accounted for and disclosed in the financial statements* in accordance with the applicable financial reporting framework.
- SA 505 requires that in case management refuses to allow the auditor to send a confirmation request, reasons adduced by management need to be inquired and audit evidence has to be sought for as to validity and reasonableness of reasons. Further, implications of such refusal on risks of material misstatement *including risk of fraud* and on nature, timing and extent of other audit procedures are to be evaluated.

It further requires auditor to perform *alternative audit procedures* designed to obtain relevant and reliable audit evidence.

II. *Relevant clauses of Part I of Second Schedule to Chartered Accountants Act, 1949*

- Under clause 7 of Part I of Second Schedule to Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.
- Under clause 8 of Part I of Second Schedule to Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion
- Under clause 9 of Part I of Second Schedule to Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

III. *Facts of the case*

NFRA initiated action u/s 132(4) of Companies Act, 2013 for investigating into professional misconduct of engagement partner of an audit firm pursuant to information received from ROC,

Mumbai regarding investigation conducted by Regional Director into affairs of WNLL, listed on SME segment of BSE. The key financial data for company for financial year 2016-17 was as under: -

Particulars	Amount (in ₹ crores)
Revenue from Operations	51.77
PBT	1.44
Inventory	20.60
Trade receivables	14.93
Trade payables	13.78

The engagement partner had issued an unmodified opinion for financial year 2016-17. The engagement partner was requested on 18.02.2022 to submit audit file and SQC1 policy of firm which was submitted by him vide email dated 18.03.2022. Subsequently, a show-cause notice was issued to engagement partner charging him with professional misconduct for failure to perform his duties as engagement partner.

IV. Major lapses pointed out by NFRA, engagement partner's submissions and NFRA's contentions/findings

[1] Failure to obtain audit evidence regarding existence and condition of inventory

The EP was charged with failure to obtain sufficient appropriate audit evidence regarding existence and condition of inventory by not attending physical inventory counting in accordance with SA 501.

	<i>EP's submissions</i>	<i>NFRA's contentions/findings</i>
1.	The appointment as statutory auditor was made on 18.4.2017. Therefore, it was not possible to attend physical verification of inventories as on 31.3.2017.	SA 501 requires if attendance at physical inventory count is impracticable , alternative audit procedures shall be performed to obtain sufficient appropriate audit evidence regarding existence and condition of inventories. If it is not possible to so, the auditor shall modify opinion in accordance with SA 705. There was no documentation in audit file of audit procedures having been performed in this respect. Reliance was also placed on decision of PCAOB, US regulator in a similar case.

2.	Inventory holding level was in accordance with past trends. Stock records were cross verified in respect of selected items and reconciled with entries of receipts and issue in books of accounts.	There was no documentation in audit file of audit procedures having been performed in this respect.

[2] Failure to identify related party and related party transactions

The EP was charged with failure to identify related parties and transactions with them. The company made almost 100% of sales to a related party which was not identified as such in annual report of the company for FY 2016-17.

	<i>EP's submissions</i>	<i>NFRA's contentions/findings</i>
1.	It was tried to be ascertained from management regarding existence of related parties and previous audit reports were also relied upon in this regard.	The related party to whom 100% of sales was made was previously identified as related party in financial statements for FY 2013-14. Since almost 100% of sales were to this party, EP should have applied professional skepticism to probe further into antecedents of the party. There is no evidence in audit file regarding this. Reliance was also placed on similar decision of PCAOB where it was held that auditor must evaluate whether related party transactions have been properly accounted for and disclosed in financial statements.

[3] Failure to obtain external confirmations for Trade receivables and Trade payables

The EP was charged with gross negligence for not obtaining direct confirmations of balances from debtors and creditors and with failure to perform any alternative audit procedure in absence of confirmations from debtors and creditors in accordance with SA 505.

	<i>EP's submissions</i>	<i>NFRA's contentions/findings</i>
1.	The company management had denied contact details of parties due to fear of losing the business information. Further, all debtors and creditors were outstanding for less than 6 months.	It shows that management had imposed a limitation on scope of audit. Limitations imposed by management may have other implications for audit such as evaluation of fraud risks and continuance of engagement as per SA 705 . No assessment of fraud risk having been evaluated is available in audit file and there is no evidence of additional procedures

		being performed by EP in absence of external confirmations. Reliance was also placed on PCAOB order in Satyam case in which failure during audit to obtain external confirmation of bank balances was highlighted.

V. Conclusion including its basis

The engagement partner did not comply with provisions of Chartered Accountants Act, 1949 and showed gross negligence and lack of due diligence in performing statutory audit. He didn't ensure audit quality and was grossly negligent of professional duties by not adhering to requirements laid down in relevant Standards on Auditing as discussed above. It led to issuance of audit report that was not backed by valid audit evidence and was lacking in audit quality.

