

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

*Answer any **four** from the rest*

Question 1

- (a) *M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA Kumar observed that there is misappropriation of assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation.*

Guide CA Kumar with respect to Risk factors related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing. (5 Marks)

- (b) *In the course of audit of Tech limited you observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Tech Limited used a service organisation to record transactions and process related data. As an auditor, what would be your considerations regarding the nature and extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk.*

Discuss with reference to relevant Standard on Auditing. (5 Marks)

- (c) *CA Madhu is the statutory auditor of Lakshmi Ltd. for the Financial year 2020-21. In respect of loans and advances of ₹ 75 Lakh given to Srinian Pvt. Ltd., the Company has not furnished any agreement to CA Madhu and in absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms.*

Justify the type of opinion which CA Madhu should give in such situation. Also, Draft an appropriate Opinion paragraph and Basis of opinion paragraph. (4 Marks)

Answer

- (a) **Guidance to CA Kumar with respect to risk factors that relate to misstatements arising from misappropriation of assets as per SA 240 is:**

As per **SA 240, "The Auditor's Responsibilities Relating to Fraud in an audit of Financial Statements"**, misappropriation of assets involves the theft of entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

Misappropriation of assets can be accomplished in a variety of ways including stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization.

Incentives/Pressures

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- (i) Known or anticipated future employee layoffs.
- (ii) Recent or anticipated changes to employee compensation or benefit plans.
- (iii) Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- (i) Large amounts of cash on hand or processed.
- (ii) Inventory items that are small in size, of high value, or in high demand.
- (iii) Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- (iv) Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- (i) Inadequate segregation of duties or independent checks.
- (ii) Inadequate oversight of senior management expenditures, such as travel and other reimbursements.
- (iii) Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- (iv) Inadequate job applicant screening of employees with access to assets.
- (v) Inadequate record keeping with respect to assets.
- (vi) inadequate system of authorization and approval of transactions (for example, in purchasing).
- (vii) Inadequate physical safeguards over cash, investments, inventory, or fixed assets.

- (viii) Lack of complete and timely reconciliations of assets.
- (ix) Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- (x) Lack of mandatory vacations for employees performing key control functions.
- (xi) Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- (xii) Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Attitudes/Rationalizations

- (i) Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
 - (ii) Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
 - (iii) Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
 - (iv) Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
 - (v) Tolerance of petty theft.
- (b) As per SA 402 “Audit Considerations relating to an Entity using a Service Organization”, when obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity’s operations, including:**
- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity’s internal control;
 - (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
 - (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and
 - (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organization.

"Based on above, the auditor will assess the effect on the audit risk and take necessary steps while conducting the audit".

- (c) In the present case, with respect to loans and advances of ₹ 75 Lacs given to Sriman Pvt. Limited, the Company has not furnished any agreement to CA Madhu. In the absence of such an agreement, CA Madhu is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidence is the loan agreement. Therefore, the absence of such document in the present case, tantamount to a material misstatement in the financial statements of the company. However, the inability of CA Madhu to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion.

Thus, in the present case, CA Madhu should give a qualified opinion

The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

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 financial statements of Lakshmi Limited 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 on 31.03.2021 and profit/ loss for the year ended on that date.

Basis for Qualified Opinion

The Company is unable to furnish the loan agreement with respect to loans and advances of ₹ 75 Lacs given to Sriman Pvt Limited. Consequently, in the absence of such an agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.

Question 2

- (a) *During the course of audit of Fortune Ltd., CA Prasad is concerned with the quality and effectiveness of internal control. Towards achieving his objective he wants to assess and evaluate the control environment. Guide CA Prasad with well-defined set of the Standard Operating Procedures in the assessment and evaluation of control. (5 Marks)*
- (b) *Mr. Khanna has been appointed as statutory auditor of RST Ltd. for the financial year ended 31st March, 2021. The financial statements of RST Ltd. are to be drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. The Chief financial officer is of the view that the disclosure requirements specified under Division II of Schedule III of the Companies Act, 2013 are complete and no other additional disclosures shall be made in the Notes or by way of additional statements. Advise on the General instructions to be considered by RST Ltd. while preparing its financial statements. (5 Marks)*
- (c) *The Cashier of a company committed a fraud and absconded with the proceeds thereof. The Chief Accountant of the company also did not know when the fraud had occurred. In*

the course of the audit, the auditor failed to discover the fraud. After the audit was completed, however, the fraud was discovered by the Chief Accountant. Investigation made at that time indicates that the auditor did not exercise proper skill and care and performed his work in a desultory and haphazard manner. With this background, the Directors of the company intend to file disciplinary proceedings against the auditor. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

