PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

*Question No. **1** is compulsory*

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

Question 1

(a) *M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y 2019-2020. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2018-19 were incorrectly brought forward. It was found that M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period.*

Accordingly, a complaint was filed against NK & Co. in relation to this matter.

You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC). ***(5 Marks)***

(b) *GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2020 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.* ***(5 Marks)***

(c) *Nam & Co., conducted Stock Audit of DEF Ltd. as per instructions issued by HEG Bank. However instead of visiting the site where the stock was lying, the firm relied on the Management Information Systems report along with inspections reports and photographs of Stock taken by the employees of DEF Ltd. The photographs were also carrying the date and time printed on them. Comment with reference to the Chartered Accountants Act, 1949 and its schedules thereto.* ***(4 Marks)***

Answer

(a) In the given question, NK & Co. did not apply audit procedures to ensure that opening balances had been correctly brought forward. A complaint was filed against the auditors in this context. As per Standard on Quality Control (SQC) 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements",

(i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:

(a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and

(b) Allegations of non-compliance with the firm's system of quality control.

(ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.

(iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

(iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.

(v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.

(b) The auditors, GHK Associates wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

(i) Sales, transfers and charges between segments, and elimination of inter-segment amounts.

(ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.

(iii) The allocation of assets and costs among segments.

(iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

(c) According to Clause (7) 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 "does not exercise due diligence or is grossly negligent in the conduct of his professional duties".

It is a vital clause which usually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

In the instant case, CA. Nam &Co. did not exercise due diligence and is grossly negligent in the conduct of his professional duties since it did not visit the site where the stock was lying and instead the firm relied on the MIS report along with inspection reports and photographs of stock taken by the employees of DEF Ltd, which is incorrect.

To conduct stock audit, ascertainment of existence and physical condition of stocks, cross tallying the stock with Stock statement submitted by bank borrower, correct classification of stocks for valuation purpose etc. is essential. Further submitting stock audit report without physically verifying the stock amounts to gross negligence.

From the above, it can be concluded that Nam & Co. is guilty of professional misconduct under Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Question 2

(a) Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd., you observed that significant deficiency exists in the internal control system and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization. ***(5 Marks)***

(b) A European company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of 51% and assets over ₹1000 Crores. It requests you to conduct "Due Diligence" of assets of this Indian Company to find out, if any of the assets is overvalued. List down the areas of due diligence exercise to find out overvalued assets. ***(5 Marks)***

(c) M/s. NKB Ltd. is engaged in the manufacturing of textile products having an annual capacity of producing 1,00,000 units of garments. NKB Ltd. is covered under the provisions of Goods and Service Tax Act with an applicable rate of 12%. During the financial year 2019-2020, NKB Ltd. received a demand notice of ₹ 15.00 Lacs pertaining to the F.Y 2013-14 when the provisions of Central Excise Act were applicable. NKB Ltd. deposited the demand amount after discussing with its legal department. Are you, as a tax auditor of NKB Ltd., required to report the same? ***(4 Marks)***

Answer

(a) In the given case of ABC Ltd, Auditors, while conducting audit has come across significant deficiency existing in the internal control system and also auditors wanted to ascertain that deficiency.

As per SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management ", Indicators of significant deficiencies in internal control include, for example:

(i) Evidence of ineffective aspects of the control environment, such as:

(a) Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.

(b) Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.

(c) Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.

(ii) Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.

(iii) Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.

(iv) Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).

(v) Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.

(vi) Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.

(vii) Evidence of management's inability to oversee the preparation of the financial statements.

(b) A European company which is manufacturing and distributing industrial gases is looking forward to acquire an Indian company having 51% market share and assets beyond ₹ 1000 crores. Areas to be covered as a part of due diligence exercise to find out over valued assets would be as under:

1. Uncollected/uncollectable receivables.

2. Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.

3. Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
4. Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
5. Litigated assets and property.
6. Investments carried at cost though realizable value is much lower.
7. Investments carrying a very low rate of income / return.
8. Infructuous project expenditure/deferred revenue expenditure etc.
9. Group Company balances under reconciliation etc.
10. Intangibles of no value.

