

**PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS**

Question No. 1 is compulsory

Answer any **four** out of remaining five

**Question 1**

- (a) *M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020-2021. The Company implemented internal controls for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement? Also discuss certain subject matters or assertions where it is difficult to detect material misstatements due to potential effects of inherent limitations.* **(5 Marks)**
- (b) *ABC Ltd. has been dealing in tyres since 1995. The Company envisaged to expand its business and wanted to manufacture the tyres besides trading. Accordingly, the machinery was imported, installed and manufacturing operations commenced. The Government also gave certain incentives like power subsidy, land acquisition subsidy, etc. After 2 years of operations, Company received a notice from the Income Tax authorities to pay tax on incentive received in the form of power subsidy. The demand notice was served for ₹ 150.00 Lakhs.*
- The Company, however, filed an appeal with higher tax authorities against the demand and the matter is undecided as on 31.03 .2021. Legal team of the Company anticipated that tax liability might mature. The Company has not made a provision of anticipated tax liability. Considering the provisions of Companies Act, 2013, how an auditor of ABC Ltd. should see this matter and report in audit report, if required?* **(5 Marks)**
- (c) *CA R, a Chartered Accountant in practice is specializing in the field of Information Systems Audit. He is considered to be one of the experts of this field because of his command over the subject. HKC Limited, a Company engaged in rendering management consultancy offered him to appoint as its managing director. CA R accepted the position of managing director without obtaining prior permission from the Institute. One of his friends, CA S informed him that now he cannot retain full time certificate of practice, thus cannot do attest function and train articled assistants. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto.* **(4 Marks)**

**Answer****(a) Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations -**

As per SA 200 - "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" and as per SQC 1 because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence.

Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in the light of the overall objectives of the auditor.

In view of above, it can be concluded that auditors did not give correct statement.

In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- (i) Fraud, particularly fraud involving senior management or collusion.
- (ii) The existence and completeness of related party relationships and transactions.
- (iii) The occurrence of non-compliance with laws and regulations.
- (iv) Future events or conditions that may cause an entity to cease to continue as a going concern.

**(b) Audit report - Legal team anticipated tax liability but the company did not make any provision for that -**

The Council of the Institute of Chartered Accountants of India has taken note of the fact that there is a practice prevalent whereby companies do not make provision for tax even when such a liability is anticipated. It has expressed the view that on an overall consideration of the relevant provisions of law, non-provision for tax (where a liability is anticipated) would amount to contravention of the provisions of Sections 128 and 129 of the Companies Act, 2013.

Accordingly, it is necessary for the auditor to qualify his report and such qualification should bring out the manner in which the accounts do not disclose a "true and fair" view of the state of affairs of the company and the profit or loss of the company.

**Applying the above to the facts given in the question, auditor should qualify his report.**

*An example of the manner in which the report on the balance sheet and the Statement of Profit and Loss may be qualified in this respect is given below: "The company has not provided for taxation in respect of its profits and the estimated aggregate amount of taxation not so provided for is ₹ .....including.....for the Year ended on .....To the extent of such non-provision for the year, the profits of the Company for the financial year under report have been overstated and to the extent of such aggregate non-provision, the reserves of the company appearing in the said balance sheet have been over-stated and the current liabilities and provisions appearing in the said balance sheet have been understated".*

**(c) Provisions of the Chartered Accountants Act, 1949 and Schedules thereto -**

As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

The Council decided to allow members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate within the meaning of the Companies Act, 2013 provided that the body corporate is engaged exclusively in rendering Management Consultancy and Other Services permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard. The name of the Management Consultancy Company is required to be approved by the Institute and such Company has to be registered with the Institute.

The members can retain full time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company. There will be no restriction on the quantum of the equity holding of the members, either individually and/ or along with the relatives, in such Company. Such members shall be regarded as being in full- time practice and therefore can continue to do attest function either in individual capacity or in Proprietorship/Partnership firm in which capacity they practice and wherein they are also entitled to train articled/audit assistants.

Thus, the action of CA R is valid.