(4 Marks)

Answer

(a) Guidance to CA Prasad with well defined set of Standard Operating Procedure is given hereunder:

- (i) **Standard Operating Procedures (SOPs):** A well defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover.
- (ii) **Enterprise Risk Management:** An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.
- (iii) **Segregation of Job Responsibilities:** A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person.

A buyer should not be involved in receiving of materials or passing of bills. Similarly bank reconciliation should be prepared by a person other than the one who maintains bank book

- (iv) **Job Rotation in Sensitive Areas:** Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example, if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.
- (v) **Delegation of Financial Powers Document:** As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.
- (vi) **Information Technology based Controls:** With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the

system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

(b) General Instructions for Preparation of Financial Statement of a Company required to comply with Ind-AS:

1. Every company to which Indian Accounting Standards apply, shall prepare its financial statements in accordance with this Schedule or with such modification as may be required under certain circumstances.
2. Where compliance with the requirements of the Act including Indian Accounting Standards (except the option of presenting assets and liabilities in the order of liquidity as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment substitution or deletion in the head or sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements under this Schedule shall stand modified accordingly.
3. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Indian Accounting Standards. Additional disclosures specified in the Indian Accounting Standards shall be made in the Notes or by way of additional statement or statements unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 2013 shall be made in the Notes in addition to the requirements set out in this Schedule.
4. (i) Notes shall contain information in addition to that presented in the Financial Statements and shall provide where required-
 - (a) narrative description or disaggregation of items recognised in those statements; and
 - (b) information about items that do not qualify for recognition in those statements.(ii) Each item on the face of the Balance Sheet, Statement of Changes in Equity and Statement of Profit and Loss shall be cross-referenced to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between providing excessive detail that may not assist users of Financial Statements and not providing important information as a result of too much aggregation.
5. Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statement including Notes except in the case of first Financial Statements laid before the company after incorporation.

6. Financial Statements shall disclose all 'material' items, i.e. the items if they could. Individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.
 7. Where any Act or Regulation requires specific disclosure to be made in the standalone financial statement of a company, the said disclosure shall be made in addition to those required under this Schedule.
- (c) **In the given case, in the course of audit, auditor failed to discover the fraud. It is clearly given that investigation indicated that the auditor did not exercise reasonable skill and care and performed his work in a casual and unmethodical manner.**

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”.

As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements", it can be concluded that the auditor did not plan and perform the audit with an attitude of professional skepticism. Thus, having regard to this and a fraud has actually taken place during the year, committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.

From the facts given in the case and by applying Clause (7) and SA 240, it is clear that the auditor is guilty of professional misconduct and the directors can file disciplinary proceedings against the auditor.

Question 3

- (a) *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. (5 Marks)*
- (b) *You have been appointed as Concurrent auditor of one of the branches of Coin Bank Ltd. This branch is dealing mainly in foreign exchange. State the suggested audit procedures to be covered by you to check the foreign exchange transactions of this branch while doing Concurrent audit. (5 Marks)*
- (c) *CA Mehta was appointed as the Auditor of CS Ltd. for the year 2020-21 in the place of retiring auditor CA Gupta. CA Mehta accepted the appointment after obtaining a certificate from the management that the provisions of the Sections 139 and 140 of the Companies Act, 2013 have been complied with.*

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

(4 Marks)

Answer

(a) 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:

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

(b) Suggested audit procedure to be covered by the Concurrent Auditor to check the foreign exchange transactions of one of the branches of Coin Bank Ltd is given hereunder:

- Check foreign bills negotiated under letters of credit.
- Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.
- Check whether inward/outward remittance have been properly accounted for.
- Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorized and necessary charges have been recovered.
- Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.
- Ensure that the overbought/oversold position maintained in different currencies is reasonable, considering the foreign exchange operations.
- Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations.

