

MOCK TEST PAPER - 1

FINAL (NEW) COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

SUGGESTED ANSWERS/HINTS

1. (a) **Related Party Disclosures:** As per definition given in the AS 18 “Related Party Disclosures” parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

In the instant case, the managing director of XYZ Ltd. is a partner in the firm with his son which has been paid Rs. 2 lakhs as job work charges. The managing director is having a substantial holding in XYZ Ltd. The case is squarely covered by AS 18. According to AS-18, in the case of related party transactions, the reporting enterprise should disclose the following:

- (i) the name of the transacting related party;
- (ii) a description of the relationship between the parties;
- (iii) a description of the nature of transactions;
- (iv) volume of the transactions either as an amount or as an appropriate proportion;
- (v) any other elements of the related party transactions necessary for an understanding of the financial statements;
- (vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and
- (vii) amounts written off or written back in the period in respect of debts due from or to related parties.”

Further, SA 550 on “Related Parties”, also prescribes the auditor’s responsibilities and audit procedures regarding related party transactions.

The approach of the managing director is not tenable under the law and accordingly all disclosure requirements have to be complied with in accordance with the AS 18. Auditor should insist to make proper disclosure as per the AS and if management refuses, the auditor shall have to modify his report. Also it has to be seen whether section 184 of the Companies Act, 2013 regarding disclosure of interest by director has been complied with. If it is not complied with, the auditor needs to modify the report appropriately.

- (b) **Applicability of IND AS:** Section 129(1) of the Companies Act, 2013, governs the requirements to be satisfied by financial statements. The provisions thereunder which should be complied with are:

- financial statements shall, give a true and fair view of the state of affairs of the company or companies as at the end of financial year, comply with the notified accounting standards under section 133 and be in such form or forms specified in Schedule III to the Companies Act, 2013 and
- the items contained in such financial statements shall be in accordance with the accounting standards.

Further, as per section 133 of the Companies Act, 2013, the Central Government has notified Companies (Indian Accounting Standards) Rules, 2015 dated 16.02.2015 in exercise of the powers conferred by section 133. The said rules list the Indian Accounting Standards (Ind AS) and the class of companies required to comply with the Ind AS while preparation of their financial statements.

Here, it may be noted that the companies covered under Section 8 are required to comply the provisions of the Companies Act, 2013, unless and until any exemption is provided. Therefore, companies registered under Section 8 are not exempted from the requirements of section 133 and section 129 of the Companies Act, 2013.

In the given case, only contention of management that being a section 8 company having charitable object, Ind-AS cannot apply to the company, therefore financial statements prepared under the earlier GAAP and a note for the same is given, is not tenable.

However, the auditor is required to ensure the **applicable** monetary limits w.r.t Ind-AS and need to advise the management to prepare the financial statements as per Ind-AS accordingly. In case of non-compliance the auditor should report accordingly.

(c) Qualified Opinion

We have audited the standalone financial statements of ABC Limited (“the Company”), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company’s branches located at *(location of branches)*)².

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the aforesaid financial statements present fairly, in all material respects, or *give a true and fair view* in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at March 31st, 2XXX and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date.

Basis for Qualified Opinion

The Company’s short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from the Accounting Standards prescribed in section 133 of the Companies Act, 2013. The Company’s records indicate that had management marked the marketable securities to market, the Company would have recognized an unrealized loss of Rs.xxx in the statement of comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at March 31, 20X1, and income tax, net income and shareholders’ equity would have been reduced by Rs.xxx, Rs.xxx and Rs.xxx, respectively.

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI’s Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

(d) Non-Compliance of Laws and Regulations & Reporting Requirements: As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statement”, it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s

operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report under clause (vii)(a) of Para 3 of CARO, 2016 whether the company is regular in depositing undisputed statutory dues including employees' state insurance with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of rupees 7.50 lakhs in his report.

2. (a) **Certification of Projected Financial Forecast: Under Clause (3) of Part I of Second Schedule** to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.

In the instant case, Mr. Lily, a chartered accountant, has **prepared** and certified a projected financial forecast of his client Amazon Ltd. which was forwarded to the client's bank to secure some loans and based on which the bank sanctioned a loan to the client is not in order.

Thus, Mr. Lily will be held guilty of misconduct in view of above.

- (b) **Reporting Requirement for Disqualifications in Cost Audit Report:** A tax auditor is required to ascertain under Clause (37) of Form 3CD whether cost audit was carried out and if yes, provide the details of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the cost auditor.

The tax auditor should obtain the copy of cost audit from the assessee. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of the details of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the cost auditor. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out.

In the given case, the cost auditor of Beam Ltd. has reported certain disqualifications in Form CRA-3 of the cost audit report.

Therefore, the tax auditor of Beam Ltd. is required to provide the details of disqualifications reported by the cost auditor under Clause (37) of the Form 3CD. Thus, the contention of the

management of Beam Ltd. not to reveal any of the disqualifications related to the cost audit on the belief that there is no correlation between tax audit and cost audit is not acceptable.

- (c) (i) A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.

