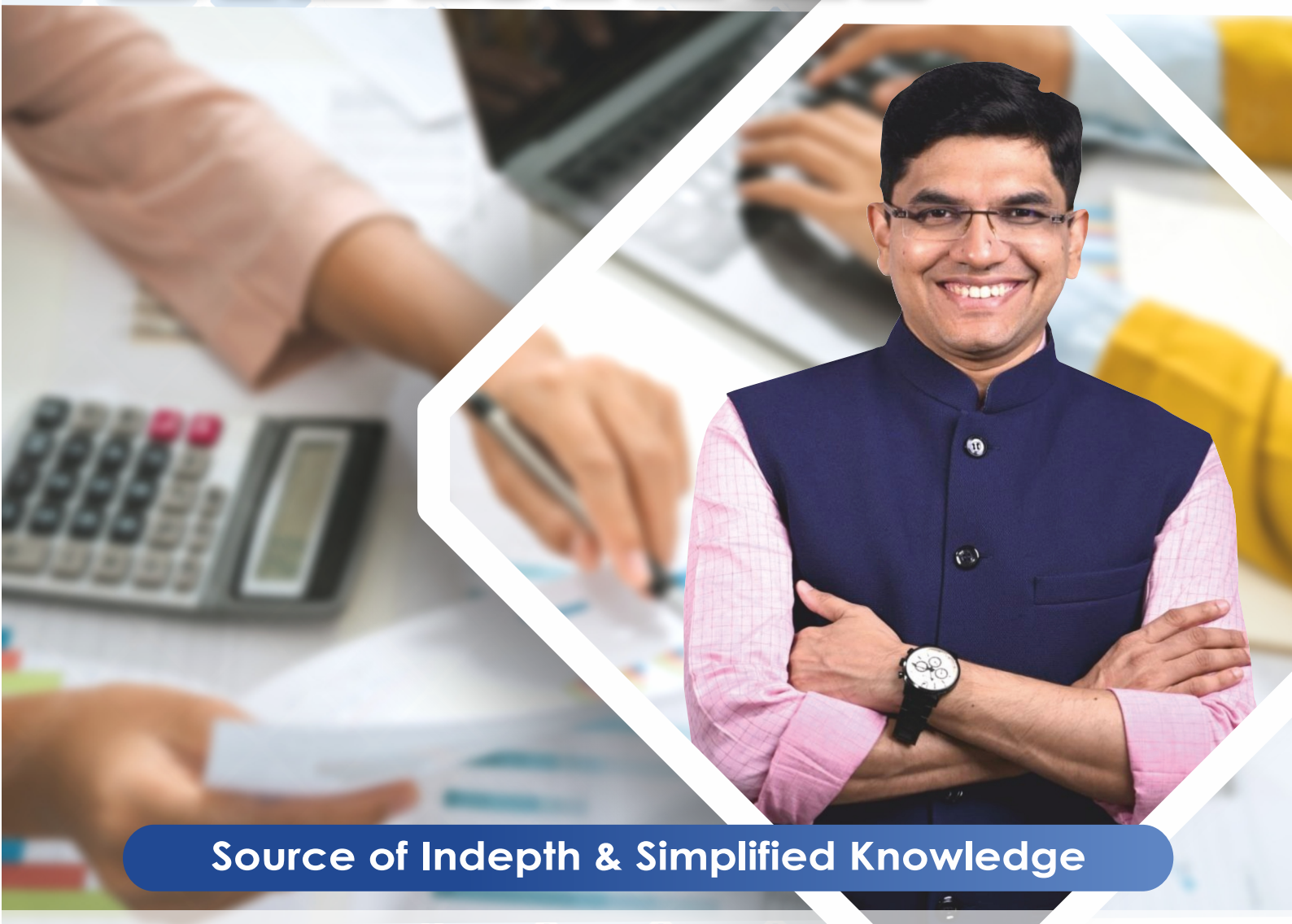
V'Smart Academy

VOLUME 2

CA FINAL AUDIT BHASKAR



Source of Indepth & Simplified Knowledge

- Applicable for Nov23
- Charts and summary to facilitate revision.
- All Questions from "PARAM" Question Bank & MCQ Book are linked with concepts of Bhaskar.

RAVI TAORI

SNEHAL TAORI

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Only for Study related doubts
9096 0000 33

PREFACE

Hello Everyone

We understand that audit is voluminous subject and sometimes it can be tiring to study so we spend lot of time in designing our books and lectures. They are like babies to us. And we are hopeful that they should make your study efforts comfortable, efficient and effective.

Important features:

- ***All amendments Till May 23 from new study material issued by ICAI & statutory updates are incorporated.***
- ***Notes are in tabular form along with corresponding headings and standard indenting so that there is ease to read and remember.***
- ***Cross referencing is given for questions and MCQs with respective books, so that students can practice questions as they cover topics. This is a game changer feature.***
- ***Questions and MCQs which do not have direct connection to any topic in Chapter, SA are given at the end of chapter as unique questions and MCQs.***
- ***Colorful charts, summaries, mnemonics, stories and logical flow of points are given to improve retention.***
- ***Significance of text color:***

Green color is for Examples, Blue is for summary, Pink is for shortcuts

Following are some important points which students should follow.

Study Methodology

1. *Watch videos and understand the concept. It is advised to watch 3-4 hours of lecture every day.*
2. *Equal time or at least half of the time should be given for self study same day. Time requirement will depend upon comfort level in Audit subject. Lectures will be of no use if they are not backed with self study.*
3. *Understanding concept and answering questions are two different things. Understanding is first step, retention is second and then knowing what to write in which question is the final step.*
4. *Use revision audios given on telegram channel (see pinned message) to increase grip over subject.*
5. *It is important for students to do writing practice of 50 to 100 questions from different chapters and standards.*
6. *Keep revising headings of the chapters covered earlier every time you start your study, just headings.*
7. *Ask each and every doubt in discussion point tab given on website www.auditguru.in.*
8. *Revise* ***FADU & PARAM*** *Question Bank multiple times. Use* ***Youtube FADU revision videos.***

Doubt Solving

It is very important to clear each and every doubt of yours. In this world of technology, you can post all your doubts anytime from anywhere. Simply login to Auditguru.in, go to discussion point tab and post all your doubts chapter wise. You can also search and read doubts of other students. I answer doubts continuously on website. You will get an email as your doubt is solved. You can take photos of any content where you have doubt, upload on Google drive and share link in questions or comments, it will make doubt

You can Connect with Ravi sir @ 9096000033, 7020699683 on Whatsapp

I would like to mention my Sincere thanks to **VSMART management. Vishal Bhattad Sir** has always inspired me to become a better professor. **Ujwal Bhattad Sir** has been my Mentor on every aspect of teaching..

I am blessed with best people in my team. They have worked passionately with all enthusiasm.
CA Vaishnavi, CS Rajni, CA Priyanka, Devesh, ACCA Akash, CA Neha, CA Anjanesh, Vaibhav B, Vaibhav R, Kunal, Rahul, Gitanjali.

Lastly but most importantly, we all are thankful to **Snehal Madam** for her contribution in making this book. She is our Fire Fighter, Trouble shooter & my Life Line.

Suggestions

Any suggestions, mistakes, errors or discrepancy noted may be kindly brought to the notice shall be dealt with suitably.

Happy Studying!!!

CA RAVI TAORI

For Administrative or technical queries, please contact @ 09322011915
E-mail @ support @ auditguru.in

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09 AUDIT OF BANK

(CNO--AOB.018) CHARACTERISTICS DISTINGUISHING BANKS FROM MOST OTHER COMMERCIAL ENTERPRISES (What is so special in Banking business?)

Topics

Short-Cut :- L[3]arge BROWN

- Custody of Large volumes of monetary items, including cash and negotiable instruments, whose physical security has to be ensured. This applies to storage and the transfer of monetary items, making banks vulnerable to misappropriation and fraud, necessitating establishment of formal operating procedures, well-defined limits for individual discretion and rigorous systems of internal control.

- Engagement in a Large volume and variety of transactions in terms of number and value which necessarily require complex accounting and internal control systems and widespread use of Information Technology (IT).

- Engagement in transactions that are initiated at one location (Card Swipe at Indore), recorded at a different location (Server at Pune) and managed at yet another location (IT Team at Bangalore & Super Vision Team at Kolkata).

- Operation through a wide network of geographically dispersed Branches and departments necessitating a greater decentralization of authority and dispersal of accounting and control functions, with consequent difficulties in maintaining uniform operating practices and accounting systems, particularly when the branch network transcends national boundaries.

- Regulatory requirements by governmental authorities often influence accounting and auditing practices in the banking sector.

- Assumption of significant commitments without any transfer of funds. These items, called 'off-balance sheet' items, may at times not involve accounting entries and the failure to record such items may be difficult to detect.

- Direct Initiation and completion of transactions by the customer Without any intervention by the bank's employees. For example, over the Internet or mobile or through automatic teller machines (ATMs).

- Integration and linkages of National (RTGS/NEFT/IMPS/UPI have different limits, execution time and charges) and international settlement systems (SWIFT/VISA/Mastercard etc) could pose a systemic risk (Collapse of entire system) to the countries in which they operate (If these systems fails, banks and entire country will get affected).

(CNO--AOB.020) REASONS FOR SPECIAL AUDIT CONSIDERATIONS IN BANK AUDIT (QNO-447.001)
(Why we need different audit strategy and methodology in banks ?)

Reasons

Shortcut: - New DONS in banking.

- the continuing development of New products and services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices. (E.g. Cash Backs, Reward Points with Various Conditions Attached)
- the extensive Dependence on IT to process transactions; (E.g. Credit Cards, Debit Cards, Online Payments)
- the scale of banking Operations and the resultant significant exposures which can arise within short period of time;(E.g. Large number of branches, customers & transactions)
- the particular Nature of risks associated with the transactions undertaken;(E.g. Heavy Cash Balances, Cash Movements, Assets in Lockers, Investments, Impact of Interest Rates)
- the effect of the Statutory and regulatory requirements; (E.g. Capital Adequacy Ratio, NPA Norms etc)

Dependence on IT

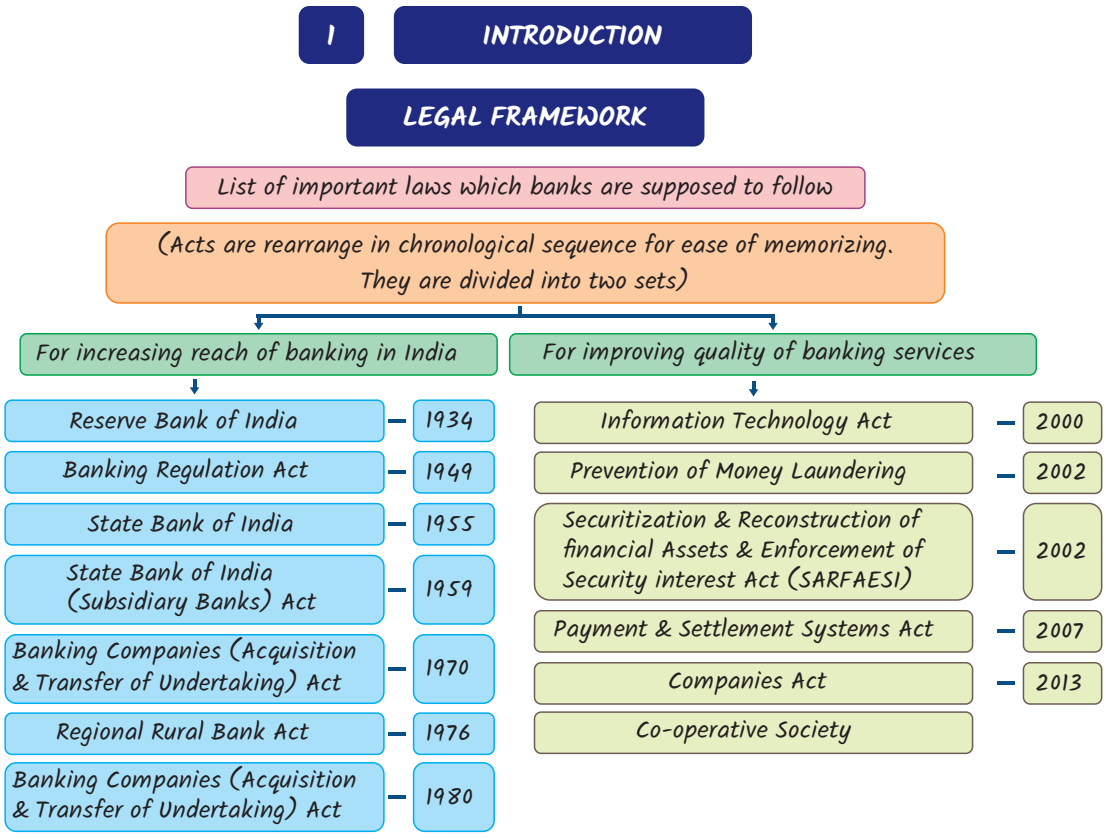
Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk. In today's environment, the banks use different applications to carry out different transactions which may include data flow from one application to other application;(E.g. Customer went on vacation, duplicate sim was issued & bank account robbed)

Effect of above factors

The auditor should consider the effect of the above factors in designing his audit approach. It is imperative for Branch Auditor and SCAs to have detailed knowledge of the products offered and risks associated with them, and appropriately address them in their audit plan to the extent they give rise to the risk of material misstatements in the financial statements

(CNO--AOB.040) LEGAL FRAMEWORK (QNO-447.000)

Chart



There is an elaborate legal framework governing the functioning of banks in India. The principal enactments which govern the functioning of various types of banks are:
(Acts are rearranged in chronological sequence for ease of memorising)

➢ 1934-Reserve Bank of India Act	➢ 2000-Information Technology Act
➢ 1949-Banking Regulation Act	➢ 2002-Prevention of Money Laundering Act
➢ 1955-State Bank of India Act	➢ 2002-Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act
➢ 1959-State Bank of India (Subsidiary Banks) Act	➢ 2005-Credit Information Companies
➢ 1970-Banking Companies (Acquisition and Transfer of Undertakings) Act (14 Banks were Nationalised)	➢ 2007-Payment and Settlement Systems Act, (RTGS, NEFT, ECS etc) RTGS – Real Time Gross Settlement System
➢ 1976-Regional Rural Banks Act	➢ 2013-Companies Act
➢ Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (6 Banks were Nationalised)	

(CNO--AOB.045) FORM AND CONTENT OF FINANCIAL STATEMENTS

Format (Banking Regulation Act)

- Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit. Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account

Companies Act and SEBI Regulation

- Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as specified under section 133 of the Companies Act, 2013, read with Rule 7 of the Companies (Accounts) Rules 2014, in so far as they apply to banking companies or the Accounting Standards issued by the ICAI.
- It may be noted that implementation of Indian Accounting Standards (Ind AS) has been deferred by RBI for all scheduled commercial banks presently.
- Public sector banks and private banks are listed on recognized stock exchange and are required to comply with SEBI regulations including LODR.

Branch Consolidation and Audit

- It is pertinent to state that preparation of balance sheet of a bank usually involves preparation of standalone financial statements and consolidated financial statements.
- Preparation of Standalone financial statements involve consolidation of branch accounts and incorporation of various verticals / departments of bank in case of a nationalized bank/public sector bank. The detailed procedures in this regard may vary from bank to bank.
- In case of private banks, the processes of accounting are centralized and there is no concept of mandatory branch audit in accordance with RBI guidelines.

(CNO--AOB.050) AUDIT OF ACCOUNTS & APPOINTMENT OF AUDITOR

Audit & Auditors

- Sub-section (1) of section 30 of the Banking Regulation Act requires that the balance sheet and profit and loss account of a banking company should be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

- Most banks, especially those in nationalised banks or public sector, appoint four or more (depending upon their size and Board decision, as per RBI guidelines) firms of chartered accountants to act jointly as statutory central auditors (SCAs).

Appointment of Auditor (MCQ - Incs.21.2)

S APPOINTMENT & REMUNERATION OF AUDITOR

Bank	Appointment of Auditor	Remuneration
SBI	C&AG in consultation with CG	RBI in consultation with CG
↓ Subsidiaries of SBI	SBI	RBI in consultation with CG
↓ Nationalized Banks	BOD with prior approval of RBI	RBI in consultation with CG
↓ Other Banking Companies	AGM by shareholder with prior approval of RBI	As per Sec 142 of Companies Act 2013
↓ RRB	Bank with approval of CG	Bank with approval of CG

- Authority appointing the Auditors - As per the provisions of the relevant enactments, the auditor of a banking company is to be appointed at the annual general meeting of the shareholders, whereas the auditor of a nationalised bank is to be appointed by the concerned bank acting through its Board of Directors.

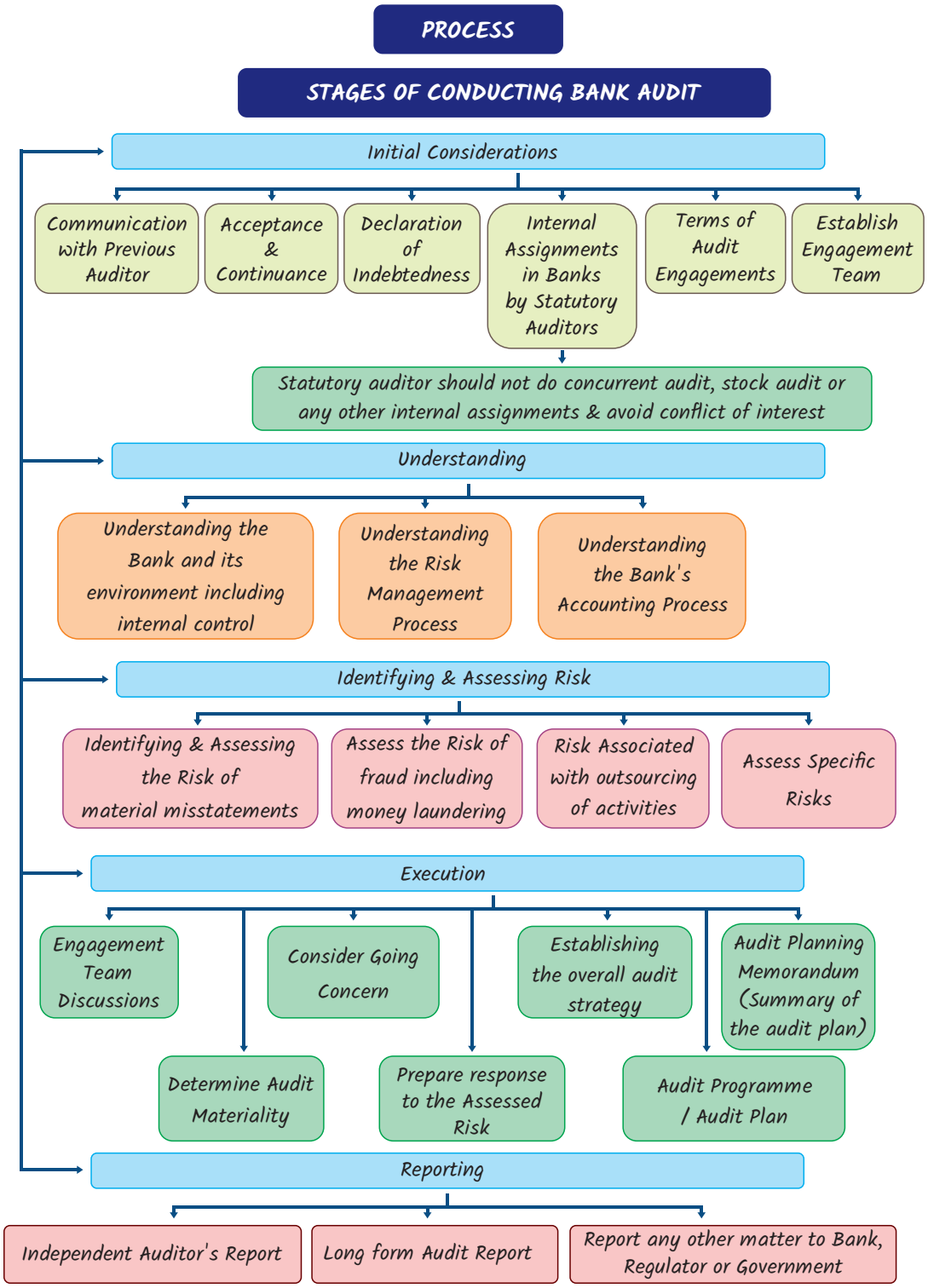
- In either case, approval of the Reserve Bank is required before the appointment is made. The auditors of the State Bank of India are to be appointed by the Comptroller and Auditor General of India in consultation with the Central Government. The auditors of regional rural banks are to be appointed by the concerned bank with the approval of the Central Government.

Appointment Letter

- **The appointment letter sent by banks in connection with the appointment of SCAs typically contains the following:**
  - Particulars of previous auditors.
  - Particulars of other central auditors.
    - A statement of division of work and review and reporting responsibilities amongst joint auditors in case of nationalised banks (Generally this is decided at a later stage)
  - Period of appointment.
  - Procedural requirements to be complied with in accepting the assignment.
    - Confirmation of (firm details) present name, constitution and address of the auditor,
    - Letter of acceptance (the letter usually contains, inter alia, averment (Confirmation) as to absence of disqualification for appointment and way in which the audit has to be conducted
    - Declaration of fidelity (Faithfulness) and secrecy, restriction on accepting other assignments from the bank, etc.
  - Scope of assignment which includes any special reports or certificates to be given by the SCAs in addition to the main report.
- In case of statutory branch auditors (SBAs), appointment letter is given on similar lines except in regard to particulars of other auditors and statement of division of work. However, it is to be noted that statutory branch audit is carried out by a single firm of chartered accountants.