**Question 2**

- (a) *MN & Associates, Chartered Accountants have been appointed as statutory Auditors of Cotton Ltd. for the F.Y 2020-2021. The Company is into the business of yarn manufacturing. For this purpose, cotton ginning is also done within the factory premises. Raw cotton is purchased from local market and processed in-house. The Company received a notice from the State Government to deposit market development fee for the last 5 years to the tune of ₹10.00 crores. The Company and all other organizations in the*

same business have not deposited the market development fee, taking shelter of an old circular issued by the Government. The trade association met with the government officials to resolve the matter and agreed to deposit the same prospectively. However, the matter relating to payment of development fee for the last 5 years is pending before the Government as at the end of the financial year. The Company, however, disclosed the same in notes to accounts, as contingent liability, without quantifying the effect and proper explanation. If the liability is provided in the books of accounts, entire reserves will be wiped off. Auditor seeks your guidance as to how this disclosure affects them while forming an opinion on financial statements. **(5 Marks)**

- (b) Milk Ltd. is engaged in the business of manufacturing and distribution of various milk products like cheese, curd, paneer, etc. Government made certain changes in rules and regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor, who can fund some part of the proposed expansion. Mr. X is interested in the venture and appoints you to act as an advisor to the proposed investment in the business of Milk Ltd. You have to investigate the audited financial statements and ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking and whether you can put reliance on already audited statement of accounts?

**(5 Marks)**

- (c) M/s RB Ltd. is engaged in the trading of engineering goods. Turnover of the Company for the year ended 31.03.2021 was ₹ 150.00 crores. During the F.Y 2018-2019, the Company claimed deduction of bad debts amounting to ₹ 100.00 lakhs while filing income tax return (Out of total debts of ₹ 150.00 lakhs due from Mr. X). However, during the F.Y 2020-2021, the Company was able to recover ₹ 75.00 lakhs from Mr. X through legal means and correctly credited to its profit and loss account. As a tax auditor, is it required to report such transactions in Tax Audit report under Income Tax Act, 1961? **(4 Marks)**

#### Answer

- (a) **Forming an opinion and reporting on financial statements –**

As per Ind AS 37, "Provisions, Contingent Liabilities and Contingent Assets", an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable.

- (a) an estimate of its financial effect, measured in the standard;
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) the possibility of any reimbursement.

#### **SA – 700 - Forming an opinion and reporting on financial statements:**

The auditor shall evaluate whether in view of the requirements of the applicable financial reporting framework –

- (i) The financial statements adequately disclose the significant accounting policies selected and applied;
- (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (iii) The accounting estimates made by the management are reasonable;
- (iv) The information presented in the financial statements is relevant, reliable, comparable and understandable;
- (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705.

In the present case, auditor may consider modifying his opinion considering the financial effect of liability not disclosed properly.

**(b) Process used for checking and reliance on already audited statement of accounts -**

Following process may be carried out-

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

Whether the investigator can put reliance on the already audited statement of account - If the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have

been carried on very casually or unless his terms of appointment clearly require to test everything afresh.

**(c) Tax audit report under Income Tax Act, 1961 -**

In the given case of RB Ltd, the company had claimed deduction on account of bad debts amounting to Rs 100 Lakhs in the F.Y. 2018-19. However, in F.Y 2020-21 company recovered Rs 75 Lakhs which was correctly credited to its profit and loss account. This amount of Rs 75 Lakhs would be taxed under section 41(4) of the Income Tax Act, 1961.

**Tax Auditor shall report this under clause 25 as under:**

Clause 25: Any amount of profit chargeable to tax under section 41 and computation thereof.

The tax auditor should obtain a list containing all the amounts chargeable under section 41 with the accompanying evidence, correspondence, etc. He should in all relevant cases examine the past records to satisfy himself about the correctness of the information provided by the assessee. The tax auditor has to state the profit chargeable to tax under this section. This information has to be given irrespective of the fact whether the relevant amount has been credited to the profit and loss account or not. The computation of the profit chargeable under this clause is also to be stated.

The tax auditor should maintain the following in his working papers for the purpose of furnishing details required in the format provided in the e-filing utility:

Sr. No.	Name of person	Amount of income	Section	Description of transaction	Computation if any
1	2	3	4	5	6

**Question 3**

- (a) *PQ Limited, a listed entity, headquartered in Mumbai and is having 15 branches all over India. The Company is in the business of buying paddy grown by farmers directly and processing to produce final products for selling in domestic as well as international markets. PQ Limited appointed four firms of Chartered Accountants for audit of its head office and branches. Your firm is one of those firms. It was agreed that your firm will act as Principal auditor. What factors will be considered by you while accepting the position of Principal auditor ?* **(5 Marks)**
- (b) *M/s GH & Associates have been appointed as Central Statutory Auditors of BNB Bank, a nationalized bank, headquartered in New Delhi for the F.Y 2020-2021. Bank functions in automated environment using "FLC Software". While preparing audit report, one of the partner highlighted that some matters covered by Companies Act, 2013 and the requirements of Companies (Auditor's Report), Order, 2016 reporting:*