The engagement partner was held guilty of professional misconduct under clauses 7, 8 and 9 of Part I of Second Schedule to Chartered Accountants Act, 1949. He was also penalized and debarred for a period of two years from undertaking any audit of financial statements or internal audit of the functions and activities of any company or body corporate.

Key Takeaways

- A Chartered Accountant, *either in practice or in service*, has to abide by these ethical behaviours. They are expected to follow the fundamental principles of professional ethics while performing their jobs.
- Service users of professionals should be able to feel secure that there exists a framework of professional ethics which governs the provision of those services. Any deviation from the ethical responsibilities brings the disciplinary mechanism into action against the Chartered Accountants.
- A distinguishing feature of the accountancy profession is its acceptance of the responsibility to act in the public interest. Code of Ethics seeks to protect the interests of the profession as a whole. It is a shield that enables us to command respect.
- Part 1 of Code of ethics deals with requirements relating to complying with the Code, Fundamental Principles and Conceptual Framework, and is applicable to all professional accountants.
- The Code delineates integrity, objectivity, professional competence and due care, confidentiality and professional behaviour as fundamental principles governing professional ethics.

- Part 2 of Code of ethics sets out requirements and application material for professional accountants in service when applying the conceptual framework. It does not describe all of the facts and circumstances, including professional activities, interests and relationships that could be encountered by professional accountants in service, which create or might create threats to compliance with the fundamental principles. Therefore, the conceptual framework requires professional accountants in service to be alert for such facts and circumstances.
- Part 3 of Code of ethics sets out requirements and application material for professional accountants in public practice when applying the conceptual framework.
- Part 4A and 4B of Code of ethics deal with independence standards for audit and review engagements (Part 4A) and assurance engagements other than audit and review engagements (Part 4B) respectively.
- There are specific provisions in Chartered Accountants Act, 1949 dealing with professional misconduct and other misconduct.
- Acts or omissions which comprise professional misconduct within the meaning of the Chartered Accountants Act are defined in two Schedules viz. the First Schedule and the Second Schedule.
- The First Schedule is divided into four parts, Part I of the First Schedule deals with the misconduct of a member in practice which would have the effect generally of compromising his position as an independent person. Part II deals with misconduct of members in services. Part III deals with the misconduct of members generally and Part IV deals with other misconduct in relation to members of the institute generally.
- The Second Schedule is divided into three parts. Part I deals with misconduct in relation to a member in practice, Part II deals with misconduct of members generally and Part III deals with other misconduct in relation to members of the Institute generally.

ANNEXURE – 1

The Chartered Accountants Act, 1949

The Chartered Accountants Act, 1949 (No. 38 of 1949) came into force on the 1st day of July, 1949. Later in the year 1959, certain amendments were made therein through the Chartered Accountants (Amendment) Act, 1959 (No.15 of 1959). After about 47 years extensive changes have been made in the Act through the Chartered Accountants (Amendment) Act, 2006 (No.9 of 2006) which have

been notified by the Central Government in the Gazette of India (Extra Ordinary) dated 23rd March, 2006. Further, few insertions were made to the principle Act through the Chartered Accountants (Amendment) Act, 2011 (No. 3 of 2012).

The entire Act is divided in nine chapters [Including chapter VIIA inserted by Chartered Accountants (Amendment) Act, 2006].

The Complete enumeration of Contents is given below:

Chapter I - Preliminary

1. Short title, Extent and Commencement
2. Interpretation

This Chapter contains preliminary aspects of the Act like applicability of the Act, definition of various terms like, Chartered Accountant, Council, holder of a restricted certificate, Registered Accountant, etc.

Chapter II - The Institute of Chartered Accountants of India

3. Incorporation of the Institute
4. Entry of names in the Register
5. Fellows and Associates
6. Certificate of Practice
7. Members to be known as Chartered Accountants
8. Disabilities

This chapter deals with various things like who shall be entitled to have his name entered in the register of members of the Institute, who shall be deemed to have become an associate member of the Institute, who shall be entered in the Register as a fellow of the Institute. This Chapter also deals with issues relating to certificate of practice and disabilities of a person for having his name entered in the Register.