(CNO--AOB.060) STAGES OF CONDUCTING BANK AUDIT

Chart

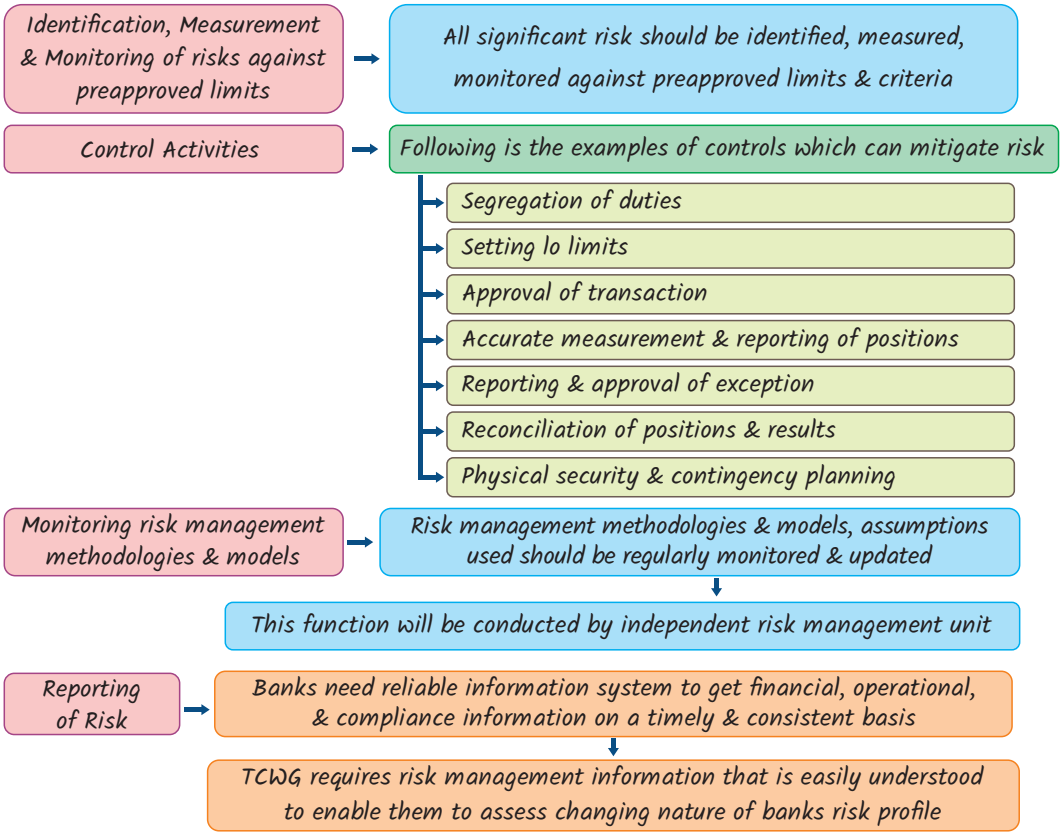


(CNO--AOB.080) RISK MANAGEMENT PROCESS OF BANK (QNO-488.010)

Chart



Continue on next Page...



(CNO--AOB.085) GENERAL INTERNAL CONTROL IN BANKS

Professional Manager

(Characters Of Story)

- The financial powers of officers of different grades should be clearly defined.
- The staff and officers of a bank should be shifted from one position to another frequently and without prior notice.
- The bank should take out insurance policies against loss due to all the risks such as fire, natural calamities, theft and employees' infidelity.
- There should be surprise inspection of head office and branches at periodic interval by the internal audit department. The irregularities pointed out in the inspection reports should be promptly rectified.

Store In charge Employee

(Characters Of Story)

- All bank forms (e.g. Cheque books, demand draft/pay order books, travellers cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery.
- The signature book and the telegraphic code book should be kept with responsible officers and access should be allowed only to authorised officers.

Dedicated Employee

(Characters Of Story)

- The work of one person should always be checked by another person (usually by an officer) in the normal course of business.
- The mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.
- The arithmetical accuracy of the books should be proved independently every day.

(CNO--AOB.90) CASH INTERNAL CONTROL

Discussion

a. Segregation of Duties

The cashier should have no access to the customer's ledger accounts and the Day Book. This is an important safeguard. Bank managements are often tempted to use cashiers because of their shorter working hours as ledger clerks in the absence of regular staff on leave, etc. This can result in substantial losses to the bank.

b. Scrolls
Receipt and payment scrolls or their totals should be compared with the cash column of the Day-Book by independent persons.

c. Signature
The counterfoil cash receipt vouchers (e.g. counterfeits of pay-in-slips lodged by the depositors) should be signed by an officer in Cash Department, in addition to the receiving cashier.

d. Approval
Payments should be made only after the vouchers (e.g. cheques, demand drafts etc.) have been passed for payment by the proper officer and have been entered in the customer's account.

e. Daily Cash
In addition to normal checking by the chief cashier, cash should be test-checked daily and counted in full occasionally by a responsible officer unconnected with the cash department. Actual cash in hand should agree with the balance shown by the Day Book every day.

f. Cash Custody
Cash should be kept in the joint custody of two responsible officers

g. High value cash receipts and payments
High value cash receipts and payments should be verified by a higher officer/ branch manager and the excess cash balance should be remitted to currency chest according to branch's retention limit on daily basis.

(CNO--AOB.95) CLEARINGS

Discussion

- Under the Cheque Truncation System (CTS) implemented by RBI, an electronic image of the cheque is transmitted to the paying branch through the clearing house, along with relevant information like data on the MICR band, date of presentation, presenting bank, etc. This effectively eliminates the associated cost of movement of the physical cheques, reduces the time required for their collection.
- As per RBI guidelines, the branch is required to either call the customer or email him for any cheque received for the amount of ` 5 lakh and above in respect of inward clearings. The Auditor may verify the compliance on test check basis.
- The Auditor is to check whether signature of the drawer of the cheque is being verified by the staff or not as else there will be liability of the paying bank under all circumstances.
- The unpaid cheques received in outward clearing should be either sent to the customers at their recorded address or the customers be informed to collect the same from bank branch.

(CNO--AOB.100) Loans and Advances

Discussion

- The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from the proper authorities of the bank.
- All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
- Sufficient margin should be kept against securities taken to cover any decline in the value thereof and to comply with Reserve Bank directives. Such margins should be determined by the proper authorities of the bank as a general policy or after detailed scrutiny for specific accounts.

- All the securities should be received and returned by responsible officer. They should be kept in the Joint custody of two such officers.
- All securities requiring registration should be registered in the name of the bank or otherwise accompanied by the documents sufficient to give title of the bank.
- All accounts should be kept within both the drawing power and the sanctioned limit as per prescribed norms. Additional temporary limit may be sanctioned, for a maximum of 20% of existing limit and 90 days maximum tenure.
- All the accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.
- The operation (in each advance account) should be reviewed at least once every year.

(CNO--AOB.105) Demand Drafts DRAFTS (QNO-474.000)

Discussion

- The signatures on a demand draft should be checked by an officer with the Signature Book.
- All the D.Ds. sold/ issued by a branch should be immediately confirmed by an advice to the paying branch.
- If the paying branch does not receive proper confirmation of any D.D. from the issuing branch or does not receive credit in its account with that branch, it should take immediate steps to ascertain the reasons.

(CNO--AOB.110) Inter Branch Accounts (QNO - 477.000)

Discussion

- The accounts should be adjusted only on the basis of advices (and not on the strength of entries found in the statement of account) received from other branches,
- Prompt action should be taken preferably by central authority, if any entries (particularly debit entries) are not responded to by any branch within a reasonable time.

(CNO--AOB.115) CREDIT CARD OPERATIONS (QNO-473.000)

Discussion

- ***Storage***

  There should be strict control over storage and issue of cards.
- ***Credit Assessment***

  There should be effective screening of applications with reasonably good credit assessments.
- ***Available Card Limit***

  There should be at system whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- ***Settlement Confirmation***

  There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- ***Reimbursement***

  Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.

- **Charge to Customer**

  All the reimbursement (gross of commission) should be immediately charged to the customer's account.

- **Statements**

  There should be a system to ensure that statements are sent regularly and promptly to the customer.

- **Monitoring**

  There should be a system to monitor and follow-up customers" payments.

  - There should be a system of periodic review of credit card holders" accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.
  - Payments overdue beyond a reasonable period should be identified and attended to carefully. Credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.

PART III – AUDIT OF ASSETS

(CNO--AOB.120) CASH, BANK BALANCES AND MONEY AT CALL AND SHORT NOTICE (Audit Procedures)

Cash

- Carry out the physical verification of cash (including foreign currency, if any, cash at ATM and cash at cash deposit machines) as close to the balance sheet date as possible.
- The cash balance as physically verified should be agreed with the balance shown in the cash register/balance in CBS.

Balance with Reserve Bank of India

- Verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements as at the year-end.
- Review the reconciliation statements, paying special attention to the following items appearing in the reconciliation statements:
  - Cash transactions remaining un-responded;
  - Revenue items requiring adjustments/write-offs; and
  - Other credit and debit entries originated in the statement provided by RBI remaining unresponded for more than 15 days.

Balance with Other Banks (Other than Reserve Bank of India)

- Apart from the procedures described above in examining the balances with Reserve Bank of India, while reviewing the reconciliation statements, the auditor should pay particular attention to the following.
- Examine that no debit for charges or credit for interest is outstanding and all the items which ought to have been taken to revenue for the year have been so taken.
- Examine that no cheque sent or received in clearing is outstanding.
- Examine that all bills or outstation cheques sent for collection and outstanding as on the closing date have been credited subsequently.
- Examine large transactions in inter-bank accounts to ensure that no transactions have been put through for window-dressing particularly towards the close of year

	➢ The balances with banks outside India should also be verified in the manner described above. These balances should be converted into the Indian currency at the exchange rates prevailing on the balance sheet date
(CNO--AOB.125) AUDIT OF INVESTMENTS	**(MCQ-BA.2)**
Review of Investment Policy	➢ Review the investment policy of the bank to ascertain that the policy conforms, in all material respects, to the RBI's guidelines as well as to any statutory provisions applicable to the bank. (E.g. Ist the exposure ceiling limits would be 15 percent of capital funds in case of a single borrower and 40 percent of capital funds in the case of a borrower group. 2nd No banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, of an amount exceeding 30 percent of the paid-up share capital of that company or 30 percent of its own paid-up share capital and reserves, whichever is less, except in case of subsidiaries) ➢ It should clearly outline the broad investment objectives separately for the investments on its own account and investments on behalf of customers.
Separation of Investment Functions (QNO - 447.005)	➢ Check the **segregation of duties** within the bank staff in terms of executing trades, settlement and monitoring of such trades, and accounting of the same (generally termed as front office, middle office and back office functions' segregation). ➢ Examine whether the bank is maintaining **separate accounts** for the investments made by it on their own Investment Account, on PMS clients' account, and on behalf of other constituents (including brokers). ➢ As per the RBI guidelines, banks are required to get their investments under PMS **separately audited by external auditors.**
Examination of Documents	➢ Ascertain whether the investments made by the bank are **within its authority.** (E.g. Check application of legal requirements as discussed in previous point) ➢ Ensure that any other **covenants** or conditions which restrict, qualify or abridge the right of ownership and/or disposal of investments, have been complied with by the bank. (E.g. lock in periods etc) ➢ The acquisition/disposal of investments should be verified with reference to the broker's **contract note, bill of costs,** receipts and other similar evidence.
Earnings from Investments (Module has Incorrectly covered it with valuation)	➢ Examine whether **income from investments** is properly accounted for. This aspect assumes special importance in cases where the bank has opted for receipt of income through the electronic/on line medium. ➢ Verify that there is a proper system for recording and maintenance of TDS certificates received by the bank. ➢ Examine whether the **profit or loss on sale** of investments has been computed properly.
Physical Verification	➢ Verify the investment scrips physically at the close of business on the **date of the balance sheet.** ➢ Verify investments held with public debt office of RBI, custodians and depository with the statement of holdings as on date of balance sheet. Independent balance confirmation requests can be made in accordance with SA-505. In case independent confirmations are not received back, alternative audit procedures like getting bank personnel to download investment statement from E-Kuber for government securities (E-Kuber is CBS platform of RBI) in auditor's presence can be designed. ➢ In respect of **BRs** issued by other banks and on hand with the bank at the year-end, the auditor should

	examine confirmations of counterparty banks about such BRs. Where any BRs have been outstanding for an unduly extended period, the auditor should obtain written explanation from the management for the reasons thereof. The auditor should examine the reconciliation of BRs issued by the bank. BRs should not be issued in respect of transactions in government securities for which SGL facility is available. ➢ If certain securities are **held in the names of nominees,** the auditor should examine whether there are proper transfer deeds signed by the holders and an undertaking from them that they hold the securities on behalf of the bank. (E.g. Temporary investments held by broker, investments in foreign nations, investments in trusts, societies etc.)
Examination of Reconciliation	➢ Examine the reconciliation of the investment account, physically verify the securities on hand, obtain confirmations from counterparty banks for BRs issued by such banks and on hand, obtain confirmation of SGL balances with the PDO, and examine the control and reconciliation of BRs issued by the bank. (E.g. securities allotted but not yet received, in transit etc.),
Examination of Valuation	➢ Examine whether the **method of accounting** followed by the bank in respect of investments, including their year-end valuation, is appropriate. ➢ Verify whether adequate disclosure of any change in method of valuation of investment is made. ➢ Examine whether the investments have been properly **classified into the three categories** at the time of acquisition based on such intention as evidenced by the decision of the competent authority such as Board of directors, ALCO or Investment Committee. ➢ Examine compliance by the bank with the **guidelines of the RBI** relating to valuation of investments. ➢ Verify that investments are classified as non-performing investments (NPI) as per applicable RBI guidelines. (Nonperforming investments are those where interest/principal is in arrears and remains unpaid for more than 90 days). In such cases, banks have not to reckon income on securities and are required to make provisions for depreciation in value of investment.
	➢ Other Special Points
Examination of classification and shifting	➢ Examine that entire investment portfolio of bank is classified under three categories i.e.HTM, HFT and AFS and shifting of securities is as per regulatory norms and laid down policy. ➢ Examine whether the shifting of the investments from 'available for sale' to 'held to maturity' is duly approved by the Board of Directors of the bank.
Dealings in Securities on Behalf of Others	➢ Examine whether prior approvals for carrying out such dealings have been obtained. ➢ Examine whether bank's income from such activities has been recorded and is fairly stated in the bank's financial statements. ➢ Consider whether the bank has any material undisclosed liability from a breach of its fiduciary duties, including the safekeeping of assets.
Special purpose Certificates Relating to Investments	➢ Examine whether the bank is maintaining separate accounts for the investments made by it on their own Investment Account, on PMS clients' account, and on behalf of other constituents (including brokers). ➢ As per the RBI guidelines, banks are required to get their investments under PMS separately audited by external auditors.

Audit, Review and Reporting	➢ Banks should undertake half-yearly reviews (as of 30th September and 31st March) of their investment portfolio. These half yearly reviews should not only cover the operational aspects of the investment portfolio but also clearly indicate amendments made to the investment policy and certify ➢ the adherence to laid down internal investment policy and procedures and RBI guidelines. The internal auditors are required to separately conduct the concurrent audit of treasury transactions and the results of their report should be placed before the CMD once every month. Banks need not forward copies of the internal audit report to RBI. However, major irregularities observed in these reports and position of compliance thereto may be incorporated in the half yearly review of the investment portfolio.

(CNO--AOB.130) INCOME ON INVESTMENTS (QNO-458.020)

Interest on Bonds and Debentures	➢ Banks may book income from Government Securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are predetermined and provided interest is serviced regularly and is not in arrears.
Interest Income Guaranteed by Government	➢ Banks may book income on accrual basis on securities of corporate bodies/ public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.
Dividend Income on shares	➢ Banks may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established
Dividend on mutual funds	➢ Banks may book income from units of mutual funds on cash basis.

(CNO--AOB.135) COMPLIANCE WITH CRR AND SLR REQUIREMENTS (MCQ-

Cash Reserve Ratio (CRR) Requirements

➢ **Meaning**

Cash Reserve Ratio (CRR) is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank.

➢ **Important Determinant**

One of the important determinants of cash balances to be maintained by banking companies and other scheduled banks is the requirement for maintenance of a certain minimum cash reserve.

➢ **Different Acts**

While the requirement for maintenance of cash reserve by banking companies is contained in the Banking Regulation. Act, 1949, corresponding requirement for scheduled banks is contained in the Reserve Bank of India Act, 1934.

➢ **Review& Compliance**

The RBI, from time to time, reviews the evolving liquidity situation and accordingly decides the rate of CRR required to be maintained by scheduled commercial banks. Therefore, the auditor needs to refer the master circular issued from time to time in this regard to ensure the compliance of CRR requirements.

Statutory Liquidity Ratio (SLR) Requirements (QNO-475.000) (MCQ-Incs.09.3/ Incs.09.4 / Incs.19.4 Incs. 57.1 Incs.57.2)

- **Meaning**
  SLR is the requirement that every scheduled commercial bank in India is required to maintain in the form of certain liquid assets such as gold, cash and government approved securities before providing credit to the customers.

- **12 Odd Dates**
  The Reserve Bank of India requires statutory central auditors of banks to verify the compliance with SLR requirements of 12 odd dates in different months of a financial year not being Fridays.

- **Report**
  The resultant report is to be sent to the top management of the bank and to the Reserve Bank. The report of the statutory auditors in relation to compliance with SLR requirements has to cover following two aspects
  - **Correctness of the compilation of DTL (Demand and Time Liabilities) position; and**
  - **Maintenance of liquid assets.**

Audit approach and procedure (QNO-475.000)

(MCQ-BA.12 / Incs.19.5 / Incs.19.6)

- **RBI Requirements**
  Obtain an understanding of the relevant circulars/ instructions (Requirements) of the RBI, particularly regarding **composition of items of DTL.**

- **Role of Branch Auditors**
  Require the **branch auditors to send their weekly trial balance** as on Friday and these are consolidated at the head office. Based on this consolidation, the DTL position is determined for every reporting Friday. The statutory central auditor should request the branch auditors to verify the correctness of the trial balances **relevant to the dates selected by him.** The branch auditors should also be specifically requested to examine the cash balance at the branch on the selected dates.

- **Unaudited Branches**
  Review the relevant **returns received from un-audited branches** to identify any obvious errors or omissions or inconsistencies.

- **Examine Consolidation on Test Basis**
  - Examine whether the consolidations prepared by the bank include the relevant information in respect of **all the branches.**
  - Examine, on a test basis, the consolidations regarding DTL position prepared by the bank with reference to the related **returns** received from branches.
  - The auditor at the central level should apply the audit procedures listed to the overall consolidation prepared for the bank as a whole. Where such procedure is followed, the central auditor should adequately describe the same in the **report.**

- **Exclusions**
  While examining the computation of DTL, specifically examine that the following items have been **excluded from liabilities-**

Shortcut: - RIL ka PM so excluded from liabilities

- Part amounts of Recoveries from the borrowers in respect of debts considered bad and doubtful of recovery.
  (Recovery of Bad Debts is not a liability)

- Amounts received in Indian currency against import bills and held in sundry deposits pending receipts of final rates.
  (Such money is not in nature of returnable deposit)

- Un-adjusted deposits/balances lying in Link branches for agency business like dividend warrants, interest warrants, refund of application money, etc., in respect of shares/debentures to the extent of payment made by other branches but not adjusted by the link branches.
  (Link branch of bank deals with RBI and other Banks, if money is received by such branches but not yet used or adjusted)

- Paid up capital, reserve, any credit balance in profit & loss account of bank, amount of loan taken from RBI and amount of refinance taken from EXIM bank, NHB, SIDBI and NABARD

- Margins held and kept in sundry deposits for funded facilities.
  (Money deposited in bank before giving loan)

- **Inclusions**
  Shortcut: - **N**ew **CBI** order included many items.

  Similarly, specifically examine that the following items have been **included in liabilities**
  - The reconciliation of Nostro accounts (with Nostro Mirror Accounts) needs to be scrutinized carefully to analyze and ascertain if any inwards remittances are received on behalf of the customers / constituents of the bank and have remained unaccounted and / or any other debit (inward) entries have remained unaccounted and are pertaining to any liabilities for the bank.

  - **Net Credit balance in branch adjustment accounts** including those relating to foreign branches.

  - Borrowings from abroad by banks in India needs to be considered as 'liabilities to other' and thus, needs to be considered at gross level unlike 'liabilities towards banking system in India', which are permitted to be netted off against 'assets towards banking system in India'. Thus, the adverse balances in Nostro Mirror Account needs to be considered as 'Liabilities to other'

  - It may be noted that, even though Interest accrues daily, it is recorded in the books only at periodic intervals. Thus, examine whether such interest accrued but not accounted for in books is included in the computation of DTL.

- **Valuation of Securities**
  The auditor should examine whether the valuation of securities done by the bank is in accordance with the guidelines prescribed by the RBI.

- **Reporting**
  - **Unaudited Branches**
    While reporting on compliance with SLR requirements, the auditor should specify the number of unaudited branches and state that he/she has relied on the returns received from the unaudited branches in forming an opinion

  - **Automated Data Flow**
    Recently, there has been introduction of Automated Data Flow (ADF) for CRR & SLR reporting and the auditors should develop necessary audit procedures around this.

ADVANCES

(CNO--AOB.200) AUDIT OF ADVANCES

Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

Audit Procedures -In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

Evaluation of Internal Controls over Advances (QNO-462.000, 465.000)

- Ensure compliance with Loan Policy of Bank as well as prudential norms of RBI including appropriate asset classification and provisioning.
- Examine area of credit appraisal and verify whether laid down procedures regarding credit appraisals including loan applications, preparation of proposals, obtaining satisfaction about credit worthiness of borrowers are being followed;
- Examine advances are sanctioned according to delegated authority;
- Examine the existence, enforceability and valuation of the security;
- Examine all necessary loan documents have been executed after sanction but before disbursals are made to borrowers;
- Ensure compliance with the terms of sanction and end use of funds.
- Examine the validity of the recorded amounts;
- Review operations of the accounts and look for adverse features like unauthorised over drawings beyond limits;
- Examine whether system laid down in bank for review/renewals of advances is being followed;
- Review whether drawing power is being calculated properly on basis of stock/book debt statements received from borrowers as stipulated in respective sanction letters;

Substantive Audit Procedures (QNO-462.000, 464.000, 465.000)

- Verify correctness of master data of loan accounts updated in CBS. Check parameters like instalments, EMI, rate of interest, tenure of loans etc.
- Verify that each customer of bank is tagged under single customer id in respect of all its accounts including those in which credit facilities are granted.
- Examine all large advances while other advances may be examined on a sample basis.
- Examine accounts identified to be problem accounts but which have not yet slipped into NPA category. This can be done by obtaining list of SMA1 and SMA2 borrowers from the bank and same can be considered for selection of problematic accounts.
- Examine those accounts which have been adversely commented upon by concurrent auditors/bank's internal inspection/RBI inspection team.
- Examine list of restructured accounts to ensure that restructure is as per RBI guidelines. Remember restructured account portfolio requires additional provisioning.
- Examine quick/early mortality accounts. Any advance slippage to NPA within 12 months of its sanction is called as quick/early mortality case.
- Verify completeness and accuracy of interest being charged.
- Carry out appropriate analytical procedures.