*You are required to answer the following:*

- (i) *To which authority auditors should submit their audit report?*

- (ii) List the matters covered under Companies Act, 2013 and  
(iii) Reporting under Companies (Auditor's Report), Order, 2016. **(5 Marks)**
- (c) CA. P was appointed GST Auditor of M/s AMR Ltd. for the F.Y 2019-2020. During the course of audit, CA. P found that the Company has wrongly claimed ITC of ₹ 10.00 lakhs on car repair and insurance expenses. Accordingly, the auditor made recommendations in GSTR-9C. Management of the company contended that recommendation of auditor is not binding upon them and they will not deposit the same. Comment. **(4 Marks)**

**Answer****(a) Factors to be considered while accepting the position of Principal auditor -**

SA 600 – Using the work of Another Auditor -

While accepting the position of Principal Auditor, the auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor.

For this purpose, the auditor would consider:

- (a) the materiality of the portion of the financial information which the principal auditor audits;
  - (b) the principal auditor's degree of knowledge regarding the business of the components;
  - (c) the risk of material misstatements in the financial information of the components audited by the other auditor; and
  - (d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.
- (b) (i) Authority to whom Auditors to submit their Audit Report -**
- In the case of a nationalised bank, the auditor is required to make a report to the Central Government.
- So, GH & Associates, Central Statutory Auditors of BNB Bank- a nationalized bank, would be required to submit their report to Central Govt.
- (ii) The auditor of a banking company is also required to state in the report the matters covered by Section 143 of the Companies Act, 2013.**
1. **Report on adequacy and operating effectiveness of Internal Controls** over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.

2. **Report on whether any serious irregularity was noticed in the working** of the bank which requires immediate attention (in accordance with sec 143(12) of the Companies Act, 2013.)
3. **As per reporting requirements cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014** the auditor's report shall also include their views and comments on the following matters, namely:
  - (a) Whether the bank has disclosed the impact, if any, of the pending litigations on its financial position in its financial statements.
  - (b) Whether the bank has made provision, as required under the law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts.
  - (c) Whether there has been any delay in transferring amounts, required to be transferred to the Investor Education and Protection Fund by the bank.

(iii) **Reporting requirements relating to the Companies (Auditor's Report) Order, 2016** are not applicable to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

**(c) Contention of Management that recommendation of GST auditor in GSTR-9C not binding upon them -**

At the outset, it can be inferred from the heading to Part V of FORM GSTR-9C that the auditor has only a recommendatory power, for recommendations given by the auditor may or may not be acceptable to the registered person. If it is acceptable, there are no further questions. But if it is not acceptable, then the question that arises is how can the auditor resolve the issue.

At this juncture, the auditor needs to exercise his professional diligence, skill, legal knowledge and care in determining any additional tax liability which is payable by the registered person. The registered person has the option to accept, reject or partially accept the recommended additional tax liability.

In line with such recommendations, though not explicitly stated anywhere in the relevant Form or GST law—

- (1) the registered person can choose to make the payment of the additional tax liability in full or in part;
- (2) the registered person can even choose to reject the complete recommendations of the auditor and not make the payment at all.

**Question 4**

- (a) *Vineet & Associates have been offered Statutory Audit of TLP Ltd. As a part of ethical requirements of the Institute of Chartered Accountants, CA V, partner of the firm, communicated with the previous auditor enquiring as to whether any professional reason*



*exists for which he should not accept the audit assignment. Previous auditor informed that he issued a qualified report, so management is changing the auditor. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto as to whether Vineet & Associates can accept the audit.* **(4 Marks)**

- (b) *The auditors are required to understand, evaluate and validate the entity level controls as a part of audit engagement, the result of which has an impact on the nature, timing and extent of other audit procedures. In evaluating the effect of such control, existence, effectiveness and assessment of the whistle-blower policy in the company is very important. Specify the procedure you would perform for an understanding and evaluation of such whistle-blower policy.* **(5 Marks)**
- (c) *CA Gudia has been appointed as Management Auditor of XYZ Ltd. The principal reason for her appointment is that current managerial decisions are not up to the mark, especially in relation to investments made by the Company. The Company is going to make huge investments in one of the ventures identified. Management Auditor was required to ensure that systems and procedures of Company are working effectively and meeting the requirements. What aspects should be considered by CA Gudia to determine that the systems and procedures are meeting current requirements?* **(5 Marks)**

#### **Answer**

#### **(a) Provisions of the Chartered Accountants Act, 1949 and Schedules thereto -**

As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

#### **The professional reasons for not accepting an audit would be:**

- (a) Non-compliance of the provisions of Sections 139 and 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The Chartered Accountants Act, 1949; and
- (b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; and
- (c) Issuance of a qualified report.