- Ensure verification/reconciliation of Nostro and Vostro account transactions/balances.
- (c) **In the given case, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management that the provisions of the Sections 139 and 140 of the Companies Act, 2013 have been complied with.**

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.

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.

Applying the above clause to the given case, 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, CA Mehta should not have accepted the audit assignment. But on the other hand, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management which is not enough and hence CA Mehta is deemed to be guilty of professional misconduct.

Question 4

- (a) *M & B Investments Ltd. is a company having paid up share capital of ₹ 1 Crore, It has a subsidiary, Investors Fund Management Ltd. Major business of M & B Investments Ltd. is to pool money from investors on a collective basis and invest this money in various funds. This company pooled ₹ 10 Crore from a number of clients, which represent the Company's*

shareholders.

While auditing books of accounts of M & B Investments Ltd. CA X observed that whole amount of ₹ 10 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company.

Now, CA X raised an issue while auditing financial statements of M & B Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013 ?

Analyse the above issue and give your opinion. **(5 Marks)**

- (b) ACT Silk Industries is a leading textile manufacturing listed company. In the course of evidence collection and analysis, it was observed that the company is involved in siphoning of funds through payments to shell companies. Hence, SEBI appointed B & S Associates, Chartered Accountants, as forensic auditors of the company.

Enumerate in brief the steps to be taken by B & S Associates in forensic audit process.

(5 Marks)

- (c) ABC Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by Government or local authorities. For the year ended 31st March, 2021 following are some extracts from the financial statements:

(i) Paid-up share capital	₹ 40.53 Cr.
(ii) Non-Current Assets - Loans & Advances	₹ 55.90 Cr.
(iii) Current Assets - Loans and advances	₹ 344.47 Cr.
(iv) Total assets of the company	₹ 530 Cr.
(v) Intangible assets	₹ 3 Cr.
(vi) Profit for the Year	₹ 7.25 Cr.
(vii) Income from interest and dividends	₹ 52 Cr.
(viii) Gross income	₹ 102.57 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise. **(4 Marks)**

Answer

- (a) According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder.

An investment entity is an entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

However, as per paragraph 33 of Ind AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Applying the above to the given case of M&B Investment Ltd, which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 and 33 of Ind AS 110, it can be concluded that M&B Investment Ltd is not required to consolidate as per Section 129 (3) of the Companies Act, 2013.

- (b) Each Forensic accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. **Steps to be taken by B & S Associates, as Forensic auditors of the company are:**

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 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, 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.

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) In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's
- (i) Financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and
 - (ii) Income from financial assets constitute more than 50 per cent of the gross income.

A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

In the given case of ABC Ltd, its Financial Assets are = ₹ 55.90 + ₹ 344.47 = ₹ 400.37 Cr

Total Assets (netted off by intangible assets) = ₹ 527 Cr

Income from financial assets = ₹ 52 Cr

Gross Income = ₹ 102.57 Cr

From the above, it is clear that ABC Ltd.'s financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitutes more than 50 per cent of the gross income. Hence, ABC Ltd. fulfils both these criteria to qualify as an NBFC.

Thus ABC Ltd. can apply for registration under Section 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

Question 5

- (a) *Mr. Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures. (5 Marks)*
- (b) *Long Age Foundations Ltd. (LAF), a pharmaceutical company, collected the data from some hospitals and their experts tried to understand medical needs of elderly people. After complete study, their experts developed an application where LAF will provide complete health care after charging a nominal amount from the customers, if customers download this application in their mobile phones. CA P in his audit has used data analytics method also known as Computer Assisted audit techniques.*

Give illustrations of suggested approach to get the benefit from the use of CAATs.

(5 Marks)

- (c) *CA M has been appointed as an auditor of Life Secure Insurance Ltd. He observed that few insurance policies have been sold by the company in the last month of the financial year ending 31st March, 2021. While recognizing income in the income statement of the company, it is the responsibility of CA M to make an assessment of the reasonability of the risk pattern managed by the management.*

Also, it is to be ensured by him that Life Secure Insurance Ltd. should not issue policies, if the risk is not established before the closure of the F.Y.2020-21.