Recoverability of Advances (QNO-465.000)

- Review ***periodic statements*** submitted by the borrowers indicating the extent of compliance with terms and conditions.
- Review ***latest financial statements*** of borrowers.
- Review auditor's reports in case of borrowers having credit facilities from the banking system beyond a cut-off limit fixed by board of directors of bank
- Review ***reports on inspection of security.***

Presentation

- Verify that the advances are **disclosed, classified and described** in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- The Third Schedule to the Act requires classification of advances made by a bank from three different angles, viz., **nature** of advance, nature and extent of **security,** and **place** of making advance (i.e. whether in India or outside India).

Extract from Financial Statements of HDFC Bank

SCHEDULE 9 - ADVANCES				
A	(i)	Bills purchased and discounted	185,136,903	177,134,003
	(ii)	Cash credits, overdrafts and loans repayable on demand	1,242,774,115	993,671,410
	(iii)	Term loans	3,218,028,571	2,484,144,899
		Total	4,645,939,589	3,654,950,312
B	(i)	Secured by tangible assets*	3,456,703,399	2,735,499,707
	(ii)	Covered by bank / government guarantees	114,128,823	63,453,979
	(iii)	Unsecured	1,073,107,367	855,996,626
		Total	4,645,939,589	3,654,950,312
* Including advances against book debts				
C	I	Advances in India		
	(i)	Priority sector	1,417,909,585	1,061,040,411
	(ii)	Public sector	134,556,082	118,068,442
	(iii)	Banks	4,659,631	51,278
	(iv)	Others	2,767,906,764	2,187,379,246
		Total	4,325,032,062	3,366,537,377
C	II	Advances outside India		
	(i)	Due from banks	6,879,777	16,094,350
	(ii)	Due from others		
		(a) Bills purchased and discounted	1,245,263	1,849,427
		(b) Syndicated loans	38,624,247	14,652,002
		(c) Others	274,158,240	255,817,156
		Total	320,907,527	288,412,935
		Total	4,645,939,589	3,654,950,312
(Advances are net of provisions)				

(CNO--AOB.250) NON-PERFORMING ASSETS

(QNO-447.010, 447.050)
(MCQ- Incs.02.2 / Incs.11.2)

Chart

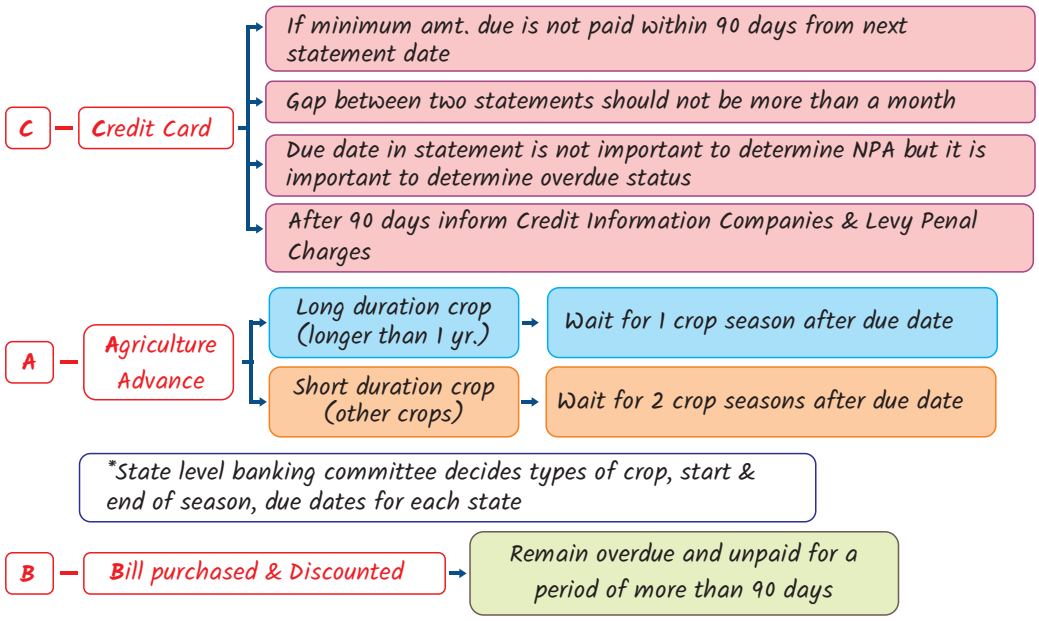
NON-PERFORMING ASSETS

Shortcut – T - C^2AB loan account is **NPA**

- **T** – Term Loan → Amount is overdue more than 90 days
- **C** – Cash Credit & Overdraft → NPA if it is out of order
  - If O/S Amt. > limit for continuously 90 days or more
  - If O/S amt. is within limit
    - No Credits
    - Credits are not sufficient to cover debit of interest

For continuously 90 days or more

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An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

The following criteria are to be applied for determining the status of various types of credit facilities:
Shortcut: - **T-C²ABS** loan account is NPA

(a) **Term Loans:** A term loan is treated as a non-performing asset (NPA) if interest and/or instalment of principal remain **overdue for a period of more than 90 days.**

(b) **Cash Credits and Overdrafts:** A cash credit or overdraft account is treated as NPA **if it remains out of order.**
An account should be treated as 'out of order' **if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.** In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but **there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.**

(c) **Credit Card Accounts:** Credit card account will be treated as non-performing asset **if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between two statements should not be more than a month.** It is further suggested by RBI that banks should follow this uniform method of determining over-due status for credit card accounts while reporting to credit information companies and for the purpose of levying of penal charges, viz., late payment charges, etc., if any.

Statement for HDFC Bank Credit Card		
Statement Date:07/11/2016	Card No: 5522 74XX XXXX 5541	
Payment Due Date	**Total Dues**	**Minimum Amount Due**
27/11/2016	593.16	200.00
Credit Limit	**Available Credit Limit**	**Available Cash Limit**
24,000	23,407	0.00

(d) **Criteria**

- A loan granted for short duration crops will be treated as NPA, if the instalment of

principal or interest thereon remains overdue for two crop seasons and, a loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

- ***Long V/s Short***
  As per the guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers Committee in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him.

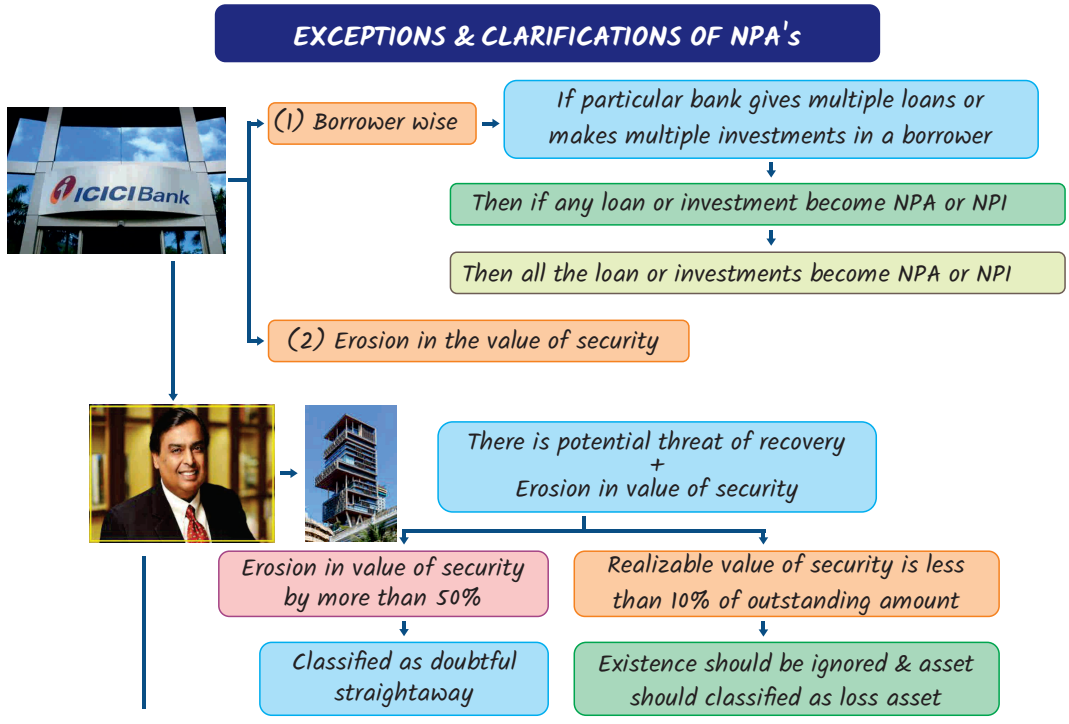
- ***Priority Sector V/s Others***
  The above norms should be made applicable to all direct agricultural advances as listed in the Master Circular on Lending to Priority Sectors. *In respect of all other agricultural loans, identification of NPAs would be done on the same basis as non-agricultural advances, which, At present, is the 90 days delinquency norm.*

- ***Natural Calamities***
  If natural calamities impair the repaying capacity of agricultural borrowers, ***banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines issued by RBI.***

(e) ***Bills Purchased and Discounted:*** *Bills purchased and discounted are treated as NPA if they* ***remain overdue and unpaid for a period of more than 90 days.***

(CNO--AOB.300) EXCEPTIONS & CLARIFICATIONS OF NPAs- (QNO-449.000 / 449.010) (MCQ-BA.8/ Incs.58.2)

Chart



Continue on next Page...



(3) Consortium Finance Two or more banks giving loan together

Biggest bank is the lead bank doing all administrative work & collect money from borrower & distribute it to other bank

Banks in consortium need to see recovery status in their given books of accounts

If it is not serviced in their own books of accounts it will be treated as NPA even if lead bank is getting all the money

Hence participating bank need to arrange their share of recovery from the lead bank or take express consent from the lead bank for transfer of their recovery to ensure proper asset classification



(4) Temporary Deficiency [Documents & procedural part not done]

In case of working capital facility –If stock statement is older than 3 months such accounts is deemed as irregular & if it continue as irregular for continuous period of 90 days it will become NPA

Renewal of regular limits – if not done within 180 days from the due date then it is NPA

Adhoc credit – if it is not renewed / resolved within 180 days from adhoc sanction it will be NPA



(5) Agriculture Advance

Natural Calamities

Banks decide their own measures conversion of short-term loan to long term reschedulement / fresh loans in such case NPA classification governed by reschedule terms

Saviours

(6) Regularisation

When overdue amt. is paid then it is called account is regularised

Such accounts are not considered as NPA

In case there are few credits before balance sheet date auditor should evaluate it carefully

- Money withdrawn subsequently
- Money was paid from new loan of same bank

If it indicate inherent weakness

Then account will be deemed as NPA even if it was regularised

(7) Government Guarantee

If guarantee is given by

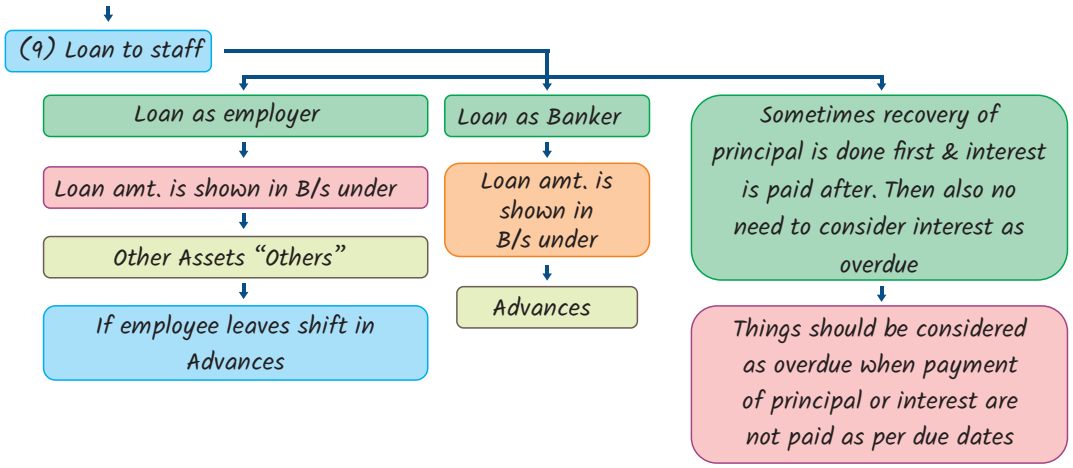
- CG: It will not be considered as NPA unless government repudiate (said no) its guarantee when invoked (ask for money)
- SG: No exemption will be given from NPA

(8) Security (Super 5)

- Term Deposit
- NSC
- KVP
- IVP
- LIP

These will not to treated as NPA if loan is take against them

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Asset Classification to be Borrower-wise not Facilitywise:

Ensure that asset classification is borrower wise and not facility wise. Therefore, it is to be ensured that all the facilities granted by a bank to borrower will have to be treated as NPA and not particular facility which has become irregular. Further, if debits arising out of devolvement of LC or invoked guarantees are kept in separate account, the outstanding balance should be treated as part of borrower's principal account for purpose of application of prudential norms on asset classification, income recognition and provisioning

Erosion in Value of Securities/ Frauds Committed by Borrowers:

In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers, such accounts need not go through the stages of asset classification. In such cases, the asset should be straightaway classified as doubtful or loss asset, as appropriate.

Further,

- Erosion in the value of securities by more than 50% of the value assessed by the bank or accepted by RBI inspection team at the time of last inspection, as the case may be, would be considered as "significant", requiring the asset to be classified as doubtful straightaway and provided for adequately.
- The realisable value of security as assessed by bank/approved valuers /RBI is less than 10% of the outstanding in the borrower accounts, the existence of the security should be ignored, and the asset should be classified as loss asset. In such cases the asset should either be written off or fully provided for.

Advances under Consortium (QNO-451.000)

Consortium advances should be based on the **record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances.** Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

Temporary Deficiencies (QNO-449.050)

In the matter of classification of accounts with temporary deficiencies, banks have to follow the following guidelines:

(a) Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets. Drawing power is required to be arrived at based on current stock statement. **However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months.**

(b) The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular.

(c) A working capital borrowing account will become NPA if such irregular drawings are

	permitted in the account for a continuous period of 90 days even though the unit may be working, or the borrower's financial position is satisfactory. **(d)** *The accounts where regular/ad hoc credit limits have not been reviewed/renewed within 180 days from the due date/date of ad hoc sanction, the account should be treated as NPA.*
Agricultural Advances Affected by Natural Calamities (QNO-450.000)	➢ *Ensure that NPA norms have been applied in accordance with the crop season determined by the State Level Bankers' Committee in each State. Depending upon the duration of crops – short term/ long term - raised by an agriculturist, the NPA norms would also be made applicable to agricultural term loans availed of by them. Also ensure that these norms are made applicable to all direct agricultural advances listed in Master Circular on lending to priority sector.* ➢ *In respect of agricultural loans, other than those specified in the circular, ensure that identification of NPAs has been done on the same basis as non-agricultural advances.*
Regularisation Near About Balance Sheet (MCQ – BA.8)	*As per the Reserve Bank guidelines, if an account has been regularised before the balance sheet date by payment of overdue amount through genuine sources, the account need not be treated as NPA. Where, subsequent to repayment by the borrower (which makes the account regular), the branch has provided further funds to the borrower (including by way of subscription to its debentures or in other accounts of the borrower), the auditor should carefully assess whether the repayment was out of genuine sources or not. Where the account indicates inherent weakness based on the data available, the account should be deemed as NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors about the manner of regularisation of the account to eliminate doubts on their performing status.* *It is to be ensured that the classification is made as per the position as on date and hence classification of all standard accounts be reviewed as on balance sheet date. The date of NPA is significant to determine the classification and hence specific care be taken in this regard. NPA should be recognized only based on concept of Past Due/ Overdue concept, and not based on the Balance Sheet date.*
Government Guaranteed Advances (QNO-458.010)	➢ *If government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked. This exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.* ➢ *In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.*
Advances Against Term Deposits, NSCs, KVPs/ IVPs, etc.	*Advances against Term Deposits, NSCs eligible for surrender, KVP/IVP and life policies need not be treated as NPAs, provided adequate margin is available in the accounts.*
Advances to Staff	*Interest bearing staff advances as a banker should be included as part of advances portfolio of the bank. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head , Others" under the schedule of Other Assets.*

(CNO--AOB.320) INCOME RECOGNITION ON ADVANCES GRANTED (QNO-458.000) (MCQ - Incs.44.1 / Incs.44.2)

Chart

INCOME & EXPENSES

AUDIT OF REVENUE ITEMS

Shortcut – **RATING** Revenue of **PM** & **CM**

R – Reversal of Income

- Reversal of Interest income
  - As soon as account becomes NPA all accrued income related to that particular loan a/c should be either reversed or provided for
  - Income from such a/c's should be booked on realization basis (cash basis)
  - This is applicable even if loan or advance is guaranteed by govt.
- Reversal of other income
  - Fees / Commission or similar income from the borrower whose a/c has become NPA should not be booked on accrual basis. It should be booked on collection basis or realization basis
- Reversal of wrongly recognized income
  - If bank has wrongly recognized any income then it should be reversed in current year or provision of equal amount should be made
- Reversal after communication from borrower
  - Borrower may point out difference or mistake of interest being charged to his accounts & if it is justified then such reversal is done. This will lead to large debits in the accounts.
  - Auditor should check it carefully

A – Allocation of Discount in Bills purchased

- If bill purchased is outstanding at the year end that means part of the discount falls in next year it is called unexpired discount or rebate on bill discounted
  - Such discount should be transferred from discount account to rebate on bill discount a/c.
  - Rebate on bill discount should be shown under the heading of other liabilities
- If Bank rediscounts bills purchased then discount expense on such rediscounting should not be netted off with discount income

T – Test Check

- Interest earned should be checked for sample items
- Fees or Commission on bills for collection, letter of credit, Bank guarantees should be checked on sample basis

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I – Investment related income

- Income on Investment
  - Includes interest on govt bonds, debentures etc & dividend income on shares
  - Exception / Adjustment
    - Dividend from subsidiaries & JVs will be excluded & shown in other Income
    - Broken period interest (accrued interest) on securities should be netted off / adjusted against interest income
    - Premium (difference between purchase price & redemption value) on SLR investment should be amortised & netted off from the interest income
  - Profit on sale on investment → Should be shown as other income
  - Profit / Loss on Revaluation of investments → Banks have to regularly value the investment as per RBI circulars → Shown in other Income

N – NPA effect on different types of loans

- Finance Lease → Finance lease is a type of loan given, installment of lease includes finance income. It is booked as per AS 19
  - In case of NPA all accruals should be reversed & income should be booked on realization basis (cash basis).
- Loan given on basis on super S securities → In case of such loans interest income will be booked to the extent of available margin
  - Ex- Loan 100
  - Value of securities 125
  - Margin 25
  - Interest can be booked upto 25 on accrual basis
- Takeout Finance
  - Meaning- Banks finance infrastructure project, after projects are completed & successfully operational for specified time banks invite financial institution to takeover this loan, so that they free their money for other projects this is called takeout finance.
  - If loan involved in takeover arrangement has become NPA in books of lending bank, then bank should be careful they should book interest income but it should be booked only when interest income is received either from taking over institution or borrower

G – General Points

- Unrecorded income → No income should remain unrecorded
- Recorded income
  - It should belong to bank
  - Recorded at proper amount
  - Allocated to proper period

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R – Restructuring

Fees or commission charged on re-negotiated / re-scheduled loans should not be booked immediately

↓

It should be booked & deferred over the remaining period of the rescheduled / renegotiated loan

P – Partial recovery

- Meaning through example → Installment overdue 10 lakhs
  Principal – 8 Lakhs
  Interest – 2 Lakhs
  Recovery – 1 Lakh
  It is called partial recovery
- Treatment → It should be as per agreement between banks & borrower
- If agreement is silent then bank has right of appropriation but bank should exercise their right in uniform & consistent manner across various loans
- Accounting policies should be as per appropriations done by the bank
- Interest income will not be booked if the funds are out of fresh additional facilities given by the bank to concerned borrower

M – Materiality level

- RBI has given two materiality levels
  - For income booked on gross basis → 1% of TI
  - For income booked on net basis Ex- P/L on sale of investment → 1% of NPBT
- Treatment → Income item which fall below materiality level can be booked on receipt basis. Auditor should not qualify audit report
- Basic principle for income recognition → Further income should be booked on accrual basis only when it is reasonable to accept ultimate collection

C – Bill for Collection

Banks earns commission on collection of bills on behalf of customers. It is a service income it should be booked only when collection is completed & amt. credited to customer account not before that.

M – Memorandum account

- Banks may maintain separate memorandum account outside financial books to keep record of accrued incomes & total amount of loan recoverable from borrowers including interest.
- It is only kept for the purpose of information & other purpose & not for counting purpose
- Amt. shown in balance sheet is net off this accrued interest income

Audit of Revenue Items is ***RATTLING-CM***

- ***Re-Negotiated / Re-Scheduled Loans***

  Fees and commissions earned by the banks as a result of re-negotiations or rescheduling *of outstanding debts should be recognized on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit. Test checks the Interest earned by the banks for sample items.*

- ***Discount Allocation in Bills Purchased***

  In the case of bills purchased outstanding at the close of the year the discount received thereon should be ***properly apportioned between the two years.*** *[The Unexpired discount / rebate on bills discounted i.e., where part of receipt comprising discount charges on bills purchased relate to the period beyond the year-end, should be recorded as "Other Liabilities"].*

  Interest(discount)component paid by Bank/Branch on rediscount of bills from other financial institutions, is not to be netted of from the discount earned on bills discounted.

- ***On Take-out Finance:***

  In the case of take-out finance, if based on record of recovery, the account is classified by the lending bank as NPA, it should not recognize income unless realized from the borrower/taking-over institution (if the arrangement so provides).

- ***Test Check***

  Test check *the Fees and commissions earned by the banks made for commission on Bills for collection; Letters of credit; Bank Guarantees.*

- ***On Leased Assets:***

  The finance charge component of finance income (as defined in AS 19 – Leases) on the leased asset which has accrued and was credited to income account before the asset became non-performing, and remaining unrealized, should be reversed or provided for in the current accounting period.