Chapter III - Council of the Institute

9. Constitution of the Council of the Institute
10. Re-election or re-nomination to Council [Substituted by Chartered Accountants (Amendment) Act, 2006]

- 10A. Settlement of dispute regarding election [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 10B. Establishment of Tribunal [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 11. Nomination in default of election or nomination
- 12. President and Vice-President
- 13. Resignation of Membership and casual vacancies
- 14. Duration and dissolution of the Council
- 15. Function of the Council
- 15A. Imparting education by Universities and Other bodies [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 16. Officers and employees, salary, allowances etc. [substituted by Chartered Accountants (Amendment) Act, 2006]
- 17. Committees of the Council
- 18. Finances of the Council

This Chapter deals with various issues like composition of Council of the Institute, manner of conducting election to the Council, mode of tendering resignation from the membership of the Council mode of filling a casual vacancy, various duties of the Council. This Chapter also deals with the permission accorded to any University established by law or any Body affiliated to the Institute to impart education on the subjects covered by the academic courses of the Institute.

Chapter IV - Register of Members

- 19. Register of Members
- 20. Removal from the Register

This chapter deals with the matters relating to register of members and removal from the register the name of any member. The Council has to maintain a Register of Members of the Institute. This Register shall include name, date of birth, domicile, residential and professional address, qualification etc. Also, the Council may remove from the Register the name of any member in certain circumstances like in case of death of the member or if the member does not pay the prescribed fees, or when a member has become subject to any of the disabilities mentioned in section 8.

Chapter V - Misconduct

- 21. Disciplinary Directorate [Substituted by Chartered Accountants (Amendment) Act, 2006]
- 21A. Board of Discipline [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 21B. Disciplinary Committee [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 21C. Authority, Disciplinary Committee, Board of Discipline and Director (Discipline) to have powers of civil court [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 21D. Transitional provisions [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 22. Professional or other misconduct defined [Substituted by Chartered Accountants (Amendment) Act, 2006]
- 22A. Constitution of Appellate Authority [Substituted by Chartered Accountants (Amendment) Act, 2006]
- 22B. Term of office of Chairperson and members of Authority [Inserted by Chartered Accountants (Amendment) Act, 2006].
- 22C. Allowances and conditions of service of Chairperson and Members of Authority (Inserted by Chartered Accountants (Amendment) Act, 2006)
- 22D. Procedure to be regulated by Authority [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 22E. Officers and other staff of Authority [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 22F. Resignation and removal of Chairperson and Members [Inserted by Chartered Accountants (Amendment) Act, 2006]]
- 22G. Appeal to Authority [Inserted by Chartered Accountants (Amendment) Act, 2006]

In this chapter professional and other misconduct has been defined. As per section 22 of the Act, the expression "professional or other misconduct" shall be deemed to include any act or omission provided in any of the Schedules. In this chapter, Section 21, 22 and 22A have been substituted by new sections 21, 22 and 22A. Other sections (Section 21A, 21B, 21C, 21D, 22B, 22C, 22D, 22E, 22F and 22G) have been inserted by Chartered Accountants (Amendment) Act, 2006. These Sections along with the Schedules deal with the new Disciplinary Mechanism.

Chapter VI - Regional Councils

23. Constitution and Functions of Regional Councils

The Councils may constitute such Regional Councils for the purpose of advising and assisting it on matters concerning its functions. The Regional councils shall exercise prescribed functions.

Chapter VII - Penalties

24. Penalty for falsely claiming to be a member etc.

24A. Penalty for using name of the Council, awarding degree of Chartered Accountancy etc.

25. Companies not to engage in accountancy

26. Unqualified persons not to sign documents

27. Maintenance of branch offices

28. Sanction to prosecute

This chapter lists penalties in various cases like, if a person who is not a member of the Institute and represents himself as a member of the Institute or uses the designation Chartered Accountant, he shall be punishable with fine which may extend to one thousand rupees (on first conviction) and with imprisonment which may extend to six months or with fine which may extend to five thousand rupees or with both (on subsequent conviction). Other provisions regarding penalties that are included in this chapter provide that a Company (Incorporated in or outside India) shall not practice as Chartered Accountant, a person other than a member of the Institute shall not sign any document on behalf of a Chartered Accountant in practice or a firm of such Chartered Accountants in his or its professional capacity, etc.

Chapter VII A Quality Review Board

[Inserted by Chartered Accountants (Amendment) Act, 2006]

28A. Establishment of Quality Review Board

28B. Functions of Board

28C. Procedure of Board

28D. Terms and conditions of services of Chairperson and Members of Board and its expenditure

After Chapter VII, the Chapter VIIA has been inserted by the Chartered Accountants (Amendment) Act, 2006. It empowers the Central Government to constitute a Quality Review Board outside the framework of the Institute. It will perform the functions like, to make recommendations to the Council

with regard to the quality of services provided by the members of the Institute, to review the quality of services provided by the members of the Institute including audit services and to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