(c) NKB Ltd. Is a manufacturer of textile products and is covered under GST Act. During financial year 2019-2020 NKB has received a demand notice of 15 lakhs which pertains to financial year 2013-2014 when the Central Excise Act was prevalent. As a tax auditor of NKB Ltd., reporting would be under Clause 41 which is given hereunder:

"Please furnish the details of demand raised or refund issued during the previous year under any tax laws other than Income Tax Act, 1961 and Wealth tax Act, 1957 along with details of relevant proceedings. "

It may be noted that even though the demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause. If there is any adjustment of refund against any demand, the auditor shall also report the same under this clause.

In this case, liability is of excise duty i.e. under Central Excise Act, other than Income Tax Act and Wealth Tax Act, thus this clause gets attracted and the reporting has to be done as per format:

S No.	Name of the Applicable Act	Demand/ Refund Order no., if any	Date of demand raised/refund issued	Financial year to which the demand/refund relates	Amount of demand/raised/refund issued	Adjustment of refund against demand, if any	Remarks

Question 3

(a) You are engaged by M/s. Real Ltd. as an internal auditor for the financial year 2020-2021. While applying risk assessment procedures of inquiring from management and various analytical procedures, you have identified some risks which in your opinion may lead to

material misstatement at the financial level and assertion level. Which factors as an auditor will you consider while exercising judgement as to whether such risks are significant risks or not? ***(5 Marks)***

(b) LDH Ltd., a company incorporated in India and Listed on a recognized Stock Exchange in India has entered into various related parties transactions during the financial year. You are required to answer the following keeping in mind the Listing Obligations and Disclosure Requirements (LODR) on corporate Governance.

(i) Who should sign the report of material transactions with related parties? ***(1 Mark)***

(ii) What type of transactions and policy are required to be disclosed in relation to related party transactions? ***(2 Marks)***

(iii) Whether disclosures of related party transactions on consolidated financial statements are required to be made? If yes, what are the guidelines? ***(2 Marks)***

(c) Please state which of the following is to be reported under Form 9C under GST audit for the period 2019-2020 ?

(i) The GST registered firm donates the old washing plant as on 25.12.2019 to a charitable institute. This machinery was purchased on 10.05.2018 for ₹ 1,75,000 Plus GST @ 12%.

(ii) Goods Transport Agent (GTA) issued a consignment note on 05.04.19. The consignment note does not charge GST. The consignor has booked the GTA. The recipient has paid the freight to GTA on 'to collect' basis.

(iii) Sale of a building after completion certification has been obtained for ₹ 50,00,000 on 14.11.2019. ***(1 + 1 + 2 = 4 Marks)***

Answer

(a) The internal auditor of Real Ltd. has identified some risks while he was applying risk assessment procedures and various analytical procedures.

As per SA 315, "Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and its Environment", in exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

(1) Whether the risk is a risk of fraud;

(2) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;

(3) The complexity of transactions;

(4) Whether the risk involves significant transactions with related parties;

(5) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

(6) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

(b) An Indian company, LDH Ltd., listed on stock exchange entered into various related party transactions.

(i) The report shall be signed either by the compliance officer or the chief executive officer of the listed entity.

(ii) (a) The company shall disclose the policy on dealing with related party transactions on its website and a web link thereto shall be provided in the Annual Report.

(b) The listed entity shall disclose the transactions with any person or entity belonging to the promoter/ promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.

(iii) (a) Yes, disclosures of related party transactions on consolidated financial statements are required to be made by the listed entity within 30 days from the date of publication of its standalone and consolidated financial results for the half year.

(b) The listed entity shall disclose related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website.

(c) (i) Permanent Transfer or disposal of business assets where input tax credit has been availed on such assets should be reported in table 5D as Deemed supply under Schedule I. The current value of washing plant in books should be reported as deemed sale in Table 5D.

(ii) Since consignment note has not charged GST @ 12%, reverse charge provisions would apply. Tax is to be paid by the person liable to pay freight, that is, the recipient and not the GTA under forward charge. Because of this, the impugned transaction has to be entered in Table 7D.

(iii) (a) No supplies include the activities covered under Schedule III which are neither a supply of goods nor a supply of services. Examples- Sale of land or completed building, actionable claims, other than lottery, betting, and gambling.

(b) Table 7B requires reduction of value of Exempted, Nil rated, Non-GST supplies, No-Supply turnover from the Annual turnover after adjustments to arrive at taxable turnover. Therefore, Sale of a building after completion certificate has been obtained is treated as no supply under GST law. The same has to be reported under Table 7B in form no 9C.