- ***Income from Investments***

  - ***Interest Income on Investments:*** *This includes all income derived from Government securities, bonds and debentures of corporates and other investments by way of interest and dividend, except income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India. Broken period interest paid on securities purchased and amortization of premium on SLR investments is net of from the interest income on investments.*

  - ***Profit on Sale of Investments:*** *Investments are dealt in the course of banking activity and hence the net profit or loss on sale of investments is taken to profit and loss account.*
  - ***Profit / Loss on Revaluation of Investments:*** *In terms of guidelines issued by RBI, investments are to be valued at periodical intervals and depreciation or appreciation in valuation should be recognized and taken to profit and loss account.*

- ***NPA Related Matters***

  (Reversal of Interest Income for First Time NPAs / Effect on Other Incomes / Ways of Accounting to give Effect of Reversal)

  If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, ***should be reversed or provided for if the same is not realized. This will apply to Government guaranteed accounts also.***

  In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require ***that banks should not recognize income on non-performing assets utilities actually realized.*** *When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year*

which has not been realized should be reversed or provided for. **This will apply to Government guaranteed accounts also.**

Memorandum Account: On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest. However, banks may continue to record such accrued Interest in a Memorandum account in their books for control purposes. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

In respect of NPAs, **fees, commission and similar income** that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have **wrongly recognized income in the past should reverse the interest if it was recognized as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).**

Furthermore, the auditor should enquire if there are any **large debits in the Interest Income account that have not been explained.** It should be enquired is there are any communications from **borrowers pointing out differences in Interest charge, and whether action as justified has been taken in this regard.**

Interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs),Kisan Vikas Patras(KVPs) and Life policies **may be taken to income account on the due date, provided adequate margin is available in the accounts.**

On Partial Recoveries in NPAs:
In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e., towards principal or interest due), banks are **required to exercise the right of appropriation of recoveries in a uniform and consistent manner and adopt an accounting policy as per appropriations.** The appropriate policy to be followed is to recognize income as per AS 9 when certainty attaches to realization and accordingly amount reversed/derecognized (earlier) or not recognized (after NPA) in the past should be accounted.

Interest partly/fully realized in NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant accounts are **not out of fresh / additional credit facilities sanctioned to the borrowers concerned.**

- **General Points – No Unrecorded Income / Recorded in Proper Amount / Allocated to Proper Period / Only Current Period Transactions**
  In carrying out an audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place **during the relevant period and pertain to the bank, that there is no unrecorded income, and that income is recorded in proper amounts and is allocated to the proper period.**

- **Bills for Collection – Recovery Basis**
  In the case of bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected. **The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc.** This procedure is inconsonance with the nature of obligations of the bank in respect of bills for collection. The commission of the branch becomes due only when the bill has been collected.

- **Materiality for Accrual Basis / Ultimate Collection**
  RBI has advised that in respect of any income which **exceeds one percent of the total income of the**

bank if the income is reckoned on a gross basis or one percent of the net profit before taxes if the income is reckoned net of costs, should be considered on accrual as perAS-9.

If any item of income is not considered to be material as per the above norms, it may be ***recognized when received and the auditors need not qualify the statements*** *in that situation.*

Banks recognize income (such as interest, fees and commission) on accrual basis, i.e., as it is earned. ***It is an essential condition for accrual of income that it should not be unreasonable to expect its ultimate collection.*** *In modern day banking, the entries for interest income on advances are automatically generated through a batch process in the CBSsystem.*

SOLUTION FOR NPAs

(CNO--AOB.330) Restructured Advances

Discussion

- *Restructuring is an act in which a lender, for economic or legal reasons relating to borrower's financial difficulty, grants concessions to the borrower. It may involve modification of terms of advances including alteration of amount of instalments/alteration of repayment period/rate of interest/sanction of additional credit facilities etc. to help in curing of default.*

RBI Guidelines

- *RBI has given revised guidelines for treatment of restructured accounts by its circular. The auditor should verify compliance with the requirements of the circular issued in this regard.*

Types of A/Cs & implication

- *Banks may restructure the accounts classified under standard, substandard or doubtful categories. Banks cannot restructure accounts with retrospective effect. Once the bank receives an application/proposal in respect of an account for restructuring, it implies that the account is intrinsically weak. Accordingly, during the time the account remains pending for restructuring, the auditors need to take a view whether provision needs to be made in respect of such accounts, pending approval for restructuring.*

Downgrade

- *On restructuring, the account will be downgraded from Standard to substandard. NPAs will remain in the same category.*

(CNO--AOB.340) CORPORATE DEBT RESTRUCTURING

Audit Procedure for Accounts falling under CDR (Corporate Debt Restructuring) Programme.
Following audit procedures are to be carried out to assess / gain an understanding about the borrower account-

- ***Eligibility***
  Auditor should ensure that accounts wherein recovery suits have been filed, the initiative to resolve under CDR system is taken by at least by 75% of the creditors by value and 60% in number provided the account meets the ***basic criteria*** *for becoming eligible under CDR mechanism.*

- ***Ineligible***
  Auditor should also ascertain whether account has been referred to NCLT, as such cases are not eligible for restructuring under CDR system. Large value NCLT cases may be eligible for restructuring under CDR if specifically recommended by CDR core group. Auditor should verify the necessary approvals / recommendations by CDR core group if auditor comes across any NCLT cases.

- ***Terms of Rehabilitation***
  Auditor should ascertain the ***terms of rehabilitation*** *along with the sacrifices, if any, assumed in the rehabilitation program to verify whether such sacrifices have been accounted in the books of accounts of the lender bank. Ascertain whether any additional financing / conversion of loan into equity have been envisaged in the rehabilitation / restructuring program.*

- **DCA &ICA**

  Review the **Debtor- Creditor Agreement (DCA) and Inter Creditor Agreement (ICA)** with respect to availability of such agreements and necessary provisions in the agreement for reference to CDR cell in case of necessity, penal clauses, stand-still clause, to abide by the various elements of CDR system etc., (DCA may be entered at the time of original sanction of loan or at the time of reference to CDR).

Classification of the account

Review the present **classification of the account** under IRAC norms adopted by the bank and corresponding provision made in the books of accounts, if any. If the account is already treated as NPA in the books of the bank, the same cannot be upgraded only because of the CDR package.

(CNO--AOB.360) SALE/ PURCHASE OF NPAS (QNO-455.000) (MCQ – BA.10 / Incs.44.3)

In case of a sale/ purchase of NPAs by the bank, the auditor should examine the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers, including non performing financial assets that may be purchased/sold, norms or such purchase/sale, valuation procedure and accounting policy.

- **Sale**

  In case of sale of an NPA, the auditor should also ensure that:
  - only such NPA has been sold which has remained NPA in the books of the bank for **at least 2 years.**
  - the NPA has been sold at **cash basis only,** Under no circumstances, NPA can be sold to another bank at a contingent price. The entire sale consideration has to be received on upfront basis.
  - the assets have been sold/ purchased **"without recourse"** only, i.e the entire credit risk associated with the non-performing asset should be transferred to the purchasing bank.
  - 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.
  - on the sale of the NPA, the same has been **removed from the books** of the account.
  - If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the **short fall in the net book value** has been charged to the profit and loss account.
  - 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 on account of sale of other non-performing financial assets.
- **Purchase**

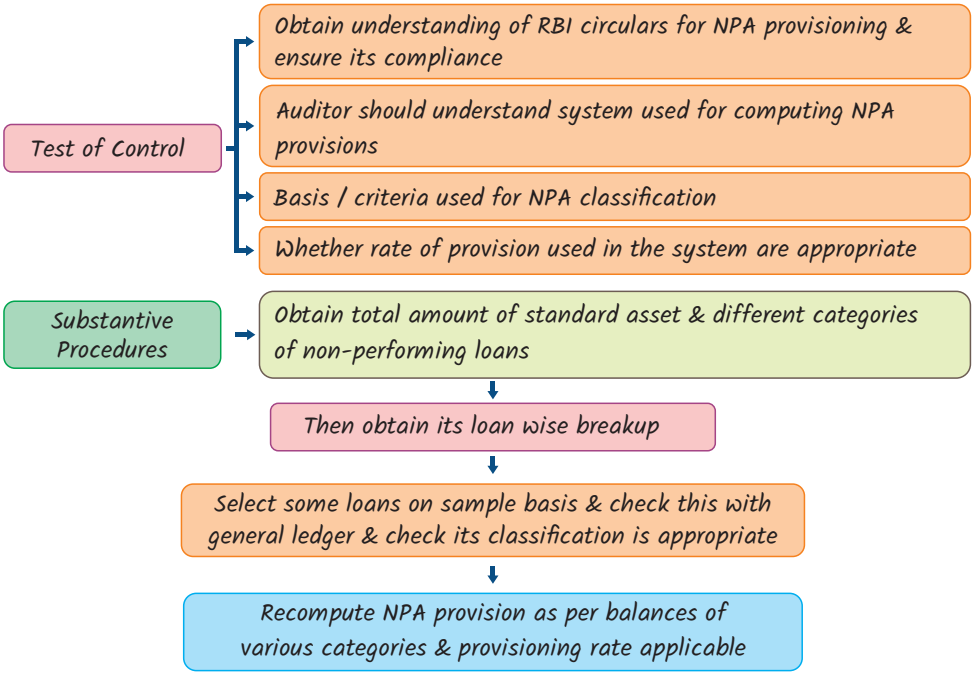
  Similarly, in case of purchase of NPAs, the auditor should verify that:
  - the bank has not purchased an NPA which it had **originally sold**
  - the NPA purchased has been subjected to the **provisioning requirements** appropriate to the classification status in the books of the purchasing bank.
  - any **recovery** in respect of an NPA purchased from other banks is first adjusted against its acquisition cost and only the recovered amount in excess of the acquisition cost has been recognised as profit.
  - for the purpose of capital adequacy, banks have assigned **100% risk weights** to the NPAs purchased from other banks.

(CNO--AOB.365) Upgradation of Account

Discussion

- Examine all the accounts upgraded from NPA to standard category during the year, to ensure that the upgrading of each account is strictly in terms of RBI guidelines. There can be a possibility of incorrect upgradation of account on the basis of partial recoveries made in the account and overdue portion might not have wiped out completely. There can also be a possibility of recoveries being made in the account after cut-off date and account being upgraded as on date of balance sheet.

(CNO--AOB.370) Audit of Classification and Provision for NPA



Discussion

- Verify whether bank has a system of ongoing identification and classification of advances through CBS without manual intervention and its accuracy in crystallising date of NPA.
- Examine whether the classification made by the branch is appropriate. Particularly, examine the classification of advances where there are threats to recovery.
- Examine whether the secured and the unsecured portions of advances have been segregated correctly and provisions have been calculated properly.
- Review and compare the date of NPA of loan accounts mentioned in current year statements with that of previous year. Reasons for any change should be ascertained.

Provisioning Towards Standard Assets

- The auditor should check the latest RBI Circulars in this regard. It is be understood that provision for standard assets is also required to be made at variable rates in respect of different sectors for the funded outstanding in accordance with RBI norms as a matter of prudence. The provisions need to be checked in detail with the statement of advances. The bifurcation of standard advances under relevant category for proper calculation of provision should be checked and certified at branches level. The definition of respective items specified should be adhered as defined by RBI

(CNO--AOB.380) DRAWING POWER CALCULATION (QNO-470.100) (MCQ-BA.9)

Discussion

Ensure that the drawing power is calculated as per the extant guidelines (i.e. the Credit Policy of the Bank) formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors reflected from respective sanction letters

Special consideration should be given to proper reporting of sundry creditors and stocks covered under LCs/guarantees for the purposes of calculating drawing power. It is to be ensured that declared stocks shall not cover borrower's liability outstanding in form of sundry creditors for goods or covered by LCs/guarantees availed for procurement of material. Similarly, in case bank has provided credit facility against primary security of book debts, net value of debtors (i.e. eligible trade debtors as per terms of sanction less bills discounted with banks) is to be arrived at. It is to be ensured that drawing power is calculated net of stipulated margin. Further, in case of consortium accounts, drawing power calculation and allocation made by lead bank is binding on member banks.

The drawing power needs to be calculated carefully in case of working capital advances to companies engaged in construction business. The valuation of work in progress should be ensured in consistent and proper manner. It also needs to be ensured that mobilization advance being received by the contractors is reduced while calculating drawing power.

The stock audit including audit of book debts should be carried out by the bank for all accounts having funded exposure of more than stipulated limit. The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.

(CNO--AOB.440) PRESENTATION OF ADVANCES (QNO -459.000)

Presentation

- From the view point of security, advances are to be classified in the balance sheet in the following manner:
  - Secured by tangible assets
  - Covered by bank/government guarantees
  - Unsecured

B	(i)	Secured by tangible assets*	2,735,499,707
	(ii)	Covered by bank / government guarantees	63,453,979
	(iii)	Unsecured	855,996,626
		Total	3,654,950,312

- An advance should be treated as secured to the extent of the value of the security on the balance sheet date. If only a part of the advance is covered by the value of the security as at the date of the balance sheet, that part only should be classified as secured; the remaining amount should be
- classified as unsecured. As mentioned earlier, the Reserve Bank has specified that advances against book debts may be included under the head "secured by tangible assets".

- The following points are relevant for classifying the advances based on security.

  - ***Security Meaning***
    "Security" means tangible security properly discharged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters, etc.

  - ***Primary Vs Collateral Security***
    While classifying the advances as secured, the primary security (if loan is given to buy house, then house is primary security) should be applied first and for the residual balance, if any, the value of collateral security should be taken into account. If the advance is still not fully covered, then, to the extent of bank/government guarantees available, the advance should be classified as , covered by bank/government guarantee". The balance, if any, remaining after the above classification, should be classified as , unsecured".

  - ***Margin requirement breached***
    An account which is fully secured but the margin in which is lower than that stipulated by the bank should nevertheless be treated as fully secured for the purposes of balance sheet presentation.

  - ***Government Guarantee***
    Government guarantees include guarantees of Central/State Governments and also advances guaranteed by Central/State Government owned corporations and financial institutions like IDBI, IFCI, ICICI, State Financial Corporations, State Industrial Development Corporations, ECGC, DICGC, etc.

- **Bank Guarantee**
  Advances covered by bank guarantees also include advances guaranteed against any negotiable instrument (say bill of exchange drawn on bank or DD issued by bank), the payment of which is guaranteed by a bank.

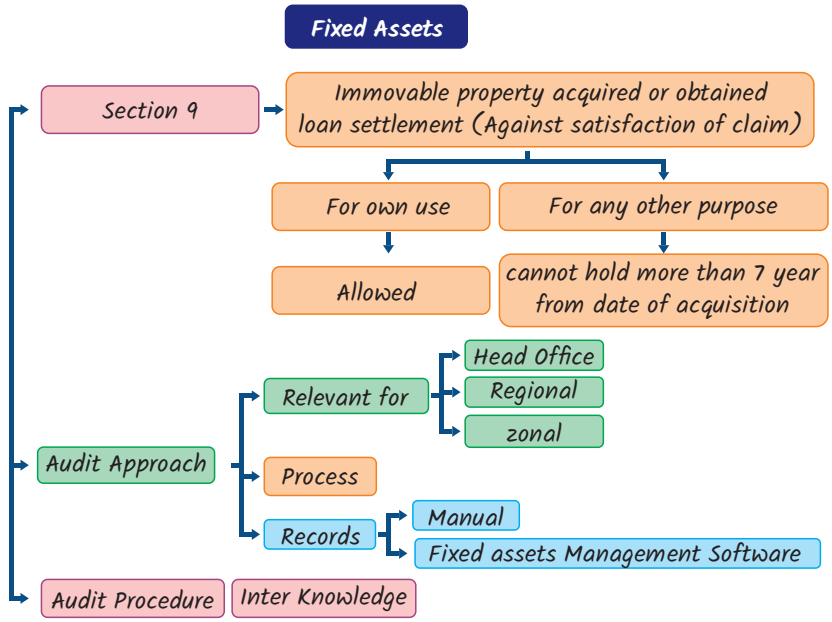
- **Amount Exceeding Guarantee**
  Advances covered by bank/government guarantees should be included in unsecured advances to the extent the outstanding in these advances exceed the amount of related guarantees.

- **ECGC / DICGC Guarantee**
  Advances covered by ECGC/DICGC guarantees should be treated as covered by guarantees to the extent of guarantee cover available. The amount already received from DICGC/ECGC and kept in sundry creditors account pending adjustment should be deducted from advances.

- **Supply Bills**
  Advances against supply bills, unless collaterally secured, should be classified as unsecured even if they have been accepted by the drawees.

- **Self-Cheques**
  Cheques purchased including self-cheques (i.e., where the drawer and payee are one and the same) should be treated as unsecured.

(CNO--AOB.450) FIXED ASSETS



Discussion

- Section 9 of the Banking Regulation Act, 1949, prohibits a banking company from holding any immovable property, howsoever acquired (i.e., whether acquired by way of satisfaction of claims or otherwise), for a period exceeding seven years from the date of acquisition, except such as is required for its own use.
- **Audit Approach :** In most of the banks, fixed assets are generally purchased by the head office or regional/zonal offices. Statutory branch auditor has to ascertain the procedure followed and plan accordingly. In most of the banks, maintenance of records is centralized at head office level. In some of the banks, information relating to purchase, sale of fixed assets is accounted for with help of Fixed asset management software. The audit procedures have to be designed accordingly
- **Audit Procedures**
  Fixed assets are not major part of bank's balance sheet, so we have not covered it's audit procedure given in ICAI module, if question comes by chance, then write answer as per CA Inter knowledge.

(CNO--AOB.460) OTHER ASSETS

Inter-Office Adjustments	➢ Examine whether Inter-branch accounts are normally reconciled at the central level. The auditor should report on the year-end status of inter-branch accounts indicating the dates up to which all or any segments of the accounts have been reconciled. The auditor should also indicate the number and amount of outstanding entries in the inter branch accounts, giving the relevant information separately for debit and credit entries. The auditor should ensure that any discrepancies found in inter-branch accounts have been properly dealt with in the books. The auditor can obtain the relevant information primarily from branch audit reports.
Tax Paid in Advance/Tax Deducted at Source	➢ Ensure that the certificates for such tax deducted at source is collected by the branch and the original copy is sent to the Head Office along with the transfer of such Tax Deducted at Source (TDS) amount to Head Office on periodic basis as defined. ➢ TDS Certificates / credits in the form 26AS, and claim of the same in Income Tax returns filed should be checked to ensure the justification of the claim towards such certificates. ➢ At Head Office level, the availability of all the TDS Certificates / credits in the form 26 AS, and claim of the same in Income Tax returns filed should be checked to ensure the justification of the claim towards such certificates.
Stationery and Stamps	➢ Ensure that the item "Stationery and Stamps" includes only exceptional items of expenditure on stationery like bulk purchase of security paper which is to be written off over a period of time. Such items should be valued at cost. Normal expenditure on stationery is charged to profit & loss account. Therefore, this item may not appear at branch level as considerable part of stationery is supplied to branches by head office. ➢ Evaluate the existence, effectiveness and continuity of internal controls over these items in the normal course of audit. It may be noted that the branch auditor is required to specifically comment on the adequacy of the relevant internal controls in the LFAR. ➢ Physically verify the stationery and stamps on hand as at the year-end, especially stationery of security items. Any shortage should be inquired into as it could expose the bank to a potential loss from misuse. ➢ Examine whether the cost of stationery and stamps consumed during the year has been properly charged to the profit and loss account for the year in the context of the accounting policy/instructions from the head office regarding treatment of cost of stationery and stamps.
Non-Banking Assets Acquired in Satisfaction of Claims	➢ Ensure that the heading includes those immovable properties/tangible assets which the bank has acquired in satisfaction of debts due or its other claims and these are being held with intention of being disposed off. ➢ Verify such assets with reference to the relevant documentary evidence, e.g., terms of settlement with the party, order of the Court or the award of arbitration, etc. ➢ Check that the ownership of the property is legally vested with the bank. If there is any dispute or other claim about the property, the auditor should examine whether the recording of the asset is appropriate or not. In case the dispute arises subsequently, the auditor should examine whether a provision for liability or disclosure of a contingent liability is appropriate, keeping in view the requirements of AS 29 "Provisions, Contingent Liabilities and Contingent Assets". ➢ Ensure compliance with Section 9 of Banking Regulation Act, on holding period of such assets. ➢ Ensure that as at date of acquisition, the assets should be recorded at lower of net book value of advance or net realisable value of asset acquired.

(CNO--AOB.470) OTHERS	(MCQ – BA.II)
Non-Interest Bearing Staff Advances	➢ Examine non-interest-bearing staff advances with reference to the relevant documentation and the policy in this regard which is framed by the bank. The availability, enforceability and valuation of security, if any, should also be examined. ➢ Ensure that the same relates to employees on the rolls of the bank on the date of the preparation of financial statements.
Miscellaneous Debit Balances on Government Account	➢ Review the **ageing statements** pertaining to these items. ➢ Examine the **recoverability** of old outstanding items. ➢ Examine whether **claims for reimbursement** have been lodged by the branch in accordance with the relevant terms and conditions. ➢ The net balances of the amount recoverable at the Head Office level should also be taken along with the age-wise analysis of the same. In case of old outstanding balances without any confirmation or proper justification of the same, should be **provided for in the accounts.** ➢ For **major variance** as compared to the previous year figures, verify whether reasons for the same have been recorded and reviewed. (Payments on behalf of government under various ⟶ schemes Only some designated branches⟶ Claim for reimbursements have been lodged ⟶ Old outstanding / aging analysis⟶ Confirmations / Justifications ⟶ If not make provisions)
Suspense Account	➢ Obtain from the management details of old outstanding entries in suspense account along with reasons for delay in adjusting the entries. Where the outstanding balances comprised in suspense account require a provision/write-off, the auditor should examine whether the necessary provision has been made/write-off
Security Deposits	➢ Examine security deposits with various authorities (e.g., on account of telephone, electricity, etc.,) and with others (e.g., deposits in respect of premises taken on rent) with reference to documents containing relevant terms and conditions, and receipts obtained from the parties concerned. ➢ Ensure that the deposit amount has not become due as per the terms and conditions. If it is so, then the recoverability of the same needs to be considered in detail and appropriate provision be made against the amount which is doubtful to recover

(CNO--AOB.475) CAPITAL

CRAR & Components of Capital

- **Capital Risk Adequacy Ratio (CRAR)**
  - The CRAR is computed as follows:
    $$\frac{\text{Eligible total capital funds}}{\text{risk weighted assets and off-balance sheet items}} \times 100$$
  - The RBI requires banks to maintain a minimum CRAR of 9 per cent on an ongoing basis. The Master Circular on Capital Adequacy contains detailed guidelines on calculation of risk weighted assets and off-balance sheet items for CRAR.
  - Eg. For secured housing loans upto Rs 75 lakh, the risk weight, subject to some conditions is 50%.for those above Rs 75 lakhs, it is 75%, for loans to commercial real estate , it is 100%.Thus for a housing loan of Rs 60 lakh given by the bank, the risk weighted asset will be taken at 60 x 50% = Rs 30 lakhs for the purpose of the denominator in the above formula.
- **Components of Capital:**
  - The Master Circular on Capital Adequacy discusses the Capital Funds in two categories – capital funds for Indian banks and capital funds of foreign banks operating in India. In case of foreign banks operating in India, RBI's Master Circular on Capital Adequacy also lays down certain additional provisions in respect of capital to be followed by such banks.
  - Capital is divided into tiers according to the characteristics/qualities of each qualifying instrument. For supervisory purposes capital is split into two categories: Tier I and Tier II, representing different instruments' quality as capital
    - Tier I capital consists mainly of share capital and disclosed reserves and it is a bank's highest quality capital because it is fully available to cover losses.
    - Tier II capital consists of certain reserves and certain types of subordinated debt. The loss absorption capacity of Tier II capital is lower than that of Tier I capital.