Chapter VIII – Miscellaneous

- 29. Reciprocity
- 29A. Power of Central Government to make rules.
- 30. Power to make regulations
- 30A. Powers of the Central Government to direct regulation to be made or to make or amend regulations
- 30B. Rules, Regulations and notification to be laid before Parliament [Substituted by Chartered Accountants (Amendment) Act, 2006]
- 30C. Power of Central Government to issue directions [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 30D. Protection of action taken in good faith [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 30E. Members etc. to be public servants [Inserted by Chartered Accountants (Amendment) Act, 2006]
- 31. Construction of References
- 32. Act not to affect right of accountants to practice as such in Acceding States.
- 33. [Repealed]

This Chapter contains miscellaneous provisions. It empowers the Council to prescribe the conditions subject to which foreign qualifications relating to accountancy shall be recognized for the purpose of entry in the Register. It also empowers the Council to make regulations for the purpose of carrying out the objects of this Act. It also empowers the Central Government to direct the Council to make any regulations or to amend or revoke any regulations already made. Section 30C, 30D, and 30E have been inserted by Chartered Accountants (Amendment) Act, 2006. Section 30C empowers the Central Government to issue directions in the event of non-compliance by the Council of any provisions of the Act. Section 30D protects Central Government, Council, Authority Disciplinary Committee, Tribunal, Board, Board of Discipline, Disciplinary Directorate or any officer thereof, for anything which is in good faith done or intended to be done under this Act or any rule, regulation,

notification, direction or order made there under. Section 30E says that the Chairperson, Presiding officer, Members and other officers and employees of the Authority, Disciplinary Committee, Tribunal, Board, Board of Discipline or the Disciplinary Directorate shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

ANNEXURE – 2

SCHEDULES TO THE ACT

Acts or omissions which comprise professional misconduct within the meaning of Section 22 of the Chartered Accountants Act are defined in two Schedules viz. the First Schedule and the Second Schedule.

The First Schedule is divided into four parts, Part I of the First Schedule deals with the misconduct of a member in practice which would have the effect generally of compromising his position as an independent person. Part II deals with misconduct of members in services. Part-III deals with the misconduct of members generally and part IV deals with other misconduct in relation to members of the institute generally. The Second Schedule is divided into three parts. Part I deals with misconduct in relation to a member in practice, Part II deals with misconduct of members generally and part III deals with other misconduct in relation to members of the Institute generally. The implication of the different clauses in the schedules are discussed below:

The First Schedule

PART I - Professional misconduct in relation to Chartered Accountants in practice

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

Clause (1) allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

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, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

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.

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 (1) of section 4 or whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships.

Clause (5) Secures either through the services of a person who is not an employee of such Chartered Accountant or who is not his partner or by means which are not open to a Chartered Accountant, any professional business.

Provided that nothing herein contained shall be construed as prohibiting any agreement permitted in terms of item (2), (3) and (4) of this part.

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 -

- (i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or
- (ii) A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.

However, as per the guideline issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

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.

Clause (8) Accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been Issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

Clause (9) Accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956, in respect of such appointment have been duly complied with.

(Now Section 139 and 140 read with Section 141 of the Companies Act, 2013. Students may note that till the time Code of Ethics etc. bare documents get updated from Ethical Standard Board of ICAI in pursuance of the Companies Act, 2013, students are required to understand the basic nature of the provision and quote the same along with the new corresponding provisions.)

Clause (10) Charges or offers to charge, accepts or offers to accept In respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

The Council of the Institute has however framed Regulation 192 which exempts members from the operation of this clause in certain professional services.

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 chartered accountant 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.

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.

PART II - Professional misconduct in relation to members of the Institute 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 or agent or customer of such company, firm or person by way of commission or gratification.

[Note: A member in the foregoing circumstances would be guilty of misconduct regardless of the fact that he was in whole-time or part-time employment or that he was holding Certificate of Practice along with his employment.]

PART III - Professional misconduct in relation to members of the Institute generally

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

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 Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.

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 I of this Schedule, gives information knowing it to be false.

PART IV - Other misconduct in relation to members of the Institute generally

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

(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.

- (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.

These clause (1) & (2) are self explanatory and any of the member of the Institute is found guilty by any civil or criminal court and prosecuted for an imprisonment in an offence involving moral turpitude or his acts bring disrepute to the profession or the Institute, irrespective of the fact whether such acts are related to profession or not, such member will be deemed to be guilty of other misconduct in Part IV of Schedule I.

The important point to note is that if imprisonment tenure exceeds six months, this case will be covered in the clause of Part III of Schedule II.

The Second Schedule

PART I - Professional misconduct in relation to chartered Accountant in practice

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he:

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.

Clause (2) If he certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee In his firm or by another chartered accountant in practice.

Clause (3) Permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in manner which may lead to the belief that he vouches for the accuracy of the forecast.