Question 4

(a) CA N was appointed as an auditor of JAL Ltd. The company has branches all over the state of Haryana. CA N, in consultation with management, decided to Visit 6 out of 10 branches. Management decided to pay him advance of ₹ 2.00 Lacs against the estimated expenses of ₹ 2.50 Lacs on visits to be conducted as a part of services rendered. As agreed, ₹ 2.00 Lacs was transferred in his bank account from which he met all the expenses. Comment with reference to Chartered Accountants Act, 1949 whether the action of CA N of receiving the advance money in his saving accounts and not keeping it in separate bank account is valid. ***(4 Marks)***

(b) The Comptroller and Auditor General of India has appointed a chartered accountant firm to conduct the comprehensive audit of Metro Company Limited (a listed government company) which is handling the Metro project of the metropolitan city for the period ending 31-03-2020. The work to be conducted under Project A handled by the Metro Company Limited was of laying down railway line of 124 kilometres. [The chartered accountant firm reviewed the internal audit report and observed the shortcoming reported about the performance of Project A regarding the understatement of the Current liabilities and Capital work in progress by ~ 84.68 crore.] Explain some of the matters to be undertaken by the chartered accountant firm while conducting the comprehensive audit of Metro Company Limited. ***(5 Marks)***

(c) JRS Limited holds the majority ownership of R Ltd. & K Ltd. S Ltd. is an intermediate subsidiary of JRS Limited in Surat. The JRS Limited presents the consolidated financial statements for audit purposes to MMT & Co. As a statutory auditor MMT & Co. obtain a listing of all the components and verify that all the components included in financial statements unless any component meet criterion for exclusion. Explain any two reasons which are considered by MMT & Co. for exclusion of components from the consolidated financial statements and reporting of reasons of exclusion thereof. ***(5 Marks)***

Answer

(a) As per Clause (10) of Part I of Second Schedule to the Chartered Accountant Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he fails to keep moneys of his client other than the fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilize such funds only in accordance with the instructions of the client or for the purposes intended by the client.

In this connection the Council has considered some practical difficulties of the members and the following suggestion, among other suggestions, has been made to remove these difficulties:

"An advance received by a Chartered Accountant against services to be rendered does not fall under Clause (10) of Part I of the Second Schedule"

In the given case, CA N was given an advance of ₹ 2 Lakhs against the estimated expenses of ₹ 2.50 Lakhs on visits to be conducted as a part of services rendered.

Applying the above, it can be concluded that CA N is not guilty of professional misconduct under Chartered Accountants Act, 1949.

(b) A CA Firm has been appointed to conduct comprehensive audit of Metro Company Limited, which is a listed Govt Company handling the Metro project. CA firm has observed the shortcomings as stated in internal audit report regarding understatement of Current liabilities and CWIP by ₹ 84.68 crore.

Matters to be undertaken by the CA Firm while conducting the comprehensive audit of Metro Company Limited are:

(i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?

(ii) Have the accepted production or operational outputs been achieved? Has there been under-utilisation of installed capacity or shortfall in performance and, if so, what has caused it?

(iii) Has the planned rate of return been achieved?

(iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?

(v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?

(vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?

(vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?

(viii) If the enterprise has an adequate system of repairs and maintenance?

(ix) Are procedures effective and economical?

(x) Is there any poor or insufficient or inefficient project planning?

(c) Where a component is excluded from the consolidated financial statements, the auditor should examine the reasons for exclusion and whether such exclusion is in conformity with the applicable financial reporting framework.

(i) Under Companies (Accounting Standards) Rules, 2006, there could be two reasons for exclusion of subsidiary, associate or jointly controlled entity- one, that the relationship of parent with the subsidiary, associate or jointly controlled entity is intended to be **temporary** or the subsidiary, associate or joint venture operates under severe **long-term restrictions** which significantly impair its ability to transfer funds to the parent.

(ii) Similarly, under the Companies Act, 2013, **intermediate subsidiary** in India is not required to present consolidated financial statements. **Ind AS 110** also prescribes certain criteria where consolidated financial statements are not required. In such cases, the auditor should satisfy himself that the exclusion made by the management falls within these categories, example in the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary, associate or joint venture is **temporary,** the auditor should verify that the intention of the parent, to dispose off the subsidiary, investment in associate or interest in jointly controlled entity, in the near future, existed at the time of acquisition of the subsidiary, making investment in associate or jointly controlled entity.