However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

- (ii) All other expenses not classified under other heads will be classified under "Other Expenses". For this purpose, any item of expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000 whichever is higher, needs to be disclosed separately. The given treatment in the scenario is not in order.
- (iii) Deferred Tax Liability should be shown under Non-Current Liabilities. Deferred Tax Asset shall be shown under Non-Current Asset. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown. Thus, DTA and DTL shown separately in the balance sheet by the company is not correct.

- (d) **SA 320 "Materiality in Planning and Performing an Audit"** prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

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

3. (a) (i) **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. 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.

- (ii) **Cost Accountant:** As stated in the preceding paragraph, 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".
- (b) 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, 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 audit report is the final step of a fraud audit. Auditors 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 and a conclusion as to the amount of loss suffered as a result of the 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.

The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.

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.

- (c) As per Para 11 of AS-15 on “Employee Benefits”, issued by the Institute of Chartered Accountants of India, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences.

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Here, Z Ltd will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence the contention of the auditor is correct that full provision should be provided by the company.

- (d) (I) **When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent:** The parent may have components located in multiple geographies outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its financial statements. Foreign components prepare financial statements under different financial reporting frameworks, which may be a well-known framework (such as US GAAP or IFRS) or the local GAAP of the jurisdiction of the component. Local component auditors may be unable to report on financial statements prepared using the parent’s GAAP because of their unfamiliarity with such GAAP.

When a component’s financial statements are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group’s consolidated financial statements, the parent’s management perform a conversion of the components’

audited financial statements from the framework used by the component to the framework under which the consolidated financial statements are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.

A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies".

When applying the approach of using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements. This ensures that the information prepared under the requirements of the group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements.

(II) When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent: Normally, audits of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India ("Indian GAAS"). In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the consolidated financial statements, the components' financial statements should also be audited under a framework that corresponds to Indian GAAS.

4. **(a) 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.

In the instance case, since computerization of land revenue records does not fall within exclusive areas for chartered accountants, M/s LMN can respond to tender as well as deposit Rs. 50,000 as earnest deposit and shall not have committed any professional misconduct.

- (b)** As per **SA 510 "Initial Audit Engagements—Opening Balances"**, in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:
- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Being new assignment audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities some audit evidence can ordinarily be obtained as part of audit procedures during the current period. For example, the collection/payment of opening balances of receivables and payables will provide audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as fixed assets, investments long term debt, the auditor will examine the records relating to opening balances. The auditor may also be able to get confirmation from third parties (e.g., balances of long term loan obtained from banks).

(c) Audit Procedure: The auditor should, *inter alia*, do the following for verification of commission:

- Ensure that commission/brokerage is not paid in excess of the limits specified by IRDAI
- Ensure that commission/brokerage is paid as per rates with the agent and rates filed with IRDAI
- Ensure that commission/brokerage is paid to the agent/broker who has solicited the business
- Ensure that the agent/broker is not blacklisted by IRDAI and is not terminated for fraud etc.
- Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.
- Check whether the vouchers are authorised by the officers-in-charge as per rules in force and income tax is deducted at source, as applicable.
- Test check correctness of amounts of commission allowed.
- Scrutinise agents' ledger and the balances, examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.
- Check whether commission outgo for the period under audit been duly accounted.

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

I. Risk Assessment Process

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

II. Understand and Evaluate

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

III. Test for Operating Effectiveness

- Assess Nature, Timing and Extent (NTE) of controls testing.
- Assess reliability of source data; completeness of population.

- Testing of key reports and spreadsheets.
- Sample testing.
- Consider competence and independence of staff /team performing controls testing.

IV. Reporting

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

- (e) **Relevant Sections and Steps involved in Audit of Government Companies:** Section 143(5), 143(6) and 143(7) of the Companies Act, 2013 are relevant sections in case of Audit of Government Companies.

The following steps are involved in the audit of government companies:

- (i) **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013** - Statutory auditors of Government Company are appointed or re-appointed by the Comptroller and Auditor General of India.

The C&AG may direct the appointed auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

- (ii) **Supplementary audit under section 143(6)(a) of the Companies Act, 2013** - The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct.

- (iii) **Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013** - Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

- (iv) **Test audit under section 143(7) of the Companies Act, 2013** - Without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

5. (a) **Printing of QR Code on Visiting Cards: As per Clause (7) of Part I of First Schedule** to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he advertises his professional attainments or services.

Ethical Standards Board has also clarified that a member in practice is allowed to print Quick Response Code (QR Code) on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card.

In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice.

Thus, Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

- (b) The Internal Control structure in an organization is referred to as the policies and procedures established by the entity to provide reasonable assurance that the objectives are achieved. The control structure in an organization basically has the following components:

1. **Control Environment** - Control environment covers the effect of various factors like management attitude; awareness and actions for establishing, enhancing or mitigating the effectiveness of specific policies and procedures.
2. **Accounting System** - Accounting system means the series of task and records of an entity by which transactions are processed for maintaining financial records. Such system identifies, assemble, analyze, calculate, classify, record, summarize and report transactions and other events.
3. **Control Procedure** - Policies and procedures means those policies and procedures in addition to the control environment and accounting systems which the management has established to achieve the entity's specific objectives.