Clause (4) Expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

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.

Clause (7) Does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Clause (8) Fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

Clause (9) Fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

Clause (10) Fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

PART II - Professional misconduct in relation to members of the Institute generally

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

Clause (1) contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

Clause (2) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer.

Clause (3) Includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

Clause (4) Defalcates or embezzles money received in his professional capacity.

Part III - Other misconduct in relation to members of the Institute generally

A member 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.

Imprisonment awarded for a term exceeding six months in any civil/criminal matter treated as a major offence under 'other misconduct' is included in this Schedule.

Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other

misconduct mentioned in the second schedule or in both the Schedule, he shall place the matter before the Disciplinary Committee.

Recent Decisions of Ethical Standards Board

1. It is permissible for a practicing Chartered Accountant holding Certificate of Practice to become a member of the 'Board of Management' in Primary (Urban) Co-operative Banks. The Ethical Standards Board noted that the position of a member of 'Board of Management' in Primary (Urban) Co-operative banks (UCBs) and the role attached to that position is similar to that of a Director-Simplicitor; where there is no involvement of a member in the day-to-day functioning/operations and not signatory etc. and only sitting fees for the services rendered are provided.
2. Member in practice cannot act as Trademark or Patent Attorney. However, Professional advice in relation to Intellectual Property Rights (IPR) is a routine professional work for a Chartered Accountants in practice and same is permissible under the provisions of the Chartered Accountants Act, 1949.
3. It is not permissible for a member in practice to accept the appointment of statutory audit of the society wherein immediate family member i.e., spouse or dependent, of member hold honorary position of one of the managing committee of the institutes governed by the society.
4. The Council decided that for the purpose of Appointment of an auditor when he is indebted to a concern, as dealt with under Chapter X of the Council General Guidelines, 2008, the term "auditor" shall not include internal auditor, concurrent auditor or an auditor giving report to the Management. In other words, the provision relating to criteria/limit of indebtedness shall apply only to statutory audits.
5. A CA Firm may register itself on Udyog Aadhar, a web portal of Ministry Micro, Small and Medium Enterprises.
6. There is no prohibition for internal auditor of a company to acquire/purchase shares of the said Company.
7. It is not permissible for a member to use Messaging Applications to send messages to make people aware about his practice, and mention the services provided therein.
8. A Chartered Accountant in practice being Director Simplicitor in a Company cannot sign ROC Forms of the Company as it is a direct conflict of role.
9. A Chartered Accountant in practice can act as Authorized Representative of a Foreign Company, provided he is not the auditor of the said Company.

10. It is permissible for two or more Chartered Accountants in practice collectively to have joint training session for their clients on GST, and share the fees collected from the clients thereof.
11. A chartered accountant in practice can provide services through kiosk only if the services provided are professional activities of a practicing chartered accountant, permitted under the Act.
12. A Chartered Accountant in service is allowed to take e-return registration if it does not conflict with employment obligation. However, he cannot certify the return.
13. In case where Chartered Accountant in practice is a non-executive director in a company, he or a Firm in which he is a partner, should not accept the appointment as a statutory auditor of a Company which is a joint venture of the original Company, as it would impact independence.
14. A Chartered Accountant in practice may be an equity research adviser, but he cannot publish retail report, as it would amount to other business or occupation.
15. There is no conflict of interest in a Chartered Accountant, who is a member of a Trust, being the auditor of the said trust. It is subject to the exception where a particular statute governing a Trust prescribes prohibition on the member of the Trust to be its Auditor or otherwise where there is conflict of interest as per the provisions of Code of Ethics.
16. A Chartered Accountant in practice may engage himself as Registration Authority (RA) for obtaining digital signatures for clients.
17. A Chartered accountant can hold the credit card of a bank when he is also the auditor of the bank, provided the outstanding balance on the said card does not exceed Rs 100,000* beyond the prescribed credit period limit on credit card given to him. (*As per the limit of indebtedness existing as on date.)
18. A Chartered Accountant in practice can act as mediator in Court, since acting as a “mediator” would be deemed to be covered within the meaning of “arbitrator”; which is inter-alia permitted to members in practice as per Regulation 191 of the Chartered Accountants Regulations, 1988.
19. A Chartered Accountant in practice is not permitted to accept audit assignment of a bank in case he has taken loan against a Fixed Deposit held by him in that bank.
20. The Ethical Standards Board in 2013 generally apply the stipulations contained in the then amended Rule 11U of Income Tax generally, wherein statutory auditor /tax auditor cannot be the valuer of unquoted equity shares of the same entity. The Board has at its recent Meeting

(January, 2017) has reviewed the above, and decided that where law prohibits for instance in the Income Tax Act and the rules framed thereunder, such prohibition on statutory auditor/tax auditor to be the valuer will continue, but where there is no specific restriction under any law, the said eventuality will be permissible, subject to compliance with the provisions, as contained in the Code of Ethics relating to independence.