Indicate the circumstances when the company should not issue the policy documents.

(4 Marks)

Answer

- (a) Factors that may assist Mr. Agarwal, the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:**

- (i) The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- (ii) The ability or willingness of the intended confirming party to respond – for example, the confirming party:
- May not accept responsibility for responding to a confirmation request;
 - May consider responding too costly or time consuming;
 - May have concerns about the potential legal liability resulting from responding;
 - May account for transactions in different currencies; or
 - May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- (iii) The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

- (b) The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs.** There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is as given below:

- Understand Business Environment including IT

- Define the objectives and criteria
 - Identify source and format of data
 - Extract Data
 - Verify the completeness and Accuracy of Extracted data
 - Apply Criteria on data obtained.
 - Validate and confirm results.
 - Report and document results and conclusions (SA 230)
- (c) The auditor, CA M appointed as an auditor of Life Secure Insurance Ltd. should ensure that policy documents have not been issued, in case:
- (i) Premium had not been collected at all;
 - (ii) Premium had been collected but the relevant cheques have been dishonoured; (refer Cheque Dishonoured Book);
 - (iii) premium had not immediately been collected due to furnishing of a bank guarantee or cash deposit but either the deposit or guarantee had fallen short or has expired or the premium had been collected beyond the stipulated time limit (i.e., there is a shortfall in bank guarantee account or cash deposit account of the insured);
 - (iv) premium had not been collected due to risk cover being increased or where stipulated limits have been exhausted in respect of open declaration policies (i.e., where premium has accrued but has not been received); and
 - (v) instalments of premium have not been collected in time in respect of certain categories of policies, e.g., marine-cum-erection policies where facility has been granted for premium being paid in instalments (such facility is normally available subject to certain conditions, e.g., that the first equated instalment is more by 5 per cent of the total premium payable by instalments).
 - (vi) Premium collected but policies not issued for long periods of time.
 - (vii) Whether the premium received during the year but pertaining to risk commencing in the following year has been accounted for under the head 'Premium Received in Advance' and has been disclosed separately

Question 6

- (a) CA Pradeep is appointed auditor of Delicious Foods Ltd. (DFL) a listed company to audit the financial statements for the year ended 31st March 2021. Paid-up share capital of DFL is ₹ 5.97 Cr. While auditing director's remuneration CA Pradeep observed that Mr. Shrinivas Gupta has been appointed as an independent director. Mr. Srinivas Gupta is holding shares of ₹ 8,95,500 in DFL and his wife is holding shares of ₹ 2,98,500 in the same company.

CA Pradeep raised an objection on the appointment of independent director, but other directors explained that holding of shares by Mr. Srinivas is less than the prescribed limit

hence, he is eligible to be appointed as independent director.

How will CA Pradeep deal with this situation and how will he report this issue? **(5 Marks)**

- (b) CA Nitesh, while carrying out the Tax audit of PQR Ltd. observed that PQR Ltd. has entered into specified financial transactions covered under Section 285BA of the Income tax Act, 1961. PQR Ltd. has furnished statement of the specified financial transaction in Form No. 61 & Form No. 61A.

Guide CA Nitesh with reporting requirements under clause 42 of Form 3CD?

The management contends that tax auditor need not report, if the transactions are not covered in the ambit of Section 269ST. Comment. **(5 Marks)**

- (c) Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto:

CA D, a practicing Chartered Accountant, was appointed as a simplicitor Director in a Pvt. Ltd. company on 01-01-2020. After serving 18 months, Mr. D resigned as the Director. He accepted the appointment as the Statutory Auditor of the company with effect from 01-10-2021.

Is CA D right in accepting the audit? **(4 Marks)**

OR

CA Manoj has been appointed as Peer Reviewer of M/s UV Associates, a Chartered Accountant firm consisting of 18 partners. As a Practicing unit what are the obligations that are to be complied by M/s UV associates in addition to furnishing the questionnaire, statements and such other particulars as the Board may deem fit? **(4 Marks)**

Answer

- (a) **LODR Regulation 17 regarding Verification regarding Composition of Board of Directors of Listed Entity:** An independent non-executive director should not be a substantial shareholder of the listed entity and in determining 'not a substantial shareholder'; he (together with his relatives) should not own 2% or more of total voting power of the listed entity.