(iii) The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements. If an entity is excluded from the consolidated financial statements for reasons other than those allowed by the applicable financial reporting framework, the auditor should consider its effect on the auditor's report to be issued.

Question 5

(a) M/s. HK & Co. was appointed as an auditor of GSB Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, GSB Limited is required to pay certain percentage of its annual revenue as license fee. GSB Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues and not only on core business revenues. Matter was disputed and went to court of law. On prudence basis, GSB Limited made a provision on estimated business in its books of accounts of agreed percentage on non-core business receipts also. The amount of provision was of such huge amount that the GSB Limited's profit and loss account for that quarter reflected loss due to that provision. How you as an auditor can evaluate this accounting estimate which involves significant risk and what if Management has not addressed the effects of estimation uncertainty on provision made?

(4 Marks)

(b) The audit team is preparing to conduct audit for ABC Company for the period ending 31.3.2020. However, the audit team has not received its audit fees from ABC Company for its audit concluded for the period ended 31.3.2019. The audit team might be tempted to issue a favorable report so that ABC Company is able to secure a loan to settle the fees outstanding for their 31.3.2019 audit. The audit team is not complying the fundamental principles of auditing hence hindering the Auditor's Independence. Explain the types of threats that may hinder Auditor's Independence while issuing Audit Report. ***(5 Marks)***

(c) Explain the concept of Integrated framework issued by Committee of the Sponsoring Organisations of the Treadway Commission (COSO Framework) duly mentioning its four out of five components and discuss the three category of objectives that can be achieved as per COSO framework. ***(5 Marks)***

Answer

(a) In the given case, HK & Co. was appointed as an auditor of GSB Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that GSB Ltd.'s profit and loss account reflected a loss due to that provision. As an auditor evaluation would be done as under:

For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

(i) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.

(ii) Whether the significant assumptions used by management are reasonable.

(iii) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.

(iv) If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.

(b) In the given case of ABC Company, audit team is preparing to conduct its audit for the F.Y ending on 31.03.2020. Audit firm did not receive its fees for the F.Y ending on 31.03.2019. Audit team is tempted to issue a favorable report so that auditee can secure a loan to settle auditor's outstanding fees. The audit team did not comply with fundamental principles of auditing and hence compromising Auditor's Independence.

Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

The Code of Ethics for Professional Accountants prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

1. **Self-interest threats**, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include (i) direct financial interest or materially significant indirect financial interest in a client, (ii) loan or guarantee to or from the concerned client, (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement, (iv) close business relationship with an audit client, (v) potential employment with the client, and (vi) contingent fees for the audit engagement.
2. **Self-review threats**, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor is having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.
3. **Advocacy threats,** which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, and e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.
4. **Familiarity threats** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways: (i) close relative of the audit team working in a senior position in the client company, (ii) former partner of the audit firm being a director or senior employee of the client, (iii) long association between specific auditors and their specific client counterparts, and (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees.
5. **Intimidation threats,** which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

(c) Concept of COSO:

COSO's Internal Control – Integrated Framework was introduced in 1992 as guidance on how to establish better controls so companies can achieve their objectives. COSO categorizes entity-level objectives into operations, financial reporting, and compliance. The framework includes more than 20 basic principles representing the fundamental concepts associated with its five components: control environment, risk assessment, control activities, information and communication, and monitoring. Some of the principles include key elements for compliance, such as integrity and ethical values, authorities and responsibilities, policies and procedures, and reporting deficiencies.

Five Components of COSO are as follows:

(i) Control Environment

(ii) Risk Assessment

(iii) Control Activities

(iv) Information and Communication

(v) Monitoring

The COSO Framework is designed to be used by organizations to assess the effectiveness of the system of internal control to achieve objectives as determined by management. **The Framework lists three categories of objectives as below:**

1 **Operations Objectives** – related to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.

2 **Reporting Objectives** – related to internal and external financial and non-financial reporting to stakeholders, which would encompass reliability, timeliness, transparency, or other terms as established by regulators, standard setters, or the entity's policies.

3 **Compliance objectives** – In the Framework, the compliance objective was described as "relating to the entity's compliance with applicable laws and regulations." The Framework considers the increased demands and complexities in laws, regulations, and accounting standards.