21. The Ethical Standards Board had in 2011 decided that it is not permissible for a member who has been Director of a Company, upon resignation from the Company to be appointed as an auditor of the said Company, and the cooling period for the same may be 2 years. The Board has at its recent Meeting (January, 2017) has reviewed the above, and noted that the Section 141 of Companies Act, 2013 on disqualification of auditors does not mention such prohibition; though threats pertaining to the said eventuality have been mentioned in Code of Ethics. Further, the Board was of the view that a member may take decision in such situation based on the provisions of Companies Act, 2013 and provisions of Code of Ethics.
22. A chartered accountant in practice cannot become Financial Advisors and receive fees/commission from Financial Institutions such as Mutual Funds, Insurance Companies, NBFCs etc.
23. A chartered accountant cannot exercise lien over the client documents/records for non-payment of his fees.
24. It is not permissible for CA Firm to print its vision and values behind the visiting cards, as it would result in solicitation and therefore would be violative of the provisions of Clause (6) of Part-I of First Schedule to the Chartered Accountants Act, 1949.
25. It is not permissible for chartered accountants in practice to take agencies of UTI, GIC or NSDL.
26. It is permissible for a member in practice to be a settlor of a trust.
27. A member in practice cannot hold Customs Brokers Licence under section 146 of the Customs Act, 1962 read with Customs Brokers Licensing Regulations, 2013 in terms of the provisions of Code of Ethics.
28. A Chartered accountant in service may appear as tax representative before tax authorities on behalf of his employer, but not on behalf of other employees of the employer.
29. A chartered accountant who is the statutory auditor of a bank cannot for the same financial year accept stock audit/inspection Audit of the same branch of the bank or any of the branches of the same bank or sister concern of the bank, for the same financial year.

30. A CA Firm which has been appointed as the internal auditor of a PF Trust by a Government Company cannot be appointed as its Statutory Auditor.
31. A concurrent auditor of a bank 'X' cannot be appointed as statutory auditor of bank 'Y', which is sponsored by 'X'.
32. A CA/CA Firm can act as the internal auditor of a company & statutory auditor of its employees PF Fund under the new Companies Act (2013).
33. The Ethical Standards Board while noting that there is requirement for a Director u/s 149(3) of the Companies Act, 2013 to reside in India for a minimum period of 182 days in the previous calendar year, decided that such a Director would be within the scope of Director Simplicitor (which is generally permitted as per ICAI norms) , if he is non –executive director, required in the Board Meetings only , and not paid any remuneration except for attending such Board Meetings.

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2023, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. Is P guilty of professional misconduct?*
2. *Mr. G, a Chartered Accountant in practice as a sole proprietor has an office in Mumbai near Church Gate. Due to increase in professional work, he opens another office in a suburb of Mumbai which is approximately 80 kilometers away from the municipal limits of the city. For running the new office, he employs three retired Income-tax Officers. Is Mr. G guilty of professional misconduct?*
3. *Write a short note on Other Misconduct.*
4. *Mr. K, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. Discuss this in the light of Professional Ethics issued by ICAI.*
5. *Mr. X who passed his CA examination of ICAI on 18th July, 2022 and started his practice from August 15, 2022. On 16th August 2022, one female candidate approached him for*

articleship. In addition to monthly stipend, Mr. X also offered her 1 % profits of his CA firm. She agreed to take both 1 % profits of the CA firm and stipend as per the rate prescribed by the ICAI. The Institute of Chartered Accountants of India sent a letter to Mr. X objecting the payment of 1 % profits. Mr. X replies to the ICAI stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the financial position of the articled clerk is very weak. Is Mr. X liable to professional misconduct?

6. *M/s XYZ, a firm in practice, develops a website “xyz.com”. The colour chosen for the website was a very bright green and the web-site was to run on a “push” technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator. Is this website in compliance with guidelines issued by ICAI in this regard?*
7. *A partner of a firm of chartered accountants during a T.V. interview handed over a bio-data of his firm to the chairperson. Such bio-data detailed the standing of the international firm with which the firm was associated. It also detailed the achievements of the concerned partner and his recognition as an expert in the field of taxation in the country. The chairperson read out the said bio-data during the interview. Discuss whether this action by the Chartered Accountant would amount to misconduct or not.*
8.
 - (a) *An advertisement was published in a Newspaper containing the photograph of Mr. X, a member of the institute wherein he was congratulated on the occasion of the opening ceremony of his office.*
 - (b) *Mr. X, a Chartered Accountant and the proprietor of X & Co., wrote several letters to the Assistant Registrar of Co-operative Societies stating that though his firm was on the panel of auditors, no audit work was allotted to the firm and further requested him to look into the matter.*
9. *A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant. Is this a misconduct?*
10. *Mr. Nigal, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While delivering the speech, he told to the audience that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment.*

11. Mr. A is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. Y a Chartered Accountant his employee for taking care of routine matters of his office. During his absence Mr. Y has conducted the under mentioned jobs in the name of M/s A & Co.