BASEL III framework

- Basel III norms relate to the Capital Adequacy requirement compliance which the Bank has to achieve as contained in the BASEL III accord. Basel capital adequacy norms are meant for the protection of depositors and shareholders by prescriptive rules for measuring capital adequacy, thereby evolving methods of determining regulatory capital and ensuring efficient use of capital.
- Basel III accord strengthens the regulation, supervision and risk management of the banking sector. It is global regulatory standard on capital adequacy of banks, stress testing as well as market liquidity risk.
- **The Basel III accord, aims at:**
  (a) improving the banking sector's ability to absorb shocks arising from financial and economic stress, irrespective of reasons thereof;
  (b) improving risk management and governance practices; and
  (c) strengthening banks' transparency and disclosure standards.

Stress Testing

RBI has required that all commercial banks (excluding RRBs and LABs) shall put in place a Board approved 'Stress Testing framework' to suit their individual requirements which would integrate into their risk management systems. Stress tests are designed to understand whether a bank has enough capital to survive plausible adverse economic conditions and to maintain enough buffer to stay afloat under extreme scenarios.

(CNO--AOB.478) DEPOSITS (QNO-470.200)(MCQ – BA.13, Incs.19.2 / Incs.21.3)

Current and Saving accounts

- Verify on a sample basis current account and saving accounts opened during the year for adherence to KYC norms. Verify that saving accounts are opened in name of individuals, HUF, some approved institutions like trusts, educational institutes etc. Remember that saving accounts are not opened for

	business or professional concern. The business transactions are carried in current accounts which can be opened for all kind of customers like companies, individuals, partnership firms etc. ➢ Verify the balances in individual accounts on a sample basis. ➢ Check the calculations of interest on a test check basis. Remember that no interest is paid generally on current accounts by banks. ➢ Examine whether the procedure for obtaining balance confirmation periodically has been followed consistently. Examine, on a sampling basis, the confirmations received. ➢ Ensure that debit balances in current accounts are not netted out on the liabilities side but are appropriately included under the head 'advances'. ➢ Inoperative accounts (both current and saving) are a high-risk area of frauds in banks. As per RBI guidelines, a savings/ current account should be treated as inoperative/dormant if there are no transactions in the account for over a period of two years. Verify on a sample basis some of inoperative accounts revived/closed during the year. Ensure that inoperative accounts are revived only with proper authority. In this regard, cases where there is significant reduction in balances of such accounts as compared to previous year, examine authorisation for withdrawals. employees on the rolls of the bank the date of the preparation of financial statements.
Term deposits	➢ Examine whether the deposit receipts and cash certificates are issued serially and all of them are accounted for in the registers. ➢ Verify in case of bulk deposits (2 crore and above for scheduled commercial banks presently), correct rate of interest has been offered. ➢ In case of closure of term deposit, test check whether required foreclosure penalty has been deducted from applicable rate of interest payable. ➢ Verify on sample basis some of recurring deposit accounts opened during the year. ➢ Verify correctness of rate of interest on term deposits on sample basis.
Deposits designated in foreign currencies	➢ Verify some of FCNR accounts opened during the year on sample basis and ensure these conform to RBI directions. ➢ Verify on sample basis permissible credits and debits in FCNR accounts as per RBI directions. ➢ In case of FCNR accounts, examine whether these have been converted into Indian Rupees at rate notified in this behalf by head office. ➢ Examine whether any resultant increase or decrease has been taken to the profit and loss account. ➢ Verify that interest on deposits has been paid on the basis of 360 days in a year.
Others	➢ In case of NRE and NRO accounts, verify on a sample basis credits and debits as per RBI guidelines. Also check reparability. NRE accounts are repatriable whereas NRO accounts are not repatriable except for all current income subject to certain conditions
General	➢ Verify that deposits of a bank are not inflated for purpose of balance sheet presentation. For example, some customers might be given overdrafts near date of balance sheet and the resultant overdrawn amounts may be placed as deposits with banks and further advances may be given on strength and security of these deposits. It would lead to inflated deposits as well as advances. The transactions may be reversed after close of the year. In such cases which indicate the possibility of window-dressing, the auditor should consider making a suitable qualification in main audit report besides other applicable reporting. ➢ Examine that interest accrued but not due on deposits is not included under the relevant deposits but is shown under the head 'other liabilities and provisions'.

(CNO--AOB.480) BORROWINGS

- **Authorisation**
  - **Money at Call & Short Notice**
    Examine whether borrowings of money at call and short notice are properly authorised. The rate of interest paid/payable on, as well as duration of such borrowings should also be examined by the auditor.
  - **Borrowings at Branch**
    Examine the relevant correspondence or other documents to ensure that the **branch has been authorised** by the head office to borrow/retain other borrowings and that the terms on which borrowings have been made are in accordance with the authorisation.
- **Documents**
  Obtain and verify confirmation certificates and other supporting documents such as, **agreements, correspondence,** etc.
- **Classification**
  - **Rediscount Vs Refinance**
    Examine whether a clear distinction has been made between **'rediscount' and 'refinance'** for disclosure of the amount under the above head since rediscount does not figure under this head.
  - **Secured Vs Unsecured**
    Examine whether the amount shown in the branch accounts is **properly classified based on security or otherwise.**
- **External Confirmation**
  External confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence that the auditor requires to respond to significant risks of material misstatement. The auditor is required to comply with the requirements of SA 505 **"External Confirmations"** which contains guidance on designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

(CNO--AOB.490) OTHER LIABILITIES AND PROVISION (QNO - 483.050)

Bills Payable

- Evaluate the existence, effectiveness and continuity of internal controls over bills payable. Such controls should usually include the following-
  - Drafts, mail transfers, traveller's cheques, etc. should be made out in standard printed forms.
  - Unused forms relating to drafts, traveller's cheques, etc. should be kept under the custody of a responsible officer.
  - The bank should have a reliable private code known only to the responsible officers of its branches, coding and decoding of the telegrams should be done only by such officers.
  - The signatures on a demand draft should be checked by an officer with the specimen signature book.
  - All the telegraphic transfers and demand drafts issued by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch.

  Examine an appropriate sample of outstanding items comprised in bills payable accounts with the relevant registers. Reasons for old outstanding debits in respect of drafts or other similar instruments paid without advice should be ascertained.

- Correspondence with other branches after the year-end (e.g., responding advices received from other branches, advices received from other branches in respect of drafts issued by the branch and paid by the other branches without advice) should be examined specially in so far as large value items outstanding on the balance sheet date are concerned.

Inter office Adjustments

- The balance in inter-office adjustments account, if in credit, is to be shown under this head.

Interest Accrued

- Examine interest accrued with reference to terms of the various types of deposits and borrowings. It should be specifically examined that such interest has not been clubbed with the figures of deposits and borrowings shown under the head 'Deposits and Borrowings'.

(CNO--AOB.500) CONTINGENT LIABILITIES & BILLS FOR COLLECTION (MCQ- Incs.02.3)

Disclosure (QNO-485.000)

The Third Schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet.

- ***Contingent Liabilities***
  - Guarantees given on behalf of constituents
    - In India
    - Outside India
  - Acceptances, endorsements and other obligations
  - Liability for partly paid investments
  - Liability on account of outstanding forward exchange contracts.
  - Claims against the bank not acknowledged as debts
  - Other items for which the bank is contingently liable
- ***Bills for Collection***

Audit Procedures

- ***Primary Concern -- Identification & Valuation***
  In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that **all contingent liabilities are identified and properly valued.** To this end, the auditor should, generally follow the audit procedures given below:

- ***Regular Constituents***
  the auditor should ensure that there exists a system whereby the non-fund-based facilities (Letter of Credit, Guarantees) or additional/ad hoc credit facilities to parties **are extended only to their regular constituents,** etc.
  Verify whether bank has extended any non-fund facility or additional/ad hoc credit facilities to other than its regular customers. In such cases, auditor should ensure **concurrence of existing bankers of such borrowers and enquire regarding financial position of those customers.**

- ***Authorisation***
  Ascertain whether there are adequate internal controls to ensure that transactions giving rise to contingent liabilities **are executed only by persons authorised to do so and in accordance with the laid down procedures.**

- ***Terms & Conditions***
  The auditor should also ensure that in case of LCs for import of goods, as required by the **Master Circular on guarantees and co-acceptances, the payment to the overseas suppliers is made on the basis of shipping documents and after ensuring that the said documents are in strict conformity with the terms of LCs.**

- ***Accounting Records***
  Ascertain whether the accounting system of the bank provides for ***maintenance of adequate records in respect of such obligations*** *and whether the internal controls ensure that contingent liabilities are properly identified and recorded.*

- ***Confirmation***
  Performs substantive audit tests *to establish the completeness of the recorded obligations. Such tests include confirmation procedures as well as examination of relevant records in appropriate cases.*

- ***Reasonableness***
  Review the ***reasonableness of the year-end amount of contingent liabilities*** *in the light of previous experience and knowledge of the current year's activities.*

- ***Special Points***
  - ***Comfort Letters***
    Review whether ***comfort letters (Willingness to support customer with loan if required) issued by the bank*** *has been considered for disclosure of contingent liabilities.*

  - ***Guarantee in respect of trade credit***
    *The auditor should also examine whether the bank has given any guarantees in respect of any trade credit (buyers credit or sellers credit) *. The period of guarantees is coterminous(match) with the period of credit reckoned from the date of shipment.*

Written Representation for contingent liability

- *The auditor should obtain representation from management that:-*
  - *all off-balance sheet transactions have been accounted in the books of accounts as and when such transaction has taken place;*
  - *all off balance sheet transactions have been entered into after following due procedure laid down;*
  - *all off balance sheet transactions are supported by the underlying documents;*
  - *all year end contingent liabilities have been disclosed;*
  - *the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/ expense and which, therefore, require creation of a provision/adjustment in the financial statements;*
  - *the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement;*
  - *in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) and that no violation of section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; and*
  - *such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities*

Claims Against the Bank Not Acknowledged as Debts

- *Examine the relevant evidence, e.g., correspondence with lawyers/ others, claimants, workers/officers, and workmen's/officers' unions.*
- *Review the minutes of meetings of board of directors/committees of board of directors, contracts, agreements and arrangements, list of pending legal cases, and correspondence relating to taxes, and duties, etc. to identify claims against the bank.*
- *Ascertain from the management the status of claims outstanding as at the end of the year.*

	➢ A review of subsequent events would also provide evidence about completeness and valuation of claims.
Liability on Account of Outstanding Forward Exchange Contracts & Derivative contracts	➢ Verify the outstanding forward exchange contracts with the statement of outstanding forward exchange contracts generated from the bank's computerised accounting system or manual register maintained by the branch. The auditor may physically verify the underlying documents including confirmations from merchants to test the existence of such outstanding contracts. ➢ The auditor may verify outstanding derivative contracts like options, interest rate swaps etc with reports generated in this regard.
Guarantees Given on Behalf of Constituents (QNO – 485.010)	➢ Ascertain whether there are adequate internal controls overissuance of guarantees, e.g., whether guarantees are issued under proper sanctions, whether adherence to limits sanctioned for guarantees is ensured, whether margins are taken from customers before issuance of guarantees as per the prescribed procedures, etc. ➢ Ascertain whether there are adequate controls over unused guarantee forms, e.g., whether these are kept under the custody of a responsible official, whether a proper record is kept of forms issued, whether stock of forms is periodically verified and reconciled with the book records, etc. ➢ Examine the guarantee register to seek evidence whether the prescribed procedure of marking off the expired guarantees is being followed or not. ➢ Check the relevant guarantee registers with the list of outstanding guarantees to obtain assurance that all outstanding guarantees are included in the amount disclosed in this behalf. ➢ Examine that expired guarantees are not included in this head. Verify guarantees with the copies of the letters of guarantee issued by the bank and with the counter-guarantees received from the customers. The auditor should also verify the securities held as margin. If a claim has arisen, the auditor should consider whether a provision is required in terms of the requirements of AS 29, "Provisions, Contingent Liabilities and Contingent Assets".
Acceptances, Endorsements and Other Obligations	➢ Evaluate the adequacy of internal controls over issuance of letters of credit and over custody of unused LC forms in the same manner as in the case of guarantees. ➢ Verify the balance of letters of credit from the register maintained by the bank. The register indicates the amount of the letters of credits and payments made under them. The auditor may examine the guarantees of the customers and copies of the letters of credit issued. The security obtained for issuing letters of credit should also be verified. ➢ Examine whether the bank has incurred a potential financial obligation in respect of letters of comfort and if such obligation has been cast, ensure the amount to be disclosed under contingent liability.
Bills for Collection	➢ Ensure that the bills drawn on other branches of the bank are not included in bills for collection. ➢ Verify outward bills for collection with reference to the corresponding register maintained. ➢ Examine collections made subsequent to the date of the balance sheet to obtain further evidence about the existence and completeness of bills for collection as on the date of Balance Sheet. ➢ Examine the procedure for crediting the party on whose behalf a bill has been collected. Confirm that this procedure is in consonance with the nature of obligations of the bank in respect of bills for collection. ➢ Examine that adequate internal controls exist that debits the customer's account with the amount of bank's commission as soon as a bill collected is credited to the customer's account. The auditor should also examine that no income has been accrued in the accounts in respect of bills outstanding on the balance sheet date

(CNO--AOB.520) MEANING OF CONCURRENT AUDIT

CRAR & Components of Capital

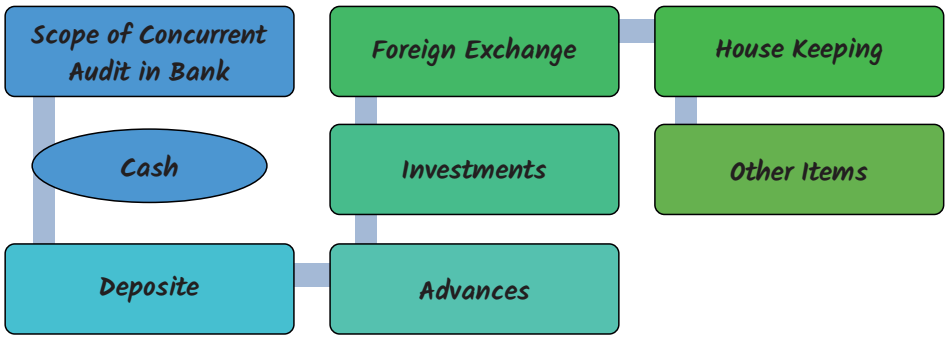
- Concurrent audit, as the name suggests, is an audit or verification of transactions or activities of an organisation concurrently as the transaction/activity takes place. It is not a pre-audit. The concept in this audit is to verify the authenticity of the transaction/activity within the shortest possible time after the same takes place. It is akin to internal audit which is a concept recognised under the Companies Act. In view of the complexities of economic activities it is now well recognised that there must be a system of someone, other than the person involved in the operations, verifying the authenticity of the transaction/activity on a regular basis, so that any deviation from the laid down procedures can be noticed in the shortest possible time and remedial action can be taken.
- The concept of concurrent audit in the public as well as the private sector banks has gained acceptance in recent years. In some banks, this task has been entrusted to the internal inspection staff who are not engaged in operational activities. In other banks, this work is allotted to outside professional firms of chartered accountants. The Reserve Bank of India (RBI) has issued certain guidelines for the conduct of this audit.

(CNO--AOB.540) SCOPE OF CONCURRENT AUDIT (QNO-478.010)

- **Who will determine scope?**
  The detailed scope of the concurrent audit should be clearly and uniformly determined for the Bank as a whole by the **Bank's Inspector and Audit Department in consultation with the Bank's Audit Committee of the Board of Directors (ACB).**

- **Cover high-risk transactions with large financial implications**
  In determining the scope, importance should be given to checking high-risk transactions having large financial implications as opposed to transactions involving lesser amounts. The detailed scope of the concurrent audit may be determined and approved by the ACB.

- **Guidelines by RBI**
  Further, the guidelines issued by the RBI cover all the key areas of activities of the branch which is under concurrent audit. Most banks have prepared an Audit Manual for this purpose. Broadly stated, the following areas are covered by these guidelines:
  Shortcut to remember – Scope Covers **A** to **I** except don't cover **BEG**
  A-Advances | **B**-Blank | **C**-Cash | **D**-Deposits | **E**- Blank | **F**-Foreign Exchange Transactions | **G**-Blank | **H**-House Keeping | **I**-Investments



(CNO--AOB.550) TYPES OF ACTIVITIES TO BE COVERED IN CONCURRENT AUDIT

General Note

- Above areas are covered in concurrent audit , audit procedures are similar to as we are discussed earlier, with more emphasis on internal controls evaluation and its compliance. We are not covering them again, as they are less important. We are covering audit procedures for 2 areas foreign exchange transactions and housekeeping as they seem important.

Foreign Exchange Transactions

- Covered in CNO AOB.620

House Keeping

- Ensure that the maintenance and balancing of accounts, ledgers and registers including clean cash is proper.
- Early reconciliation of entries outstanding in the inter-branch and inter-bank accounts, Suspense Account, Sundry Deposits Account, DDRR Account, Drafts Account, etc.
- Ensure timely adjustment of large value entries.

(CNO--AOB.560) APPOINTMENT OF AUDITORS AND ACCOUNTABILITY

- ***Discretion – Own Staff Vs External Auditors***

  The option to consider whether concurrent audit should be done by bank's **own staff or external auditors** is left to the discretion of individual banks.

- ***Own Officials***

  In case the bank has engaged its own officials, they should be experienced, well trained and sufficiently senior. The staff engaged on concurrent audit must be independent of the branch where concurrent audit is conducted.

- ***External Audit Firm***
  - ***Appointment***

    Appointment of an external audit firm may be initially for one year and extended up to three years - after which an auditor could be shifted to another branch subject to satisfactory performance.

  - ***Removal***

    If external firms are appointed and any serious acts of omissions or commissions are noticed in their working their appointments may be cancelled and the fact may be reported to RBI & ICAI.

(CNO--AOB.580) COVERAGE OF BUSINESS/BRANCHES (QNO-478.000) (MCQ-BA.1)

Discussion

- The scope of work to be entrusted to concurrent auditors, coverage of business/branches, etc. is left to the discretion of the head of internal audit of banks with the due prior approval of the Audit Committee of the Board of Directors (ACB).
- Banks may, however, ensure that risk sensitive areas identified by them as per their specific business models are covered under concurrent audit. The detailed scope of the concurrent audit may be determined and approved by the ACB.
- The broad areas of coverage under concurrent audit shall be based on the identified risk of the unit and must include random transaction testing of sufficiently large sample of such transactions wherever required.

(CNO--AOB.600) REPORTING SYSTEMS (MCQ-BA.3 / Incs.21.4)

- ***Structured Format***

  There should be proper reporting of the findings of the concurrent auditors. For this purpose, each bank should prepare a structured format. The major deficiencies/ aberrations noticed during audit should be highlighted in a special note and given immediately to the bank's branch/controlling offices. A quarterly review containing important features brought out during the concurrent audits should be placed before the ACB.

- ***Treatment of Minor Vs Serious Irregularities***

  Minor irregularities pointed out by the concurrent auditors are to be rectified on the spot. Serious

irregularities should be straightaway reported to the controlling offices/ Head Offices for immediate action.

- **Treatment for Frauds**
  Whenever fraudulent transactions are detected, they should immediately be reported to Inspection & Audit Department (Head Office) as also the Chief Vigilance Officer as well as Branch Managers concerned (unless the branch manager is involved).

- **Branch wise Vs Zone wise**
  Concurrent auditors should be attached to the branches and not the zonal offices.

- **Reporting to ACB Zone wise**
  There should be zone-wise reporting of the findings of the concurrent audit to ACB (Audit Committee of Board of Directors) and an annual appraisal/report of the audit system should be placed before the ACB.

- **Follow-up Action**
  Follow-up action on the concurrent audit reports should be given high priority by the controlling office/Inspection and Audit Department and rectification of the features done without any loss of time.

(CNO--AOB.620) FOREIGN EXCHANGE TRANSACTIONS (QNO-479.010) (MCQ – Incs.19.1)

Shortcut to Remember: – F^3AN of Foreign Exchange Trading

- FCNR Facility Rules
  Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.

- Forward Contracts Extension or Cancellation
  Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorised, and necessary charges have been recovered.

- Foreign Bill Negotiation
  Check foreign bills negotiated under letters of credit. (Exporter come to bank with all documents of export & letter of credit issued by foreign customer, on the basis of these documents exporter gets advance receipt, this is called foreign bill negotiation)

- Accounting of Remittances
  Check whether inward/outward remittance have been properly accounted for.

- Nostro Account
  - Balance within Limits
    Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the RBI.
  - Reconciliation
    Ensure verification/reconciliation of Nostro and Vostro account transactions/balances.

- Foreign Exchange Trading
  - Dealing Room Operations
    Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations.
  - Reasonable Position

Ensure that the overbought/oversold position maintained in different currencies is reasonable taking into account the foreign exchange operations.