There is no rule, written or unwritten, which would prevent an auditor from accepting the appointment offered to him under the circumstance of Issuance of qualified report. However, before accepting the audit, he should ascertain the full facts of the case. For nothing will bring the profession to disrepute so much as the knowledge amongst the public that if an auditor is found to be "inconvenient" by the client, he could readily be replaced by another who would not displease the client and this point cannot be too over-emphasised.

From the above it can be concluded that Vineet & Associates may accept the audit of TLP Ltd if CA V is satisfied that the attitude of the retiring auditor was not proper and justified. If, on the other hand, CA V feels that the retiring auditor had qualified the report for good and valid reasons, he should refuse to accept the audit of TLP Ltd.

**(b) Procedure for understanding and evaluation of whistle-blower policy -**

**Auditors are required to understand, evaluate and validate the entity level controls as a part of an audit engagement.** The results of testing entity level controls could have an impact on the nature, timing and extent of other audit procedures including testing of controls. For example, when the entity level controls at a company are effective, the auditor may consider reducing the number of samples in the test of controls and where the auditor finds the entity level controls ineffective, the auditor may consider to increase the rigour of testing by increasing sample sizes. In small and less complex companies, the entity level controls may not formally defined or documented. In such situations, the auditor should design audit procedures accordingly to obtain evidence of the existence and effectiveness of entity level controls.

The following example shows how the auditor performs an understanding and evaluation of the whistle-blower policy in a company:

- (i) Does the company have a whistle-blower policy?
- (ii) Is this policy documented and approved?
- (iii) Has the whistle-blower policy been communicated to all the employees?
- (iv) Are employees aware of this policy and understand its purpose and their obligations?
- (v) Has the company taken measures viz., training, to make the employees understand the contents and purpose of the policy?
- (vi) Does the company monitor effectiveness of the policy from time-to-time?
- (vii) How does the company deal with deviations and non-compliance?

**(c) Aspects to be considered by Management auditor to determine that the systems and procedures are meeting current requirements -**

CA Gudia should proceed as under :

The evaluation of a system or a procedure actually includes three separate considerations. First, is the system or procedure meeting all of the current requirements? Second, is it operating effectively? And third, what is the degree of effectiveness?

**To determine whether the system or procedure is meeting current requirements, the following among other things should be considered:**

1. Is the system or procedure designed to promote the achievement of the company's objectives, and is it accomplished effectively?

2. Does the system or procedure operate within the framework of the organisational structure?
3. Does the system or procedure adequately provide methods of control in order to obtain maximum performance with the least expenditure of time and effort?
4. Do the routines designated in the system or procedures indicate performance in a logical sequence?
5. Does the system or procedure provide the means for effective coordination between one department and another?
6. Have all required functions been established?
7. Has the necessary authority been designated to carry out responsibilities?
8. Can any changes be made to improve effectiveness?

The important thing is to make sure that the system or procedure is designed to meet the desired results.

#### Question 5

- (a) *M/s ALM Ltd. is into the business of trading of toys since 2001. The company was performing well till year 2015 and after that sales started showing downward trend. The Company had borrowed working capital funds from LP Bank Ltd. On 01.08.2020, account of the borrower was classified as NPA. Bank appointed forensic auditor, to identify, if any diversion of funds is there or not. Forensic auditor confirmed the diversion of funds. Matter went to the court of law and company was asked to recast its financial statements for the last 5 years. Management contended that Companies Act, 2013 does not allow recasting for more than three preceding financial years. Do you agree with the views of the management?* **(5 Marks)**
- (b) *HK & Co. Chartered Accountants have been auditors of SAT Ltd (a listed entity) for the last 8 financial years. CA. H, partner of the firm, has been handling the audit assignment very well since the appointment. The audit work of CA. H and her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards and regulatory and legal requirements. CA. K was out of India for some personal reasons, so this year CA. G has been asked to review the audit work. In your opinion, what areas CA. G should consider at the time of review. List any four areas and also comment whether firm is complying with Standard on Quality Control or not.* **(5 Marks)**
- (c) *M/s GSB Limited is into the business of construction for the past 25 years. Management of the Company came to know that building material sent to construction sites are of substandard quality whereas the payment released by the accounts department of the Company are on the higher side. Forensic Auditor was asked to carry out detailed investigation. Forensic auditor completed his investigation and now preparing his report. What are the broad areas of information that needs to be incorporated in the report of forensic auditor?* **(4 Marks)**