In this regard, the management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent that they are appropriate to the size and nature of the business. There should be reasonable assurance for the auditor that the accounting system is adequate and that all the accounting information required to be recorded has in fact been recorded.

Internal controls normally contribute to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. Where the auditor concludes that he can rely on certain internal controls, he could reduce his substantive procedures which otherwise may be required and may also differ as to the nature and timing.

Specific Requirement under **SA 315 - "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment"** deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control.

- (c) **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 authority and responsibility of important executives.
- The internal auditor should examine the reasonableness of the span of control of each executive (the number of sub-ordinates 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.
- Finally, he should evaluate the process of managerial development in the enterprise. This is a vital aspect in a fast growing enterprise.

(d) Stage 1- Pre-audit or Planning Stage:

Audit planning is vital to the success of the audit undertaken. During this stage of audit, generally following steps are taken:

Collect background information about the entity

- (ii) Define objectives of audit
- (iii) Define scope –
- (iv) Choose audit criteria
- (v) Select the audit team members
- (vi) Develop audit plan and protocols
- (vii) Inform the facility
- (viii) Desktop review.

Stage 2 - On-site or Field Audit

The following are steps involved in on-site or field audit:

- (i) Opening conference.
- (ii) Facility tour
- (iii) Site/ facility inspection
- (iv) Evidence
- (v) Records/ document review
- (vi) Staff interviews
- (vii) Initial review of findings
- (viii) Closing/ exit conference.

Stage 3- Post – Audit

Steps involved in post – audit are as follows:

Final evaluation of findings

- (ii) Draft preliminary audit report
- (iii) Get approval of the management
- (iv) Hold exit conference
- (v) Discuss recommendations, if any

- (vi) Prepare and submit final report.

Stage 4.: Follow up or Review Stage :

This is also called corrective action follow-up phase. While not technically part of the audit, the audit manager or team leader may be involved in developing a corrective action plan for addressing audit findings with the facility and reporting to senior management as to the progress of this plan.

(e) Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

1. The Audit Committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
2. All members of Audit Committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (i): The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3. The Chairperson of the Audit Committee shall be an independent director and he shall be present at Annual General Meeting to answer shareholder queries.
4. The Company Secretary shall act as the secretary to the committee.
5. The Audit Committee at its discretion shall invite the finance director or the head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee, provided that occasionally, the Audit Committee may meet without the presence of any executives of the listed entity.

6. (a) Consideration for Assessing Presentation and Disclosure of Prospective Financial Information and Underlying Assumptions: As per SAE 3400 “The Examination of Prospective Financial Information”, when assessing the presentation and disclosure of the prospective financial information and the underlying assumptions, in addition to the specific requirements of any relevant statutes, regulations as well as the relevant professional pronouncements, the auditor will need to consider whether-

- (i) the presentation of prospective financial information is informative and not misleading;
- (ii) the accounting policies are clearly disclosed in the notes to the prospective financial information;
- (iii) the assumptions are adequately disclosed in the notes to the prospective financial information. It needs to be clear whether assumptions represent management’s best-estimates or are hypothetical and, when assumptions are made in areas that are material and are subject to a high degree of uncertainty, this uncertainty and the resulting sensitivity of results needs to be adequately disclosed;
- (iv) the date as of which the prospective financial information was prepared is disclosed. Management needs to confirm that the assumptions are appropriate as of this date, even though the underlying information may have been accumulated over a period of time;
- (v) the basis of establishing points in a range is clearly indicated and the range is not selected in a biased or misleading manner when results shown in the prospective financial information

are expressed in terms of a range; and

- (vi) there is any change in the accounting policy of the entity from that disclosed in the most recent historical financial statements and whether reason for the change and the effect of such change on the prospective financial information has been adequately disclosed.

- (b) False Declaration as Authorized Representative:** In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable **under section 278** of the Income Tax Act 1961. Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

In the instant case, Mr. Ram, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration, thus, he would be liable under section 278 of the Income Tax Act, 1961.

- (c) Considerations for Planning and Performing Audit in case of Special Purpose Framework:** As per SA 800 "Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks", financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

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

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

- (d) **Classification of Account as NPA in case of Multiple Banking:** If the account remains overdue for more than 90 days, the account becomes Non-Performing Assets. The account will also be called as overdue, if there are not sufficient credits in the cash credit account which even could not serve the interest charged. In this case, there are no credits in accounts, it means interest has not been served in the account. Thus, accounts become overdue after 90 days for non-credit of amounts which could even serve the interest amount. Thus, cash credits will become as NPA if no credits/sale proceeds are deposited in that account.

However, in multiple banking system, each bank is independent for classification of account as NPA. If SBI declares the account as NPA due to non-serving of interest amount, other bank will be free and will not classify the term loan accounts as NPA, if they are regular.

- (e) Reviewers, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a **reviewer may qualify the report due to one or more of the following:**

- ◆ non-compliance with technical standards;
- ◆ non-compliance with relevant laws and regulations;
- ◆ quality control system design deficiency;
- ◆ non-compliance with quality control policies and procedures; or
- ◆ non-existence of adequate training programmes for staff.