(CNO--AOB.660) AUDITOR'S REPORT

Format

The auditors, central as well as branch, should also ensure that the audit report issued by them complies with the requirements of SA 700, "Forming an Opinion and Reporting on Financial Statements", SA 705, "Modifications to the Opinion in the Independent Auditor's Report", SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", SA 710, "Comparative Information-Corresponding Figures and Comparative Financial Statements" and SA 720, The Auditor's Responsibility Relating to Other Information in Documents Containing Audited Financial Statements

Unaudited Branches

The auditor should ensure that not only information relating to **number of unaudited branches is given but quantification of advances, deposits, interest income and interest** expense for such unaudited branches has also been disclosed in the audit report. Such disclosure in the audit report is not only in accordance with the best international trends but also provides useful information to users of financial statements.

Matters prescribed by law for SBI & Nationalised Banks

In the case of a nationalised bank, the auditor is required to make a report to the Central Government in which the auditor should state the following:
The report of auditors of State Bank of India is also to be made to the Central Government and is almost identical to the auditor's report in the case of a nationalised bank

(Transactions → Return from branches → B/S + P&L → All information & explanation → Any other matter)

- Whether or not the **transactions** of the company which have come to his notice have been **within the powers of the company;**
  (E.g. Cannot give loan on the basis of own shares)
- Whether or not the **returns received from the offices and branches of the bank** have been **found adequate for the purpose of his audit;**
- Whether, in his opinion, **the balance sheet is a full and fair** balance sheet containing all the necessary particulars and is properly drawn up so as to exhibit a true and fair view of the affairs of the bank.
- Whether the **profit and loss account** show a true balance of profit or loss for the period covered by such account; and
- Whether or not the **information and explanations** required by him have been found to be satisfactory;
- any **other matter** which he considers should be brought to the notice of the shareholders of the company.

Matters prescribed by Companies Act for Banking Companies

It may be noted that, in addition to the aforesaid, the auditor of a banking company is also required to state in the report in respect of matters covered by Section 143 of the Companies Act, 2013.
However, it is pertinent to mention that the reporting requirements relating to the Companies (Auditor's Report) Order, 2020 is not applicate to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.
Reporting requirements Rule 11 of the Companies (Audit and Auditors) Rules, 2014 the auditor's are also applicable to banking companies, see company audit chapter for detailed discussion on rule 11

(CNO--AOB.680) LFAR (QNO-486.000) (MCQ-BA.14)

Long Form Audit Report-

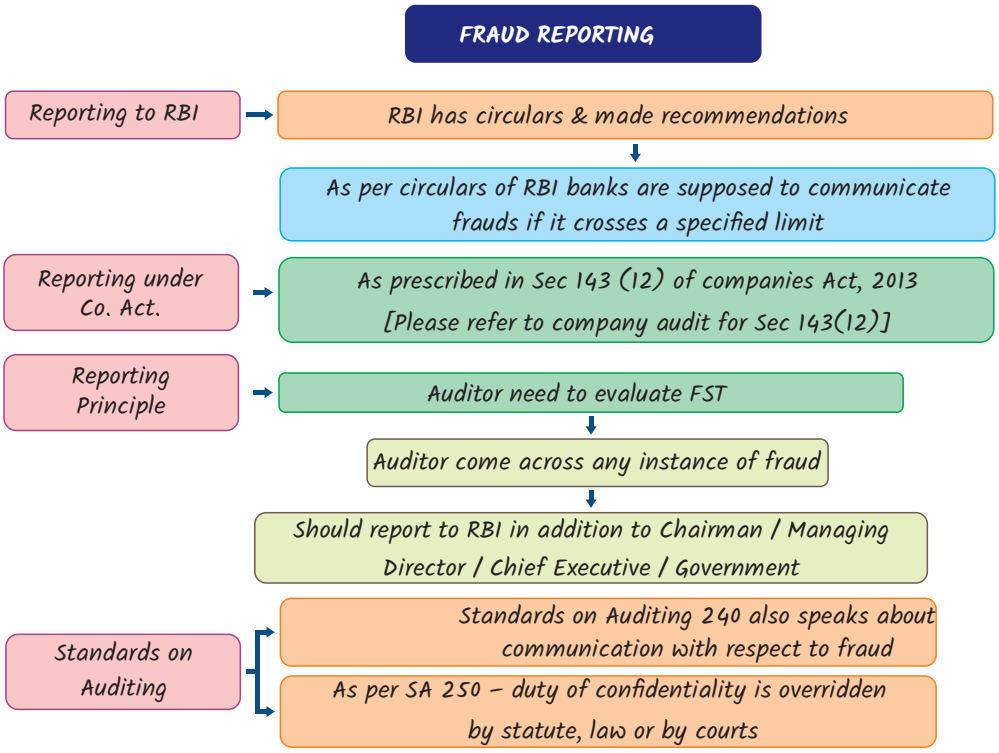
- Besides the audit report as per the statutory requirements discussed above, the terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR). The long form audit report is to be given by statutory branch auditors as well as statutory central auditors. The LFAR for branch auditors is in form of questionnaire where observations/comments have to be provided on

range of matters including cash, balance with banks, investments, advances, deposits etc. These are submitted by the statutory branch auditors to statutory central auditors.

- The consolidation is done at head office level and LFAR for bank is submitted by statutory central auditors to management. The LFAR, on the bank, after due examination, should be placed before the ACB of the bank indicating the action taken/proposed to be taken for rectification of the irregularities, if any, mentioned therein; and a copy of the LFAR and the relative agenda note, together with the Board's views or directions, is submitted to RBI within 60 days of submission of LFAR by statutory auditors.

(CNO--AOB.700) FRAUD REPORTING

Chart



Reporting to RBI –

The RBI issued a Circular relating to implementation of recommendations of Committee on Legal Aspects of Bank Frauds applicable to all scheduled commercial banks (excluding Regional Rural Banks). The said circular provides details regarding liability of accounting and auditing profession including the professional conduct, non-disclosure of client information and need to report fraud.

Standards on Auditing

Auditor should also consider the compliance with provisions of Standards on Auditing.

- SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", explains that the duty of confidentiality is over-ridden by statute, law or by courts.
- Whereas an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error according to SA 240.

Fraud Reporting

- Further, as per sub-section 12 of section 143 of the Companies Act, 2013, if an auditor of a company, in the course of the performance of duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.
- It must be noted that auditor is not expected to consider each and every transaction but to evaluate the system as a whole. Therefore, if the auditor while performing normal duties comes across any instance, he/she should report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank.

(CNO—AOB.740) REPORTS AND CERTIFICATES IN ADDITION TO MAIN AUDIT REPORT

Chart

REPORTING

TYPES OF BANK AUDIT REPORTS TO BE ISSUED (GENERALLY)

*Shortcut : - Report Should be in **ITALICS***

- *Report on IRAC done as per RBI guidelines*
- *Report on treasury operation conducted as per RBI instructions*
- *Report on adverse credit deposit ratio in rural areas*
- *Long form Audit Report*
- *Bank registered as companies* → *Report u/s 143(3)(i) of the companies Act 2013*
- *Report on compliance of bank regard to implementation & recommendation on*
  - *Ghosh Committee (relates to fraud & malpractices)*
  - *Jilani Committee (relates to internal control & inspection / credit system)*
- *Report on compliance with SLR requirements*

Different Reports

- *Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:*
  - *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.*
  - *Long Form Audit Report. (LFAR)*
  - *Report on compliance with SLR requirements.*
  - *Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.*
  - *Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.*
  - *Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.*
  - *Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.*
  - *Report on instances of adverse credit-deposit ratio in the rural areas.*

(CNO--AOB.780) SPECIAL CONSIDERATIONS IN IT ENVIRONMENT – WHAT INFORMATION SHOULD BE COLLECTED FROM BANK WITH RESPECT TO IT SYSTEM

Overall IT System and its Role in Accounting –

Considering the importance of IT systems in preparation and presentation of financial statements, it is imperative that bank should share detailed information with auditors like-

- *Overall IT policy, structure and environment of Bank's IT system*
- *Accounting manual and critical accounting entries, their processes and involvement of IT systems*
- *Process of generating various information related to various disclosures in financial statements and involvement of IT systems*

Data	➢ Data processing and data interface under various systems ➢ Data integrity and data security ➢ Business Continuity plans and disaster control plans
Controls and Reports	➢ Controls over key aspects, use of various account heads, expense booking, overdue identification etc. ➢ Controls on recording of various e-banking and internet banking products and channels ➢ MIS reports being generated and their periodicity ➢ Major exception reports and process of generation including embedded logic

(CNO--AOB.800) SPECIAL CONSIDERATION IN IT ENVIRONMENT – KEY SECURITY CONTROL ASPECTS THAT AUDITOR NEEDS TO UNDERSTAND AND EXAMINE

Key Controls Related to IT Department

The key security control aspects that an auditor needs to address when undertaking audit in a computerised bank include:

- **Control Over Access By Unauthorized Persons :** – Verify whether "Access controls" assigned to the staff-working match with the responsibilities as per manual. It is important for the auditor to ensure that access and authorisation rights given to employees are appropriate.

- **Control Over Segregation Of Duty In Authorized Persons:** – Verify that Segregation of duties is ensured while granting system access to users and that the user activities are monitored by performing an activity log review.

- **Control Over Unauthorized Amendments to Programmes:** – Ensure that the system prevents Unauthorised amendments to the programmes.

- **Control Over Changes To Parameters (used for automated entries) & User levels(Powers):** – Verify that Changes made in the parameters or user levels are authenticated.

- **Control Over Manual Calculation & Accounting:** – Verify that Charges calculated manually for accounts when function is not regulated through parameters are properly accounted for and authorised.

- **Control Over Changes To Account Masters(Heads) & Balances:** –Verify that the Account master and balance cannot be modified/amended/altered except by the authorised personnel.

- **Control Over General Level Account Codes:** – Verify that all the General ledger accounts codes authorised by Head Office are in existence in the system.

- **Control Over Data Processing:** – Ensure that authorised, accurate and complete Data is made available for processing.

- **Controls To Handle Interruption (Break):** – Ensure that in case of Interruption due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records.

- **Control Ledger Reconciliation:** – Verify that balance in general ledger Tallies with the balance in subsidiary book.

- **Control Related To Exceptional Transactional Report:** – Verify that Exceptional transaction reports are being authorised and verified on a daily basis by the concerned officials. It is important for auditor

to understand the nature of exception and its impact on financials.
(E.g.Very large deposit, Heavy transfers etc)

(CNO--AOB.820) CENTERAL AUDIT AND INSPECTION

Central audit and inspection department & Its Functions

- **Department head, Primary Function & Distribution of Work** -- Central audit and inspection department in Banks is a combination of centralized function (Audit Strategy at HO) with some level of decentralization (Planning & Execution at Br) which is usually headed by a Chief Audit Executive. The primary function is to ensure that the audit function is handled smoothly, effectively & efficiently.

- **Risk-based Internal Audit (RBIA)** -- It is responsible for undertaking risk-Based Internal Audit (RBIA) as per the framework as stipulated by RBI.

  - It is also responsible for identification of branches for revenue audit,
  - concurrent audit
    - appointment of concurrent auditors,
    - deciding their scope,
    - meeting the concurrent auditors,
    - discussing their issues,
    - conducting trainings if needed, and
    - review of work of concurrent auditors.

Risk-Based Internal audit

Risk-Based Internal audit is conducted based upon the risk assessment of business and control risks of branches. The risk assessment process includes: -

- Identification of inherent business risks in various activities undertaken by branches (Business risk) (Eg. Credit Risk in Loan, Market risk in investment & Forex etc.)
- Assessment of effectiveness of control systems for monitoring inherent risks of business activities of branch (Control risk)
- Making an assessment of level (How Big) and direction (Expected Change in next 12 months) of various risk areas and assess level and direction of overall business risk and control risk
- Drawing up of risk matrix taking into account factors viz. Risk of branch

(CNO--AOB.830) AUDIT COMMITTEE

Discussion

- Banks are required to constitute an Audit Committee of their Board in pursuance of RBI guidelines. One of the functions of this committee is to provide direction and also oversee the operations of the total audit function in the bank. The committee also has to review the internal inspection/audit function in the bank, with special emphasis on the system, its quality and effectiveness in terms of follow up. The committee has to review the system of appointment and remuneration of concurrent auditors.
- The Audit Committee is, therefore, connected with the functioning of the system of concurrent audit. The method of appointment of auditors, their remuneration and the quality of their work is to be reviewed by the Audit Committee. It is in this context that periodical meetings by the members of the audit committee with the concurrent auditors and statutory auditors help the audit committee to oversee the operations of the total audit function in the bank.

UNIQUE QNO's

QNO- 447.006	Bank unable to check the work and records being small branch with shortage of manpower
QNO 470.000	Advances (LIP)
QNO 479.000	Verification of Balances (Foreign Country)
QNO 488.500	Bank Audit Report -- Submission, Requirement of Company's Act, Applicability of CARO

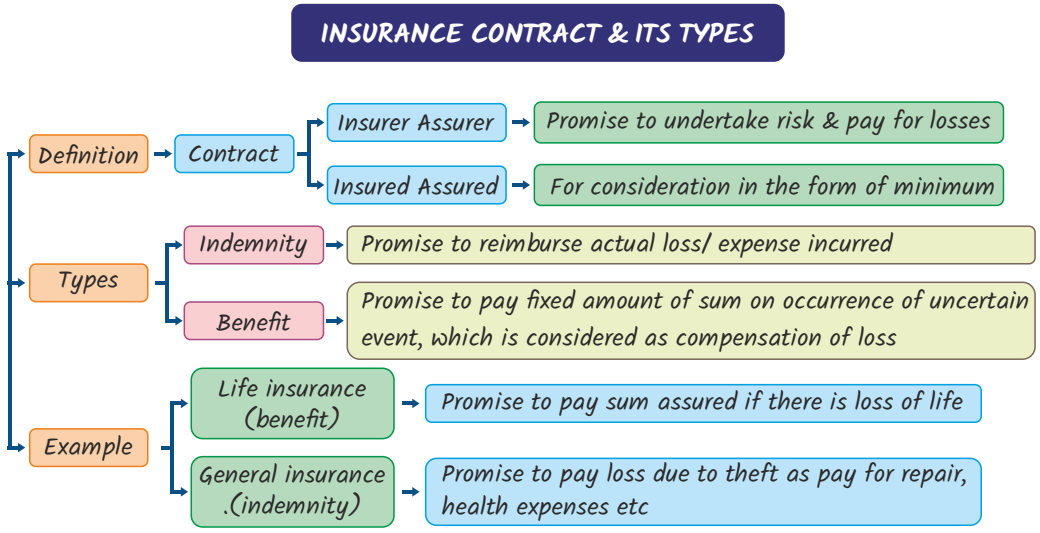
UNIQUE MCQS	
MCQ No.	BA.6
MCQ No.	BA.7

10 AUDIT OF INSURANCE COMPANY

Part - I INSURANCE COMPANIES (COMMON PORTION)

(CNO—INS.020) INSURANCE CONTRACT & Its TYPES

Chart



Insurance Contract

Insurance is a contract between two parties whereby one party agrees to undertake the risk of another in exchange for consideration known as premium and promises to pay a fixed sum of money to the other party on happening of an uncertain event (death) or after the expiry of a certain period (in case of life insurance) or to indemnify the other party on happening of an uncertain event (in case of general insurance). The party bearing the risk is known as the 'insurer' or 'assurer' and the party whose risk is covered is known as the 'insured' or 'assured'.

2 Types

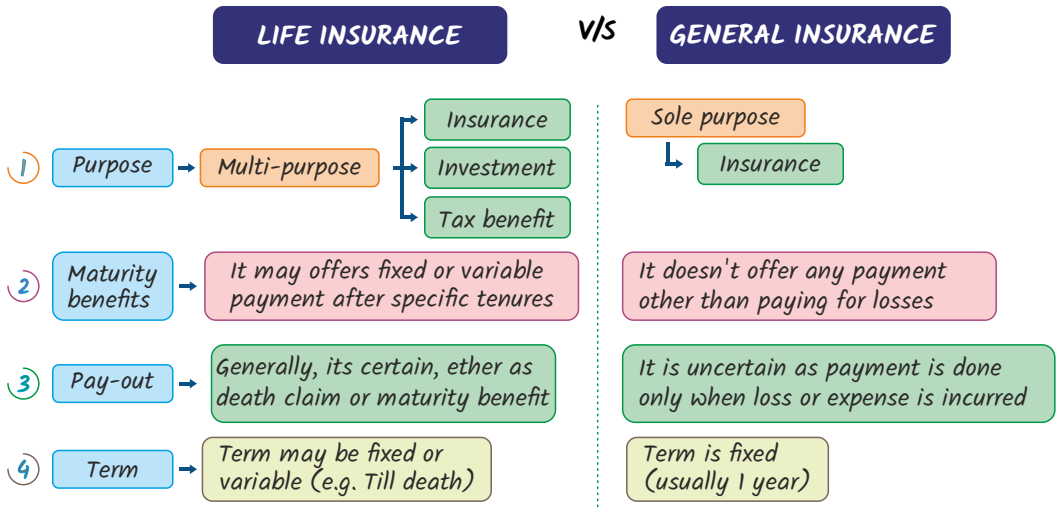
- Insurance contracts are of two types i.e. indemnity and benefit.
- Indemnity contract is a re-imbursement of the actual loss incurred by the insured. Generally non-life insurance contracts are reimbursement contracts. Examples are loss by fire or repair cost of a motor vehicle. The actual cost/value of loss incurred is reimbursed/indemnified to the policy
- An benefit contract is not an actual re-imbursement of the cost/value of loss incurred but is a lumpsum amount which can be construed to be equal to the cost/value of loss incurred.

Example

- Sum assured in a life insurance is a benefit contract as the value of loss of life cannot be computed but is a lumpsum amount.
- Another example of a difference between the two is a health insurance contract which re-imburses for the actual hospital bills (re-imbursement contract) but instead of pre-imbursing the actual cost, if the insurance company pays a lumpsum amount of Rs 500 per day of hospitalization, then that contract is a benefit contract.

(CNO—INS.040) DISTINCTION BETWEEN LIFE INSURANCE AND GENERAL INSURANCE

Chart

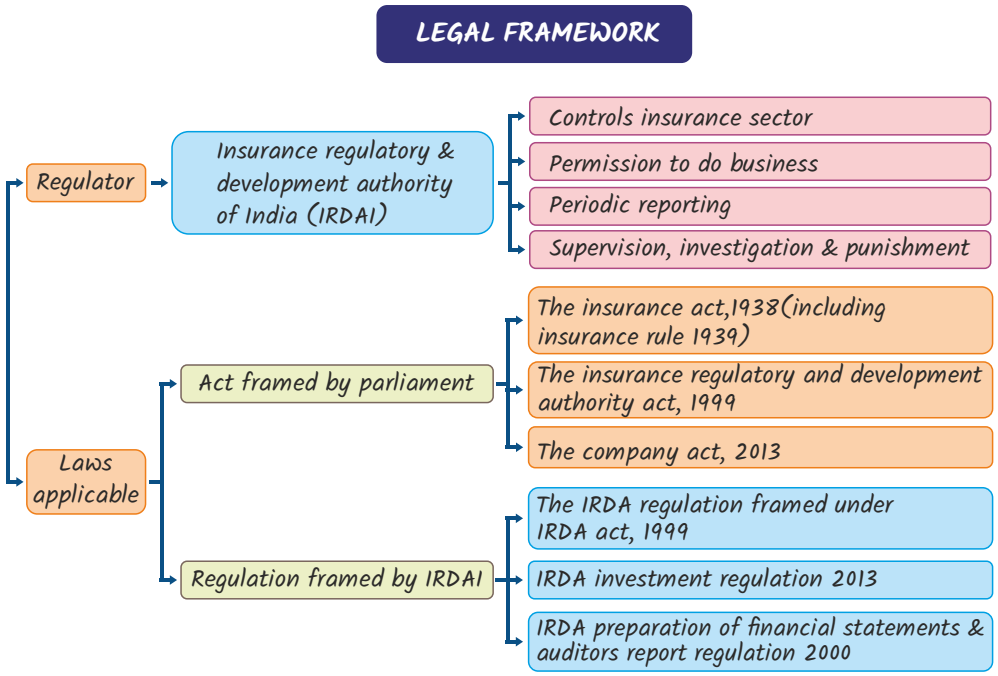


Discussion

Life Insurance	General Insurance
Life Insurance can be seen as an investment apart from insurance as it offers maturity benefits after specific tenures	General Insurance, mostly, doesn't give any maturity benefits but promises payout in case of loss due to unavoidable circumstances
Term may be fixed or variable.	Term is fixed (usually 1 year)
Pay-outs are certain either as claims or maturity benefits.	Pay-outs are uncertain as claims may or may not arise.
Multi-purpose (e.g. investment, tax benefits, insurance).	Solely for the purpose of insurance.