**Answer****(a) Recasting of financial statements -**

**Re-opening of accounts on Court's or Tribunal's orders: Section 130 of the Companies Act, 2013** states that a company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board of India (SEBI), any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that—

- (i) the relevant earlier accounts were prepared in a fraudulent manner; or
- (ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

The Order for reopening of accounts not to be made beyond eight financial years immediately preceding the current financial year unless and until Government has, under Section 128(5), issued a direction for keeping books of account longer than 8 years, reopening of accounts can be made for such longer period.

However, a notice shall be given by the Court or Tribunal in this regard and shall take into consideration the representations, if any.

Keeping in view above, the contention of the ALM Ltd that the Companies Act, 2013 does not allow recasting for more than three preceding financial years is incorrect.

**(b) Compliance with Standard on Quality Control on review of audit work -**

As per SQC 1, an engagement quality control review for audits of financial statements of listed entities includes considering the following:

- (i) The work has been performed in accordance with professional standards and regulatory and legal requirements;
- (ii) Significant matters have been raised for further consideration;
- (iii) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- (iv) There is a need to revise the nature, timing and extent of work performed;
- (v) The work performed supports the conclusions reached and is appropriately documented;
- (vi) The evidence obtained is sufficient and appropriate to support the report; and
- (vii) The objectives of the engagement procedures have been achieved.

The firm should establish policies and procedures:

- (i) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and
- (ii) For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with the Code.

The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre-defined period, normally not more than seven years.

From the facts given in the question and from the above stated paras of SQC 1, it can be concluded that firm is not complying with SQC 1 as Engagement Partner H is continuing for more than 7 years.

**(c) Broad areas of information to be incorporated in the report of Forensic auditor -**

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.

**Question 6**

- (a) *One of the objectives of Internal control relating to accounting system is that all transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability of assets. To achieve this objective, certain matters should be ensured by accounting controls. List down matters to be ensured by accounting controls.* **(5 Marks)**

- (b) CA S has been appointed as Statutory Auditor of SRT Ltd. for the financial year 2020-2021. The Company while preparing financial statements for the year under audit prepared one additional profit and loss account that disclosed specific items of expenditure and included the same as an appendix to the financial statements. CA. S has not been able to understand this as the additional profit and loss account is not covered under applicable financial reporting framework. Guide him as to how he should deal with this issue while reporting on the financial statements of SRT Ltd. **(5 Marks)**
- (c) CAB Insurance Company Ltd. was incorporated on 01.07.2020. Company is mainly in the area of health insurance and planning to expand in other fields of general insurance. You have been appointed as Chief Financial Officer (CFO) of the Company. The company has made investment as per guidelines in real estate investment property and Equity Securities and Derivatives. Guide CFO as to how the same should be valued? **(4 Marks)**

OR

M/s. SR & Associates is one of the three firms shortlisted by ARG Cooperative Bank for assignment of Statutory Audit for the F.Y 2020-2021. Bank mailed the list of branches to the audit firms along with the maximum fee per branch and asked them to submit the quotations. SR & Associates responded to the bank and submitted their quotation. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto. **(4 Marks)**

**Answer**

**(a) Matters to be ensured by accounting controls -**

**Basic Accounting Control Objectives:** The basic accounting control objectives which are sought to be achieved by any accounting control system are -

- (i) Transactions are executed in accordance with management's general or specific authorisation;
- (ii) Transactions and other events are real & promptly/timely recorded at correct amounts;
- (iii) Transactions should be classified in appropriate accounts and in the appropriate period to which it relates;
- (iv) Transactions are properly posted.
- (v) Transactions should be recorded in a manner so as to facilitate preparation of financial statements in accordance with applicable accounting standards, other accounting policies and practices and relevant statutory requirements;
- (vi) Transactions are properly disclosed.

- (vii) Recording of transactions should facilitate maintaining accountability for assets;
  - (vii) Assets and records are required to be protected from unauthorized access, use or disposition;
  - (ix) Records of assets, such as sufficient description of the assets (to facilitate identification, its location should also be maintained, so that the assets could be physically verified periodically.
  - (x) Transactions are properly summarized.
- (b) If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.