- (i) He issued the audit queries to client which were raised during the course of audit.
- (ii) He issued production certificate to a client under the GST Act.
- (iii) He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.

Please comment on eligibility of Mr. Y for conducting such jobs in name of M/s A & Co. and liability of Mr. A under the Chartered Accountants Act, 1949.

12. XYZ Co. Ltd. has applied to a bank for loan facilities. The bank on studying the financial statements of the company notices that you are the auditor and requests you to call at the bank for a discussion. In the course of discussions, the bank asks for your opinion regarding the company and also asks for detailed information regarding a few items in the financial statements. The information is available in your working paper file. What should be your response and why?
13. Mr. A, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. X gave him an idea to start online services and give stock certifications to traders with Cash Credit Limits in Banks. Mr. A started a website with colorful catchy designs and shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services". Besides, Mr. A entered in an agreement with a Digital Marketer to give him 5% commission on each service procured through him. Discuss if the actions of Mr. A are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.
14. Mr. D, a practicing CA, is appointed as a Director *Simplicitor* in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. Is Mr. D right in accepting the auditor position?
15. Mr. F, a Chartered Accountant, gave advisory services to PQR Pvt. Ltd. Further, he gave them GST consultancy, compilation engagement for historical financial information and helped in ERP set up. Later, the company turned out to be a part of a group of companies involved in money laundering. Mr. F was asked to provide details of the companies. Mr. F

refused on the grounds that he gave only consultancy services to the company and wasn't supposed to keep any information about the company. Is Mr. F right as per the guidelines issued by the ICAI?

16. *Mr. S, the auditor of ABC Pvt. Ltd. has delegated following works to his articles and staff:*

- i. Issue of audit queries during the course of audit.*
- ii. Issue of memorandum of cash verification and other physical verification.*
- iii. Letter forwarding draft observations/financial statements.*
- iv. Issuing acknowledgements for records produced.*
- v. Signing financial statements of the company.*

Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

17. *Mr. S is a practising chartered accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper-setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members).*

Hints/Answers to Theoretical Questions

1. **Advising on Portfolio Management Services:** The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking,

underwriting and portfolio management services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients.

In view of this, P would be guilty of misconduct under the Chartered Accountants Act, 1949.

2. In terms of section 27 of the Chartered Accountants Act, 1949, if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. There is however an exemption for the above if the second office is located in the same premises, in which the first office is located; or the second office is located in the same city, in which the first office is located; or the second office is located within a distance of 50 kms from the municipal limits of a city, in which the first office is located. Since the second office is situated beyond 50 kms of municipal limits of Mumbai city, he would be liable for committing a professional misconduct.
3. Refer Para 7.2
4. **Sharing of Audit Fees with Non-Member:** As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant in practice pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

In the instant case, Mr. K, a practising Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. L, under the nomenclature of office allowance and such an arrangement continued for a number of years. In this case, it is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into.

The Chartered Accountant had shared his profits and, therefore, Mr. K will be held guilty of professional misconduct under the Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949.

5. **Sharing Fees with an Articled Clerk:** As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner

or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

In view of the above, the objections of the Institute of Chartered Accountants of India, as given in the case, are correct and reply of Mr. X, stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the position of the articled clerk is weak is not tenable.

Hence, Mr. X is guilty of professional misconduct in terms of Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949.

6. **Posting of Particulars on Website:** The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s XYZ are:

- ◆ No restriction on the colours used in the website;
- ◆ The websites are run on a “pull” technology and not a “push” technology;
- ◆ Names of clients and fees charged not to be given.

However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that “This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].

In view of the above, M/s XYZ would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

7. Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means since it shall constitute professional misconduct. The bio-data was handed over to the chairperson during the T.V. interview by the Chartered Accountant which included details about the firm and the

achievements of the partner as an expert in the field of taxation. The chairperson simply read out the same in detail about association with the international firm as also the achievements of the partner and his recognition as an expert in the field of taxation. Such an act would definitely lead to the promotion of the firms' name and publicity thereof as well as of the partner and as such the handing over of bio-data cannot be approved. The partner would be held guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

8. (a) **Publishing an Advertisement Containing Photograph:** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.