(CNO—INS.060) LEGAL FRAMEWORK

Chart



Discussion

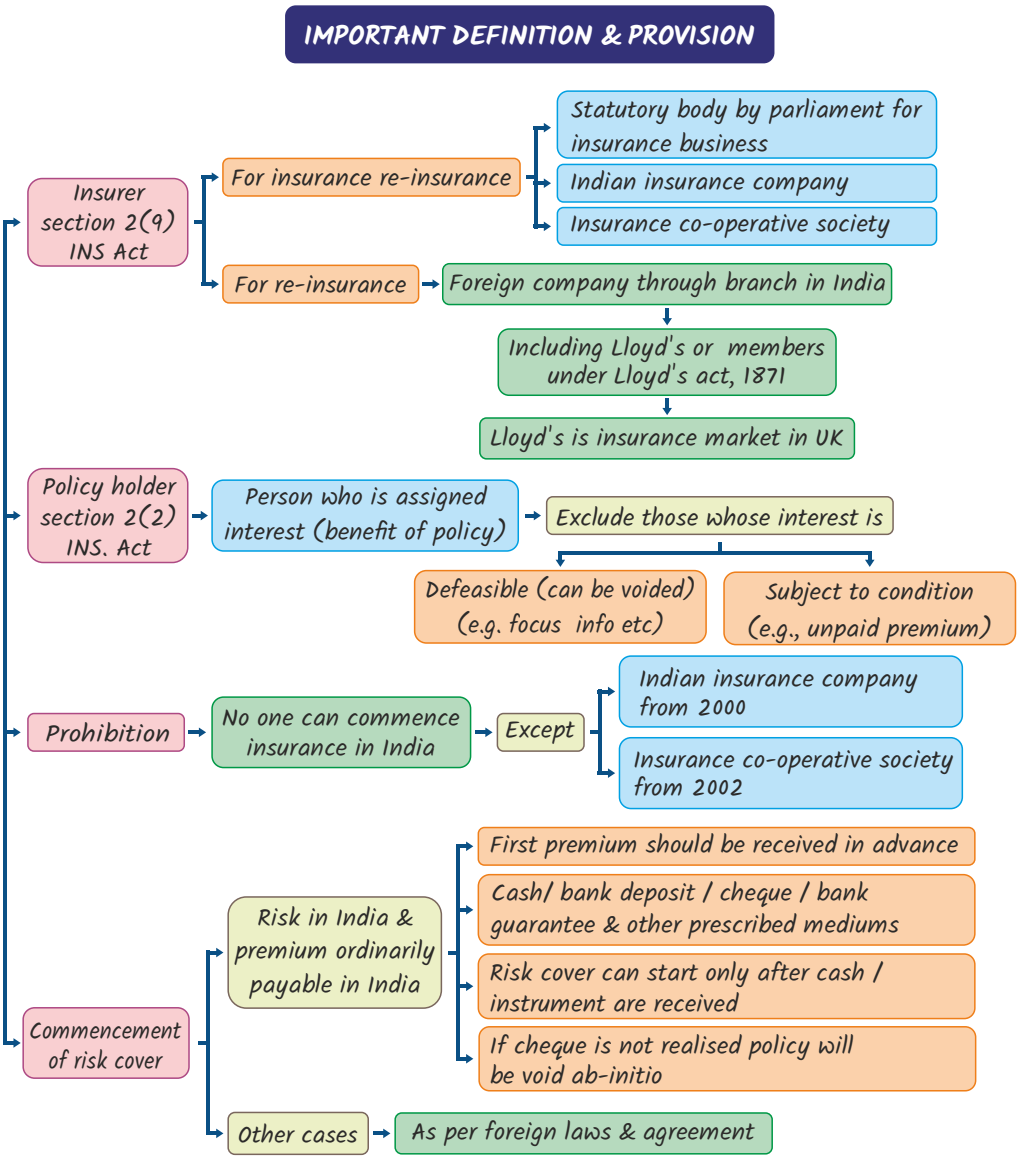
- The Regulator for Insurance Companies is Insurance Regulatory & Development Authority of India (IRDAI)
- The primary legislations which deal with the insurance business in India are the Insurance Act, 1938 and the IRDA Act, 1999. Various aspects relating to audit are dealt with around the framework of the following statutes and rules made thereunder:
  - The Insurance Act, 1938 as amended by the Insurance Laws (Amendment) Act, 2015

(including Insurance Rules, 1939);

- The Insurance Regulatory and Development Authority Act, 1999 as amended by the Insurance Laws (Amendment) Act, 2015;
- The Insurance Regulatory and Development Authority Regulations framed under the IRDA, Act, 1999;
- The Companies Act, 2013; and
- IRDA Investment Regulations, 2013 (as amended from time to time).
- IRDAI Preparation of Financial Statements and Auditors Report Regulations 2000

(CNO—INS.080) SOME IMPORTANT DEFINITION AND PROVISIONS

Chart



Insurer

Section 2(9) of the Insurance Act, 1938 defines the term 'Insurer' as:

(a) an Indian Insurance Company, or
(b) a statutory body established by an Act of Parliament to carry on insurance business, or
(c) an insurance co-operative society, or
(d) a foreign company engaged in re-insurance business through a branch established in India.

It may be noted that a "foreign company" shall mean a company or body established or incorporated under a law of any country outside India and includes Lloyd's established under the Lloyd's Act, 1871 (United Kingdom) or any of its Members

Policy Holder

Section 2(2) of the Insurance Act, 1938 defines the term policy holder as a person to whom the whole of the interest of the policy holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is defensible or is for the time being subject to any condition

Prohibition of Insurance Business by Certain Persons

Third proviso to section 2C(1) of the Insurance Act, 1938 (inserted by the IRDA Act, 1999) prohibits persons other than an Indian insurance company to begin to transact the insurance business after the commencement of the IRDA Act, 1999.

Section 64 (VB)

Section 64 (VB) of The Insurance Act prohibits an insurer from assuming risk without receipt of funds.

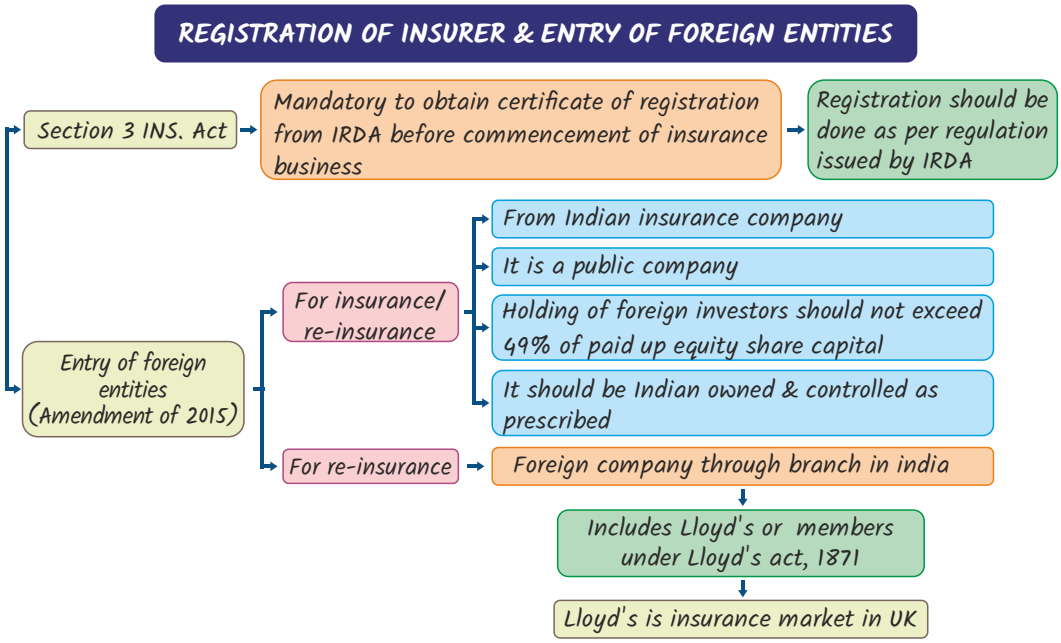
As per section 64VB. no risk to be assumed unless premium is received in advance-

(1) No insurer shall assume any risk in India in respect of any insurance business on which premium is not ordinarily payable outside India unless and until the premium payable is received by him or is guaranteed to be paid by such person in such manner and within such
time as may be prescribed or unless and until deposit of such amount as may be prescribed, is made in advance in the prescribed manner

(2) For the purposes of this section, in the case of risks for which premium can be ascertained in advance, the risk may be assumed not earlier than the date on which the premium has been paid in cash or by cheque to the insurer.

(CNO—INS.100) REGISTRATION OF INDIAN INSURANCE COMPANIES:

Chart



Discussion

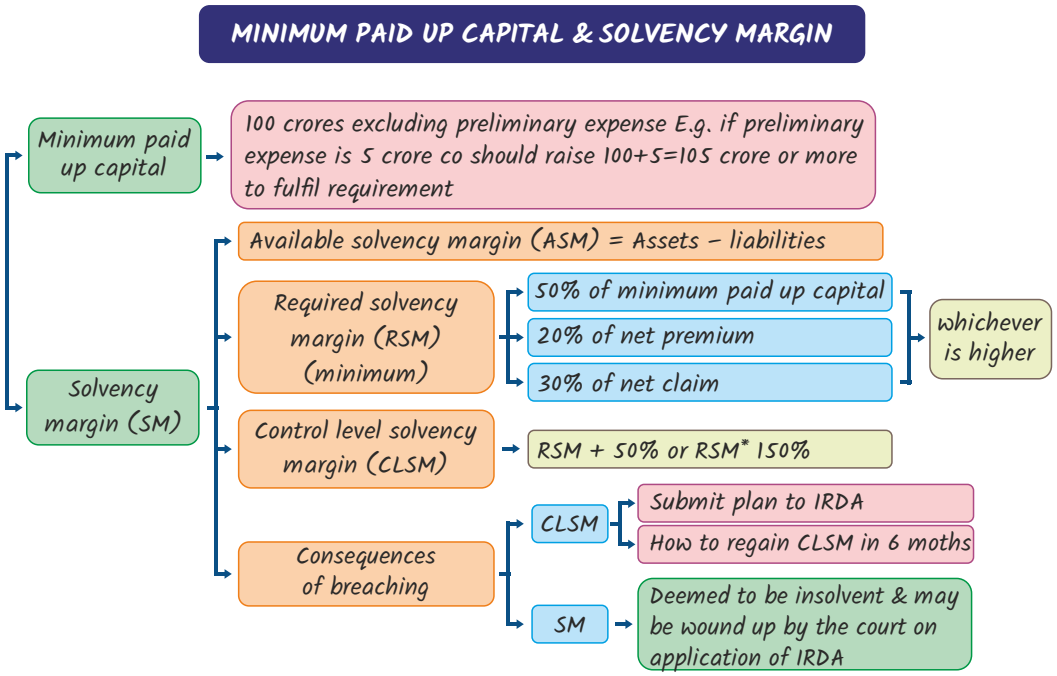
- Section 3 of the Insurance Act, 1938 requires every insurer to obtain a certificate of registration before commencement of insurance business in India. The section empowers the Authority to make regulations for registration of insurers. It may be noted here that no insurer other than an Indian insurance company can commence the insurance business after the enactment of the IRDA Act, 1999. The registration of Indian insurance companies is done in accordance with the IRDA (Registration of Indian Insurance Companies) Regulations, 2000.

- Amending the Insurance Act in 2015, certain stipulations have been added governing the definition and formation of insurance companies in India.

  - An Indian Insurance company includes a company "in which the aggregate holdings of equity shares by foreign investors, including portfolio investors, do not exceed forty-nine percent of the paid-up equity capital of such Indian insurance company, which is Indian owned and controlled, in such manner as may be prescribed".
  - Amendment to the Insurance Act also stipulates about foreign companies in India, a foreign insurance company can engage in reinsurance through a branch established in India. The term "re-insurance" means the "insurance of part of one insurer's risk by another who accepts the risk for a mutually acceptable premium".

(CNO—INS.120) REQUIREMENTS AS TO THE MINIMUM PAID-UP CAPITAL:

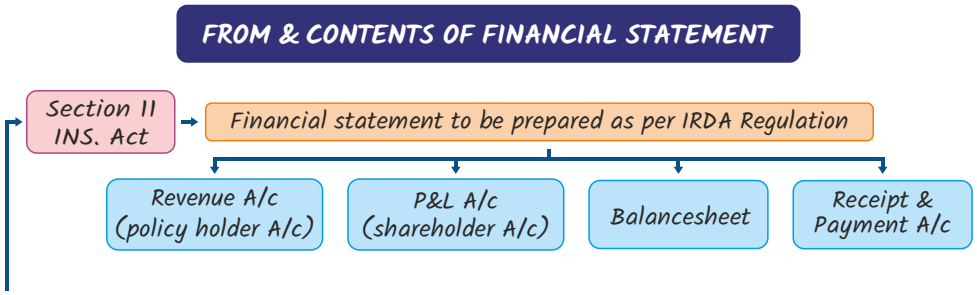
Chart

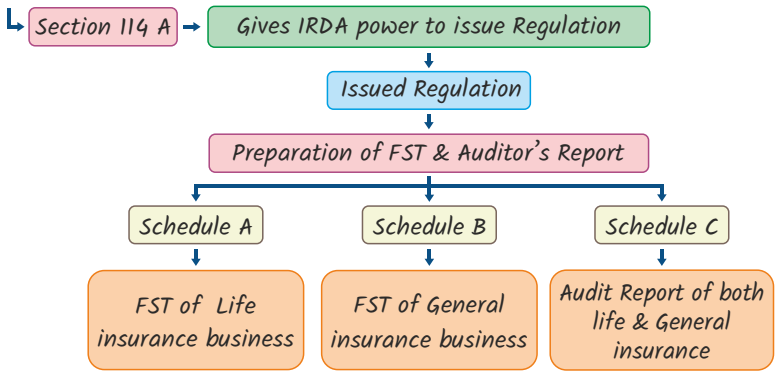


Discussion

- The minimum paid-up equity share capital of an Indian insurance company carrying on insurance business should be `100 crores excluding preliminary expenses incurred in the formation and registration of company. The insurer may enhance the same in accordance with the provisions of the Companies Act, 2013, SEBI Act, 1992 and the rules, regulations or directions issued thereunder or any other law for the time being in force.
- Insurance companies are required to maintain a minimum solvency ratio of 150%. Solvency Ratio is the excess of assets over liabilities of an Insurance Company. There is a detailed working provided by IRDAI on the manner of computing Solvency Margin

(CNO—INS.140) FORM AND CONTENTS OF FINANCIAL STATEMENTS (QNO-505.000)





Discussion

- Every insurer, in respect of insurance business transacted and in respect of shareholder's funds, is required to prepare a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments, a Revenue Account for each year in accordance with the Regulations as may be specified. Every insurer should keep separate accounts relating to funds of shareholders and policyholders.
- Section 11 of the Insurance Act, 1938 provides that every insurer, on or after the date of the commencement of the Insurance Laws (Amendment) Act, 2015, in respect of insurance business transacted by him and in respect of his shareholders' funds, shall, at the expiration of each financial year, prepare with reference to that year, balance sheet, a profit and loss account, a separate account of receipts and payments, a revenue account in accordance with the regulations as may be specified.
- The Authority, in pursuance of the powers conferred to it by the provisions of section 114 A of the Insurance Act, 1938, has issued regulations for the preparation of the financial statements and auditor's report of companies carrying on insurance business. The Regulations contain three schedules.
  - Schedule A is applicable to companies carrying on Life Insurance business.
  - Schedule B is applicable to Companies carrying on General Insurance business.
  - Schedule C to the Regulations lays down the matters to be dealt with by the auditor's report of an insurance company. Schedule C is applicable to insurers carrying on general insurance business as well as life insurance business.

(CNO—INS.160) AUDIT OF ACCOUNTS

Discussion

- Under section 12 of the Insurance Act, 1938, the financial statements of every insurer are required to be audited annually by an auditor. Section 2(4) of the Insurance Act, 1938 defines the term 'auditor' as a person qualified under the Chartered Accountants Act, 1949 to act as an auditor of a company. The auditor, for audit of financial statements, has the powers to exercise the right vested in, and discharge the duties and be subject to the liabilities and penalties imposed on auditors of companies under the Companies Act, 2013.
- The provisions of section 12 of the Insurance Act, 1938 apply only in a case where the financial statements of the insurer are not subject to audit under the Companies Act, 2013. A company carrying on general & life insurance business is subject to audit requirements laid down under the Companies Act, 2013

(CNO—INS.180) APPOINTMENT OF AUDITORS (QNO - 507.100) (MCQ – Incs.27.2)

Discussion

- The appointment of statutory auditors in the General Insurance Corporation of India, and its subsidiaries and the divisions as well as other public sector Insurance Companies is made by the Comptroller and Auditor General of India, as in the case of other public sector undertakings (For example, in the case of New India Assurance Company Ltd., United India Insurance Company Ltd.).
- However, in the case of others, auditor is appointed at the AGM after ensuring that the auditor satisfies the compliance requirements with the relevant sections of the IRDAI Guidelines on Corporate Governance. These guidelines pose certain restrictions on the number of insurance companies a statutory auditor can audit. Currently, an auditor can conduct audit only for three insurance companies and not more than 2 life or 2 general. The Guidelines also mandate a mandatory joint audit for all insurance companies.

(CNO—INS.200) BRANCH/DIVISIONAL OFFICES

Discussion

- It is a practice in certain public sector insurance companies that the divisional offices prepare atrial balance in a manner that it provides information required to be included in the various formats of financial statements prescribed in the Insurance Act. Each trial balance, in which are incorporated the figures relating to the branches of the divisions, is required to be audited and the report thereon is furnished to the statutory auditors. The divisions of the companies carrying on general insurance business are treated for the purposes of the Companies Act, 2013 as their branches. It follows that the branch auditors appointed to conduct the audit of the divisions have the same rights and obligations under the statute as those of the, statutory auditors to whom they are expected to submit their report.
- However, in case of private companies, the accounting and operational systems of the company are centralized and hence, the principle of divisional offices preparing accounts and they being consolidated is not applicable to such companies. The accounts of all the divisions, trial balances and their balance sheets are prepared at the Head office only.

(CNO—INS.220) INVESTMENT RISK MANAGEMENT SYSTEMS AND PROCESS AUDIT

Discussion

- The IRDA vide Circular No. INV/CIR/008/2008-09 Dt. 22nd Aug, 2008 advised that the Chartered Accountants firm, which is not the Statutory or Internal or Concurrent Auditor of the concerned Insurer shall certify that the Investment Risk Management Systems and Processes are in place. For this purpose, the ICAI has also issued "Technical Guide on Review and Certification of Investment Risk Management Systems and Processes of Insurance Companies" in consultation with the IRDA.

(CNO—INS.240) REQUIREMENTS OF THE INSURANCE ACT, 1938 VIS A VIS THE COMPANIES ACT, 2013

Sec 129 Companies Act

- Proviso to sub-section (1) of section 129 of the Companies Act, 2013 provides that the financial statements of a company shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose, in the case of an insurance company, any matters which are not required to be disclosed under the Insurance Act, 1938, or the IRDA Act, 1999. However, if an insurance company so desires, it may disclose additional information that is not specifically required to be disclosed under the Insurance Act,1938

Sec 1 Companies Act

- According to section 1 of the Companies Act, 2013, the provisions of the Companies Act, 2013 shall apply to insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999.

Sec 117 Insurance Act

- Section 117 of Insurance Act, 1938, provides that nothing in the Insurance Act, 1938 shall affect the liability of an insurer, being a company, to comply with the provisions of the Companies Act, 2013 in matters not otherwise specifically provided for by Insurance Act, 1938.

Conclusion

- Therefore, the provisions of the Companies Act, 2013 would be applicable wherever the Insurance Act, 1938 does not cover the relevant aspects and the insurer is a company within the meaning of the Companies Act, 2013. The provisions of the Companies Act, 2013 should be applied in a harmonised manner with the provisions of the Insurance Act, 1938, and the rules and regulations framed thereunder.

- Disclosures under the Companies Act, 2013 relating to the Balance Sheet and Profit and Loss Account of the company also apply to an insurance company

(CNO—INS.260) TAX AUDIT

Discussion

- **Audit under Sec 44AB**
  It is necessary for general insurance companies to get their accounts audited under Section 44 AB of the said Act.

- **Appointment of Tax Auditor**
  For this purpose, the tax auditor(s) may be appointed by the company itself by means of a resolution of the Board of Directors or by the Chairman/ Managing Directors if so authorized in this behalf. The company is expected to fix separate remuneration for the auditor(s) appointed for this purpose.

- **Form of Audit Report**
  The Form of tax audit report applicable would be Form 3CA and the prescribed particulars would have to be given in Form 3CD, in accordance with Rule 6G of the Income Tax Rules, 1962, pursuant to Section 44AB of the Income Tax Act, 1961.

(CNO—INS.280) SIGNATURES AND REPORTS TO BE ATTACHED WITH THE ACCOUNTS AND STATEMENTS

Discussion

- Sub-section (3) of section 11 of the Insurance Act, 1938 provides that the accounts and statements referred to in sub-section (1) should be signed, in the case of a company, by the chairman, if any, and two directors and the principal officer of the company. It further provides that the accounts and statements should be accompanied by a statement containing the names, descriptions and occupations of, and the directorships held by, the persons in charge of the management of the business during the period to which such statements refers and by a report on the affairs of the business during that period.

(CNO—INS.300) CONTENTS OF AUDITOR'S REPORT

Discussion

- Apart from normal contents of Auditor's report, as prescribed for 'Limited Companies' IRDAI has prescribed the certain matters to be dealt with by the Auditors' in their Report vide Regulation 3 under Schedule C of IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. The Schedule C is reproduced below –

1. "The report of the auditors on the financial statements of every insurer shall deal with the specified herein –
   a. That they have obtained all the information and explanations which, to the best of their knowledge and belief, were necessary for the purposes of their audit and whether they have found them satisfactory;
   b. Whether proper books of account have been maintained by the insurer so far as appears from an examination of those books;
   c. Whether proper returns, audited or unaudited, from branches and other offices have been received and whether they were adequate for the purpose of their audit;
   d. Whether the Balance Sheet, Revenue Accounts and Profit and Loss Account dealt with by the report and the Receipts and Payments Account are in agreement with the books of account and returns;
   e. Whether the actuarial valuation of liabilities is duly certified by the appointed actuary,

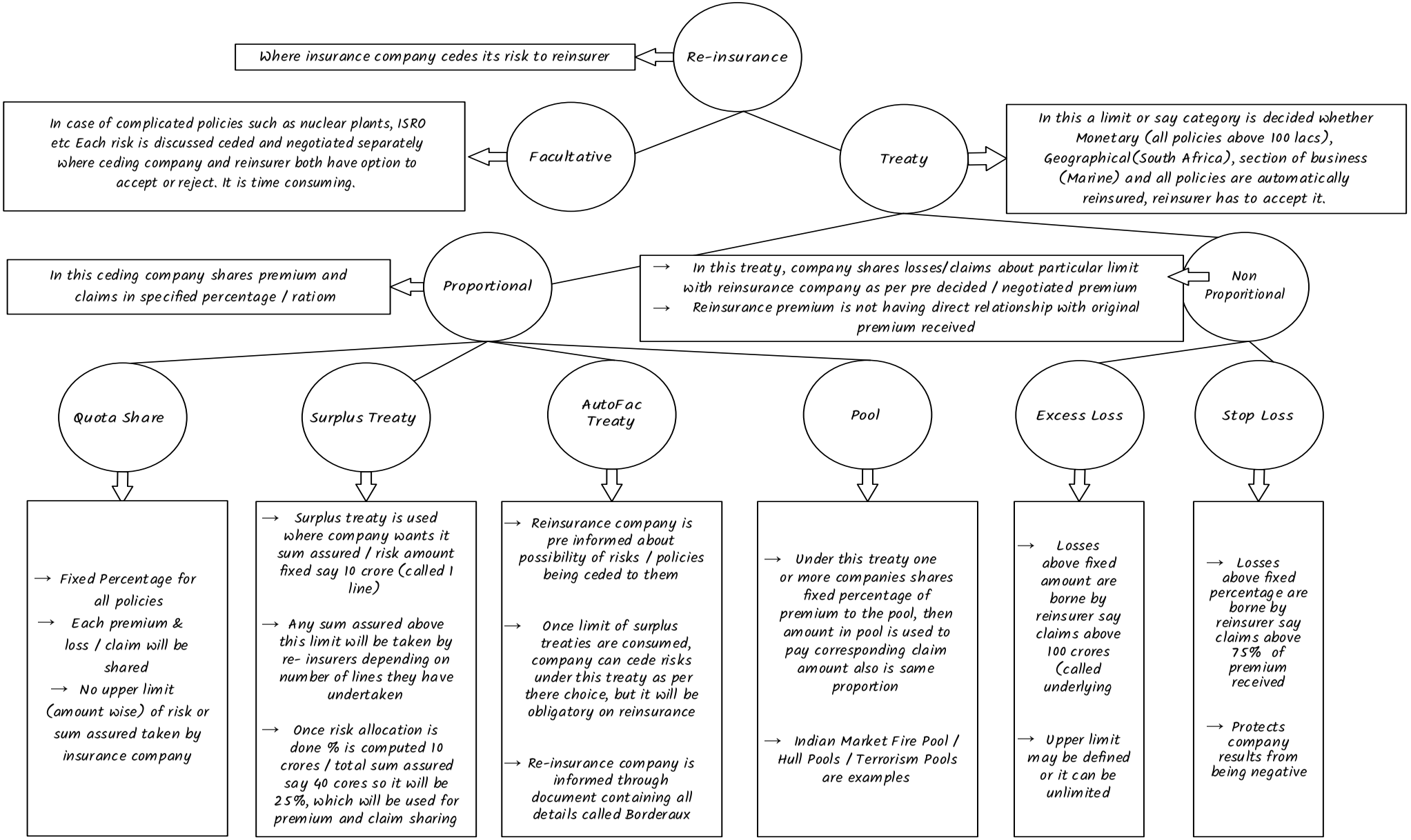
including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India in concurrence with the Authority.