If supplementary information that is not required by the applicable financial reporting framework is not considered an integral part of the audited financial statements, the auditor shall evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented.

If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.

When an additional profit and loss account that discloses specific items of expenditure is disclosed as a separate schedule, included as an appendix to the financial statements, the auditor may consider this to be supplementary information that can be clearly differentiated from the financial statements.

Thus, additional profit and loss account is not considered an integral part of the audited financial statements and the auditor shall evaluate that supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements.

- (c) **Valuation of Real estate investment property and Valuation of Equity Securities and Derivative Instruments that are traded in markets -**

In case of CAB Insurance Company Ltd dealing in Health Insurance and Planning to expand in other fields of general insurance: Guidance to CFO for Valuation of Real estate investment property and Valuation of Equity Securities and Derivative Instruments that are traded in markets.

**Valuation of Real estate investment property** – The value of investment property shall be determined at historical cost, subject to revaluation at least once in every three years. The change in the carrying cost of the investment property shall be taken to revaluation reserve.

- The insurer shall assess at each balance sheet date whether any impairment of the property has occurred.
- Gains/losses arising due to changes in the carrying amount of real estate shall be taken to equity under 'Revaluation Reserve'. The Profit on sale of investments or loss on sale of investments, as the case maybe shall include any accumulated changes in the carrying amount previously recognized in equity under the heading revaluation reserve in respect of particular property and being recycled to the relevant revenue account or profit and loss account on sale of that property.
- The bases for revaluation shall be disclosed in the notes to accounts. The authority may issue directions specifying the amount to be released from the revaluation reserve for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the authority's direction, no other amount shall be distributed to shareholders out of revaluation reserve account.

An impairment loss shall be recognized as an expense in the revenue/ Profit and loss account immediately, unless the asset is carried at revalued amount. Any impairment loss of a revalued asset shall be treated as a revaluation decrease of that asset and if the impairment loss exceeds the corresponding revaluation reserve, such excess shall be recognized as expense in the Revenue/Profit and loss account.

**Valuation of Equity Securities and Derivative Instruments that are traded in markets-**

Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value on the balance sheet date. For the purpose of calculation of fair value, the lowest of the last quoted closing price at the stock exchanges where the securities are listed shall be taken.

- The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.
- Unrealised gains/losses arising due to changes in the fair value of the listed equity shares and the derivative instruments shall be taken to equity under the head 'Fair value change account'. The profit on sale of investments or loss on sale of investment as the case maybe shall include accumulated changes in the fair value previously recognized under equity under the heading 'Fair value changes account' in respect of a particular security and being recycled to the relevant Revenue account or Profit



and loss account on actual sale of that security.

- The Authority may issue directions specifying the amount to be released from the Fair Value Change Account for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the Authority's prescription, no other amount shall be distributed to shareholders out of Fair Value Change Account. Also, any debit balance in Fair Value Change Account shall be reduced from profit/free reserves while declaring dividends.

The insurer shall assess, on each balance sheet date, whether any impairment has occurred. An impairment loss shall be recognized as an expense in Revenue/Profit and Loss Account to the extent of the difference between the re-measured fair value of the security/investment and its acquisition cost as reduced by any previous impairment loss recognized as expense in Revenue/ Profit and Loss Account. Any reversal of impairment loss earlier recognized in Revenue/Profit and Loss Account shall be recognized in Revenue/Profit and Loss Account.

**Unlisted and other than actively traded Equity Securities and Derivative Instruments** – Unlisted equity securities and derivative instruments and listed equity securities and derivative instruments that are not regularly traded in active markets shall be measured at historical cost. Provision shall be made for diminution value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its' carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost. For the purposes of this regulation, a security shall be considered as being not actively traded, if as per guidelines governing mutual funds laid down from time to time by SEBI, such a security is classified as "thinly traded".

OR

**(c) Provisions of the Chartered Accountants Act, 1949 and Schedules thereto -**

As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he Solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Provided that nothing herein contained shall be construed as preventing or prohibiting -

- (i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or

- (ii) A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.

However, as per the guideline issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services.

However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the given case of ARG Cooperative Bank, Bank mailed the list of branches to the audit firms along with maximum fees per branch, in response to which SR & Associates responded and submitted their quotation.

Keeping in view the facts, clause 6 and guideline issued by the council, it can be concluded that SR & Associates is guilty of Professional misconduct.