In the given case, Mr. X published an advertisement in a Newspaper containing his photograph on the occasion of the opening ceremony of his office. On this context, it may be noted that the advertisement which had been put in by the member is quite prominent. If soliciting of work is allowed, the independence and forthrightness of a Chartered Accountant in the discharge of duties cannot be maintained.

The above therefore amounts to soliciting professional work by advertisement directly or indirectly. Mr. X would be therefore held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

- (b) **Soliciting Professional Work:** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means.

In the given case, Mr. X, a Chartered Accountant and proprietor of M/s X and Co., wrote several letters to the Assistant Registrar of Co-operative Societies, requesting for allotment of audit work. In similar cases, it was held that the Chartered Accountant would be guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The writing of continuous letter to ascertain the reasons for not getting the work is quite alright but in case such either amount to request for allowing the work then Mr. X will be liable for professional misconduct.

Consequently, Mr. X would therefore be held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

9. **Cost Accountant:** As stated in the Illustration given in clause 7 with reference to tax consultant, this would also constitute misconduct under section 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. A chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". However as per the Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant".
10. **Using Designation Other Than a CA and Providing Details of Services Offered:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write

must not be promotional of his or his firm but must be an objective professional view of the topic under consideration.

Thus, it is improper to use designation "Management Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Management Expert" in his speech and also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6).

- 11. Delegation of Authority to the Employee:** As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA A proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- (i) In the given case, Mr. Y, a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here Y is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
- (ii) Further, issuance of production certificate to a client under GST Act by Mr. Y being an employee of M/s A & Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA A is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.
- (iii) In this instance, Mr. Y, CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax

Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

12. As per Clause (1) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force. SA 200 on "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

In the instant case, the bank has asked the auditor for detailed information regarding few items in the financial statements available in his working papers. Having regard to the position stated earlier, the auditor cannot disclose the information in his possession without specific permission of the client. As far as working papers are concerned, working papers are the property of the auditor. The auditor may at his discretion, make portions of or extracts from his working papers available to his client".

Thus, there is no requirement compelling the auditor to divulge information obtained in the course of audit and included in the working papers to any outside agency except as and when required by any law.

13. As per Clause (6) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Mr. A is wrong in seeking clients through family and friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines.

In the given situation, Mr. A shared the website address on his all social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock

Certification Services” mentioning his current clients as well. This is in complete contravention of the guidelines on website issued by the ICAI.

Thus, CA A would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

- 14.** As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company. In view of above provisions Mr. D cannot accept the Directorship of the company until the completion of two years after his resignation.

Thus, CA D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.

- 15.** The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice.

In the given situation, CA. F, gave GST consultancy, compilation engagement for historical financial information and helped in ERP set up along with advisory services to PQR Pvt. Ltd. Mr. F was asked to provide details of the companies as the company, turned out to be a part of a group of companies, involved in money laundering. Contention of Mr. F that he gave only consultancy services and compilation engagement for historical financial information to the company and wasn't supposed to keep any information about the company is not valid as

Mr. F should have kept following information in compliance with KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestation functions.

In the given case of PQR Pvt. Ltd., a Corporate Entity, Mr. F should have kept following information:

A. General Information

-  Name and Address of the Entity
-  Business Description
-  Name of the Parent Company in case of Subsidiary
-  Copy of last Audited Financial Statement

B. Engagement Information

-  Type of Engagement

C. Regulatory Information

-  Company PAN No.
-  Company Identification No.
-  Directors' Names & Addresses
-  Directors' Identification No.

16. As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

- (i) Issue of audit queries during the course of audit.
- (ii) Asking for information or issue of questionnaire.
- (iii) Letter forwarding draft observations/financial statements.
- (iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.

- (v) Acknowledging and carrying on routine correspondence with clients.
- (vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
- (vii) Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.
- (ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
- (x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

In the instant case, Mr. S, the auditor of ABC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company.

Therefore, Mr. S is correct in allowing first four tasks i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles.

However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, Mr. S is wrong in delegating signing of financial statements to his staff.

Conclusion: In view of this, S would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

17. Given situation can be visualised in following parts:

(A) Mr. S used to involve himself in equity research and used to advise his friends, relatives and other known people: As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation.

In the given case, though Mr. S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr. S shall not make him guilty of professional misconduct.

- (B) Mr. S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities: As per Clause 11 of Part I of First Schedule of Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.

Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include:

- Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination.
- Owning agricultural land and carrying out agricultural activities.

Therefore, in the given case, the activities of Mr. S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct.

- (C) **Mr. S was discharged insolvent: Disabilities for the Purpose of Membership :** Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period.

In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council.

In the given case, it is clearly stated that Mr. S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. S has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.