In the given case of Delicious Foods Ltd. (DFL), Mr. Shrinivas Gupta along with his wife is substantial shareholder of the DFL, Listed Company, because their holding in DFL is 2 % of the total voting power of the DFL calculated as under:

Mr. Shrinivas Gupta's holding in DFL	= ₹ 8,95,500
His wife's holding in DFL	= ₹ 2,98,500
Combined holding of Mr. Shrinivas Gupta and his wife	= ₹ 11,94,000
Total Voting Power of DFL	= ₹ 597,00,000
Percent calculation	= $11,94,000 \times 100 / 59700000$
	= 2%

Hence objection raised by CA Pradeep on the appointment of independent director is valid and Mr. Shrinivas is not eligible to be appointed as independent director of the company.

In this case CA Pradeep should specifically mention in his report about the disqualification of appointment as independent director of Mr. Shrinivas. He should mention name of the disqualified director, date of disqualification and reasons of disqualifications in his audit report.

- (b) Clause 42 has been introduced where the tax auditor has to report that whether the taxpayer is required to furnish a statement of the specified financial transaction (in Form No.61 or Form No. 61A or Form No. 61B).

With respect to Form 61, the tax auditor should verify whether the taxpayer has entered into any transaction where the other party was required to quote PAN. He should verify whether the taxpayer has obtained declaration in Form No. 60 where the other party has not furnished his PAN. Wherever the taxpayer has received declarations in Form No. 60, the auditor should verify if the taxpayer has filed Form No. 61 including therein all the necessary particulars.

With respect to Form 61A, the tax auditor should ascertain whether the taxpayer is required to report any transactions under Section 285BA read with Rule 114E. It may be noted that specified transactions under Section 285BA include the issue of bonds, issue of shares, buy-back of shares by a listed company, etc. These transactions may not happen every year and hence special attention should be given in the year when a company taxpayer issues any security or a listed company undertakes buyback of shares.

While verifying the same, the tax auditor should ensure that the provisions of Rule 114E(3) have been properly considered and applied.

Failure to do so may result in a certain transaction not being reported. It may be noted that the payment may be received for various transactions and on different dates, and hence these may not be covered under Section 269ST but will have to be reported under Section 285BA.

Keeping in view above provisions, contention of the management that tax auditor need not report is incorrect and hence tax auditor will have to report under Section 285BA.

He would be required to report under clause 42 of Form 3CD as under:

S. No.	Income Tax Department Reporting entity Identification No.	Type of Form	Due date for furnishing	Date of furnishing, if furnished	Whether the form contains information about all details/ transactions which are required to be reported	If not please furnish list of the details/ transactions which are not reported
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- (c) 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 *Simpliciter* in Pvt. Ltd. Company. Mr. D resigned as the Director and after 18 months of resignation accepted the Statutory Auditor position of the Company. In view of above provisions Mr. D cannot accept the Directorship of the company as tenure of two years after his resignation is yet to be completed.

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.

OR

(c) M/s UV Associates-Practice Unit, in addition to the prescribed information to be furnished including the questionnaire, statements and such other particulars as the Board may deem fit, shall comply with the following:

- (i) Produce to the Reviewer or allow access to, any record, document or prescribed register maintained by the Practice Unit or any other record or document which is of a class or description so specified, and which is in the possession or under the control of the Practice Unit.
- (ii) Provide to the Reviewer such explanation or further particulars/ information in respect of anything produced in compliance with a requirement under sub clause (1) above, as the Reviewer shall specify.
- (iii) Provide to the Reviewer all assistance in connection with Peer Review.
- (iv) Where any information or matter relevant to a Practice Unit is recorded otherwise than in a legible form, the Practice Unit shall provide and present to the Reviewer a reproduction of any such information or matter, or of the relevant part of it in a legible form, with a translation in English or Hindi, if the matter is in any other language, and if such translation is requested for by the Reviewer. The Practice Unit shall be responsible and accountable for the accuracy and truthfulness of the translation so provided.