Question 6

(a) CA K have been doing audit of branch of LUD Bank Ltd. The principal business of the branch is lending advances to large corporates. Since last one year, many large accounts have become Non-Performing Asset (NPA) as per guidelines. The Management of the Bank decided to sell one of the NPA account and consequently one NPA namely DEF Ltd. amounting to ~ 10.00 Crores was sold to Asset Reconstruction Company. What audit points CA K should keep in mind while doing audit of this transaction? ***(5 Marks)***

(b) CA S has been appointed as peer reviewer of Shivam & Co. LLP. Shivam & Co. LLP submitted a list of its assurance and due diligence services for the peer review. CA S is in the process of deciding as to how many assurance services should be reviewed. Guide CA S in deciding the number of assurance services engagement to be reviewed. ***(5 Marks)***

(c) TNT Limited is engaged in the Life Insurance business. The company's operations have been considerable in the Northern India and its Head Office is also based at New Delhi. TNT Ltd. while preparing financial statements have classified administrative expenses under 14 heads as mentioned in Schedule 3 forming part of financial statements given under schedule A to IRDA Regulations, 2002. What is your responsibility as an auditor particularly in relation to administrative/expenses of management? ***(4 Marks)***

OR

CA AB, a practicing chartered accountant, is a promoter director of ABG Pvt. Ltd. and moreover he is also a sleeping partner in his family business of garments manufacturing firm. Is CA. AB liable for professional misconduct as per Chartered Accountant Act 1949?

(4 Marks)

Answer

(a) CA K conducting audit of branch of LUD Bank Ltd. whose principal business is lending money to large corporates. Many large accounts of this branch have turned NPA category and Management sold DEF Ltd.'s NPA account amounting to ₹ 10 Crores to Asset Reconstruction Company.

CA K should proceed as under:

In case of Sale of NPA by Bank, the auditor should examine

(i) the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers.

(ii) only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.

(iii) the assets have been sold "without recourse' only.

(iv) subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.

(v) the NPA has been sold at cash basis only.

(vi) on the sale of the NPA, the same has been removed from the books of the account.

(vii) the short fall in the net book value has been charged to the profit and loss account.

(viii) where the sale is for a value higher than the NBV, no profit is recognised and the excess provision has not been reversed but retained to meet the shortfall/ loss because sale of other non-performing financial assets.

(b) In the given case, CA S appointed as peer reviewer of Shivam & Co. LLP, is in the process of deciding as to how many assurance services need to be reviewed.

The number of assurance service engagements to be reviewed shall depend upon:

(i) Standard of quality controls generally prevailing;

(ii) The size and nature of assurance service engagements undertaken by the Practice Unit.

(iii) The methodology generally adopted by the Practice Unit in providing assurance services.

(iv) The number of partners / members involved in assurance service engagements in the Practice Unit;

(v) The number of locations / branch offices of the practice Unit;

(vi) The Fees charged / received / service tax paid by the Practice unit.

(c) Operating Expenses related to Insurance Business (Expenses of Management):

(i) Any major expenses (₹ 5 lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately.

(ii) The auditor should ensure that these expenses are first aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis.

(iii) The accounting policy should clearly indicate the basis of apportionment of these expenses to the respective Revenue Accounts (i.e., Participating and Non-participating policies and in between Linked and Non- Linked business) along with the certificate that all expenses of management, wherever incurred, directly or indirectly, read with the accounting policy, have been fully debited to the respective Revenue Account as expenses.

(iv) Any expenses which are not covered under the 14 heads as mentioned in Schedule 3 are required to be disclosed under the head 'Others'.

OR

(c) Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage.

Promoter/Promoter Director - There is no bar for a member to be a promoter / signatory to the Memorandum and Articles of Association of any company. There is also no bar for such a promoter / signatory to be a Director Simplicitor of that company irrespective of whether the object of the company include areas which fall within the scope of the profession of chartered accounts. Therefore, members are not required to obtain specific permission of the Council in such cases.

Sleeping partner in the family business-

Prior Approval - Members of the Institute in practice may engage in the following category, among other points, of business or occupations, after obtaining the specific and prior approval of the Council in case of:

Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken.

In the given case, CA AB is a promoter director of ABG Pvt Ltd and also he is a sleeping partner in his family business of garments manufacturing firm. Applying the above to the given case, it can be concluded that-CA AB:

- As Promoter Director- Not guilty of professional misconduct under Chartered Accountants Act, 1949
- As Sleeping Partner- guilty of professional misconduct under Chartered Accountants Act, 1949 as he did not obtain prior approval of the Council.