2. *The auditors shall express their opinion on:*
   a.
      I. *Whether the Balance Sheet gives a true and fair view of the insurer's affairs as at the end of the financial year/period;*
      II. *Whether the Revenue Account gives a true and fair view of the surplus or the deficit for the financial year/period;*
      III. *Whether the Profit and Loss Account gives a true and fair view of the profit or loss for the financial year/period;*
      IV. *Whether the Receipts and Payments Account gives a true and fair view of the receipts and payments for the financial year/period;*
   b. *The financial statements stated at (a) above are prepared in accordance with the requirements of the Insurance Act, 1938 (4 of 1938), the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999) and the Companies Act, 1956 (1 of 1956) [now Companies Act, 2013], to the extent applicable and in the manner so required.*
   c. *Investments have been valued in accordance with the provisions of the Act and the Regulations.*
   d. *The accounting policies selected by the insurer are appropriate and are in compliance with the applicable Accounting Standards and with the accounting principles, as prescribed in these Regulations or any order or direction issued by the Authority in this behalf.*
3. *The auditors shall further certify that:*
   a. *they have reviewed the management report and that there is no apparent mistake or material inconsistencies with the financial statements; and*
   b. *the insurer has complied with the terms and conditions of the registration stipulated by the Authority.*
4. *A certificate signed by the auditors (which is in addition to any other certificate or report which is required by law to be given with respect to the balance sheet) certifying that:*
   a. *they have verified the cash balances and the securities relating to the insurer's loans, reversions and life interests (in the case of life insurers) and investments;*
   b. *the extent, if any, to which they have verified the investments and transactions relating to any trusts undertaken by the insurer as trustee; and*
   c. *no part of the assets of the policyholders' funds has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investments of the policyholders' funds."*

Part – 2 GENERAL INSURANCE COMPANIES

(CNO--GIC.020) CO-INSURANCE

Meaning	**Co- Insurance means** sharing of a particular risk by more than one insurer. Co-Insurance will be applicable where the value of risk is high, and more than one insurer agrees to share the risk at an agreed percentage.
Lead Insurer	**Lead Insurer: the leading insurer –** ➢ Issues policy documents containing a co-insurance clause, ➢ Collects premiums, ➢ Settles claims on the occurrence of events, and ➢ Renders statements of accounts to other co – insurers. The co – insurers meet periodically to settle balances and exchange statements as agreed between them.
Accounting	**Co-insurance can be both –** ➢ Incoming and ➢ Outgoing. Balance of other company relating to premiums and claims accounted under "co-insurance amount due to / due from other insurance companies".
Audit Procedures	**(Common points for inward & outward)** ➢ Evaluate the efficacy of internal control relating to co-insurance. ➢ Review the co-insurance agreement to ensure that the risks are covered as per the terms and conditions with adequate consideration and proper settlement. ➢ **Council** Co-insurance agreements between co-insurers are entered as per norms of general insurance council (council of Insurers). While entering into Co- Insurance agreement, the insurance council recommends norms on settlements of claims, settlements of commission, collection and remittance of service tax, etc
Outgoing Co-Insurance (QNO-489.000)	➢ Study the transactions relating to the outgoing business, i.e. where the company is the leader. ➢ Verify the transaction with reference to the relevant risk assumed under policies and correspondingly for debits arising to the Co-Insurer on account of their share of claims.
Incoming co –insurance (QNO-489.000)	➢ Ensure that the Premium account is credited on the basis of statements received from the leading Insurer. ➢ Where the statement is not received, verify that the premium is accounted for on the basis of advices, to ensure that all premium in respect of risks assumed in any year, is booked in the same year. ➢ Examine communication in the post – audit period and obtain a written confirmation to the effect that all incoming advices have been accounted for. ➢ Examine claims provisions and claims paid with reference to advice received from the leading insurer.


Re-insurance
Where insurance company cedes its risk to reinsurer
Facultative
In case of complicated policies such as nuclear plants, ISRO etc Each risk is discussed ceded and negotiated separately where ceding company and reinsurer both have option to accept or reject. It is time consuming.
Treaty
In this a limit or say category is decided whether Monetary (all policies above 100 lacs), Geographical(South Africa), section of business (Marine) and all policies are automatically reinsured, reinsurer has to accept it.
Proportional
In this ceding company shares premium and claims in specified percentage / ratiom
Non Proportional
→ In this treaty, company shares losses/claims about particular limit with reinsurance company as per pre decided / negotiated premium
→ Reinsurance premium is not having direct relationship with original premium received
Quota Share
→ Fixed Percentage for all policies
→ Each premium & loss / claim will be shared
→ No upper limit (amount wise) of risk or sum assured taken by insurance company
Surplus Treaty
→ Surplus treaty is used where company wants it sum assured / risk amount fixed say 10 crore (called 1 line)
→ Any sum assured above this limit will be taken by re- insurers depending on number of lines they have undertaken
→ Once risk allocation is done % is computed 10 crores / total sum assured say 40 cores so it will be 25%, which will be used for premium and claim sharing
AutoFac Treaty
→ Reinsurance company is pre informed about possibility of risks / policies being ceded to them
→ Once limit of surplus treaties are consumed, company can cede risks under this treaty as per there choice, but it will be obligatory on reinsurance
→ Re-insurance company is informed through document containing all details called Borderaux
Pool
→ Under this treaty one or more companies shares fixed percentage of premium to the pool, then amount in pool is used to pay corresponding claim amount also is same proportion
→ Indian Market Fire Pool / Hull Pools / Terrorism Pools are examples
Excess Loss
→ Losses above fixed amount are borne by reinsurer say claims above 100 crores (called underlying
→ Upper limit may be defined or it can be unlimited
Stop Loss
→ Losses above fixed percentage are borne by reinsurer say claims above 75% of premium received
→ Protects company results from being negative

(CNO--GIC.040) TYPES OF RE-INSURANCE (MCQ-IC.2, Incs-58.5)

Facultative Reinsurance (QNO-490.000) (MCQ – IC.7/ IC.8 / Incs.11.6 / Incs.27.4 / Incs.39.4)

It is that type of reinsurance whereby the contract relates to one particular risk and is expressed in the reinsurance policy. This is the oldest method of reinsurance and it necessitates consideration of each risk separately. Each transaction under facultative reinsurance has to be negotiated individually. Each party to the transaction has a free choice, i.e., for the ceding company to offer and the reinsurer to accept. The main drawbacks of this type of insurance are the volume of work involved and time taken to cover the risk. It is, however, still used even today, mainly when:

- Automatic covers have already been exhausted.
- The risk is excluded from the Treaties.
- The insurer does not want his reinsurance treaties overburdened with particularly heavy and abnormal risks.
- The insurer has no automatic cover at his disposal in a particular branch, where he issues policies rarely.
- The nature of business is such that technical guidance or consultation with the reinsurer is required at every stage of acceptance of the risk itself or for a type of business where the number of risks is very small, for example, in atomic energy installations, oils rigs, etc.

Treaty Reinsurance

Under this type of reinsurance, a treaty agreement is entered into between the ceding company and the reinsurer(s) where reinsurances are within the limits of the treaty. These limits can be monetary, geographical, section of business, etc. Under this contract, it is obligatory for the reinsurer to accept all risks within the scope this treaty and it is obligatory for the ceding company to cede risks in accordance with the terms of the treaty. In the case of treaty reinsurance contracts, the insurer generally prepares a statement of treaty reinsurances accounts, either on quarterly basis or on half-yearly basis.

These statements are sent to the re-insurer for the purpose of reconciliation of claims lodged under the reinsurance contracts, outstanding claims, claims paid, and claims paid in advance. It may be noted here that the treaty reinsurance contracts generally provide that in the event of any large claim being lodged with the insurer, the re-insurer shall make the payment even before the claim is finally settled or the statement of treaty reinsurance is received by the reinsurer.

The reinsurer, in such cases, treats the amount paid to the insurer as 'advance against claim'. The Advance against Claim Account is squared up as and when the claim is settled, and the information of this settlement is sent to the reinsurer through statement of treaty reinsurances. Such payments by the reinsurer are called Cash Loss Payments. Treaties can also be divided into two categories, viz., proportional treaties and non-proportional treaties.

Proportional Vs Non Proportional

- Proportional Treaties - Such treaties are based on pro-rata apportionment of the sum insured, premium and losses, according to a pre-determined percentage/ratio.
- Non-Proportional Treaties - Such treaties are characterised by a distribution of liability between the ceding company and the reinsurer on the basis of losses rather than the sum insured, as is the case in proportional reinsurance.
- The following are the other characteristics of non-proportional treaties:
  - Premium is not calculated on each cession, but on the whole portfolio of the ceding company.
  - The premium rate is predetermined.
  - Cost of reinsurance can vary substantially each year, depending on the premium income, loss ratio and reinsurance marked situations.
  - Normally no commission is paid.

Proportional Treaties (QNO-491.000) (MCQ- Incs.27.3)

Such treaties are based on pro-rata apportionment of the sum insured, premium and losses, according to a pre-determined percentage/ratio. These treaties can be further classified as follows:

- **Quota share treaty –**
  Under this treaty, the ceding company binds itself to cede a fix percentage of all policies issued by it

under a defined scope of business covered by the agreement. The accounting under this treaty is simpler than any other form of treaties. The advantage to the reinsurer under this treaty is that the reinsurer receives the same proportion of all business of the treaty class defined under the treaty. In other words, there is no selection against him. The advantage to the ceding company under this treaty is that, it cannot vary its retention/line for any particular risk, and therefore, it may have to pay premiums even on small risks which could have been retained by the ceding company itself. The use of this treaty is appropriate when a company commences business at a branch where no relevant data is available.

- ***Surplus Treaty –***
  Where a company cedes those amounts which it cannot or does not want to retain for its net account, such type of contract is known as surplus reinsurance treaty. If certain risk is totally retained, no surplus is left to be ceded. Surplus is always determined in multiples of ceding company's retention. A company can arrange more surplus treaties by having, say, second surplus treaty or third surplus treaty, etc. An example is given below:
  - Sum Assured Rs.500 lacs
  - Line Rs.5 lacs
  - Surplus Rs.495 lacs

  If first surplus treaty is 10 lines, it would cede Rs.50 lacs to the treaty and the balance of Rs.445lacs would have to be ceded to other treaty arrangements.

- ***Auto-fac Treaty –***
  Under this treaty, a ceding company may reinsure upto a defined limit after cession of its surplus treaties. It is obligatory for the reinsurer to accept cessions within the purview of the agreement. It, thus, resembles a facultative reinsurance treaty as the acceptance is obligatory and in many instances, the details of the risks are submitted by way of a Bordereaux.

- ***Pools –***
  More than one insurer may form a Pool under an agreement whereby its members cede a pre-determined proportion of a particular category of business directly written by them into the Pool. They also share the aggregate premiums and claims in the proportion and the share of premium ceded by each member. In India, the examples of this system are Indian Market Fire Pool and Hull Pools.

Non-Proportional Treaties (QNO-491.000)

Such treaties are characterised by a distribution of liability between the ceding company and the reinsurer on the basis of losses rather than the sum insured, as is the case in proportional reinsurance. The following are the other ***characteristics of non-proportional treaties:***

- Premium is not calculated on each session, but on the whole portfolio of the ceding company.
- The premium rate is predetermined.
- Cost of reinsurance can vary substantially each year, depending on the premium income, loss ratio and reinsurance marked situations.
- Normally no commission is paid.

Non-Proportional Treaties can be further classified into following categories.

- ***Excess of Loss (XL) Treaties –***
  In this type of treaty, the reinsurer's liability arises only when a claim exceeds a predetermined figure relating to a specific branch of the ceding company's business or to its entire business. The Treaty would provide for maximum liability as well as the amount upto which the ceding company would bear the loss itself, which is called the 'Underlying Limit'. The XL cover can also be arranged for an unlimited amount in excess of the underlying limit.

- ***Stop loss treaties –***
  This is also known as 'Excess of Loss Ration Cover' and it protects the company from losing more than a specified amount for a given class of business. Normally, the amount is fixed in relation to the ceding company's annual premium income for the class of business and is represented as a percentage. Thus, the reinsurer is liable for the losses which exceed the agreed percentage of loss ratio, until the limit of liability is reached which is expressed in the form of loss ratio. Such a treaty protects the annual results of a company in one branch against negative deviation due to increase in the number and cost of claims/losses.

(CNO--GIC.060) VERIFICATION OF RE-INSURANCE OUTWARD (QNO-492.000) (MCQ – Incs.39.2)

The following steps may be taken by the auditor in the verification of re-insurance outward:

- ***In the flow of reinsurance outward process***

  - ***Parameters and Guidelines applicable***
    *The auditor should check whether the pattern of re-insurance underwriting for outward cessions fits within the **parameters and guidelines applicable** to the relevant year. The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk.*

  - ***Agreements***
    *The auditor should verify whether the cessions have been made as per the **agreements** entered into with various companies.*

  - ***Foreign Exchange Payment to Foreign Reinsurers***
    It should also be seen whether the outward remittances to foreign re-insurers have been done as per the foreign exchange regulations.

  - ***Commission Receivable***
    - *It should also be seen whether the commission on cession has been calculated as per the terms of the agreement with the re-insurers.*
    - *The auditor should verify the computation of **profit commission** for various automatic treaty arrangements in the light of the periodical accounts rendered and in relation to outstanding loss pertaining to the treaty.*

  - ***Losses Confirmed by Re-insurers***
    *He should see whether provisioning for **outstanding losses** recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified.*

  - ***Cash Loss Recoveries (Immediate Payment if loss amount exceeds pre decided limit)***
    The auditor should examine whether the cash loss recoveries have been claimed and accounted on a regular basis.

- ***Records & Accounting***
  - ***Underwriting Returns***
    *The auditor should verify that re-insurance **underwriting returns** received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims.*

  - ***Accounting***
    ***Accounting aspects** of the re-insurance cession premium, commission receivable, paid claims*

recovered, and outstanding losses recoverable on cessions have to be checked.

- ***Sub Ledger***
  The auditor should also check that the **re-insurers balance** on cessions and whether the sub edger balances tallies with the general ledger balances.

- ***Opening Outstanding Claims Receivable***
  He should verify whether **opening outstanding claims** not received during the year find place in the closing outstanding claims vis-a-vis the reinsurance inwards outstanding losses payable on cessions appears in both opening and closing list. If not, the reason for the same should be analysed.

- ***Closing Claims Received Shown as Outstanding***
  The auditor should also verify whether the Claims Received item appears in **Outstanding Claims** list by error. This can be verified at least in respect of major claims.

- ***Confirmation***
  He should verify whether the balances with re-insurers are supported by necessary **confirmation** obtained from them.

- ***Provisioning***
  The auditor should review the **individual accounts** to find out whether any balance requires provisioning / write off or write back.

- ***Subsequent Events***
  Any **major event after the Balance Sheet** date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re - insurance balances will need to be brought out suitably.

- ***Percentage Pattern (Analytical Procedures)***
  The auditor should check **percentage pattern** of gross to net premium, claims paid and outstanding claims to ensure comparative justification.

(CNO--GIC.080) AUDIT OF PREMIUM (QNO-493.000/ 493.500/ 494.000/494.500)

- ***Most Important Basic Rule -- No Risk Assumption without Premium***
  No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co - insurance premium.

- ***Verification of Premiums -Verification of premium is of utmost importance to an auditor. The auditor should apply, inter alia, the following procedures for verification of premium –***

- ***Internal Control System & Compliance***
  Before commencing verification of premium income, the auditor should look into the **internal controls and compliance** thereof as laid down for collection and recording of the premiums. The auditor should broadly review the **systems** used by the company to collect money, underwrite and issue the policy.

- ***Premium Collection***
  - ***Periodical Premium***
    *Where policies have been issued with a provision to **collect premium periodically** (i.e., under instalment clause, special declaration policy or periodical declaration under open policies in marine insurance), the auditor should check whether premium are collected as and when they become due.*
  - ***Collection by Agents***
    *The auditor should also check that money **collected by the agents** from the policyholders have been received by the company as quickly as possible.*
  - ***Outstanding Premiums***
    *The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit. Also examine whether instalments of premium falling due in the subsequent year have not been recognised in the accounts as **outstanding premium**.*
  - ***Advance***
    *The auditor should verify the year end transactions to check that amounts received during the year in respect of risks commencing/ instalments falling due on or after the first day of next financial year are not credited to premium account but credited to **Premium Received in Advance Account**.*

- ***Premium Register***
  *The auditor should check whether **Premium Registers** have been maintained chronologically, for each underwriting department, giving full particulars including GST charged as per acceptance advice on a day-to-day basis. The auditor should verify whether the figures of premium mentioned in the register tally with those in General Ledger.*

- ***Cover Notes***
  *The auditor should ascertain that all the **cover notes** relating to the risks assumed have been serially numbered for each class of business. The auditor should also verify that there is an adequate internal check on the issue of stationery comprising of cover notes, policy documents, stamps, etc. The auditor may apply sampling techniques for verification of larger volume of transactions.*

- ***Policy Documents***
  *The auditor should verify that **policy documents have not been issued,** in case:*
  - *premium had **not been collected** at all;*
  - *premium had been collected but the relevant **cheques have been dishonoured;** (refer Cheque Dishonoured Book);*
  - *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);*
  - *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*
  - *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).

- ***GST***

*The auditor should verify whether **GST** has been charged from the insured, at the rates in force, on the total premium for all classes of business other than those exempted under GST laws. Check whether GST so collected is disclosed under 'Current Liabilities' to the extent not deposited in Government's Account.*

*In the case of co-insurance business, the auditor should verify whether **GST** at the rates in force, based on the place of business and place of delivery on the whole premium has been charged or collected from the insured by the company in case it is the leader. Check that GST/service tax so collected on premium charged from the insured by the company have been regularly deposited in the Government's Account.*

- ***Accounting***
  - ***Risk Inception***

*The auditor should ensure that premium in respect of **risks incepting** during the **relevant accounting year** has been accounted as premium income of that year on the basis of premium revenue recognition. The auditor, as part of his audit procedures, should make an assessment of the reasonability of the risk pattern established by the management. The auditor should also see 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. Normally, such instances relate to the issue of cover notes and certificates at the end of the accounting year relating to risks commencing in the next accounting period. Generally, there is a column in the Premium Register called "Commencement of Risk", indicating the date and time from which the risk under the policy issued has commenced.*

  - ***Cut Off Date***

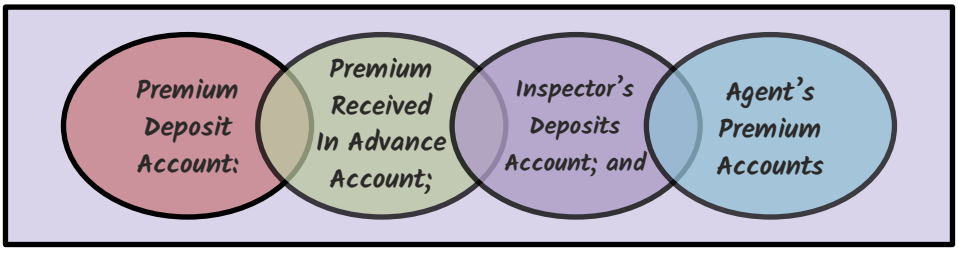
*The auditor should verify the collections **remitted by agents** immediately after the **cut -off date** to verify the risk assumed during the year under audit on those collections.*

  - ***After Balance Sheet Date***

*The auditor should verify the collections lodged by **agents after the balance sheet date to see** whether any collection pertains to risk commencing for the year under audit. The auditor should also check that the premium has been recorded originally at the gross figure, i.e., without providing for unexpired risks and reinsurances.*

- ***Special Points***
  - ***Reinsurance***

*The auditor should examine whether the **reinsurance company is not under a risk** in respect of amount lying at credit and outstanding as at the year-end in the following accounts:*



- ***Co-Insurance***

  *In case of **co-insurance business,** where the company is not the leader, because of the non-availability of the relevant information in many cases the premium is not booked even though the risk has commenced during the relevant accounting year. The auditor should see that the company's share of the premium has been accounted for on the basis of the available information on nature of risk and the provisional premium charged by the leading insurer. The auditor should examine the communications issued to the company by the leading insurers advising them of the company's share of premium income. Such communications should be seen even in respect of the post-audit period. Where the company is the leader, the auditor should obtain a reasonable assurance that only the company's own share of premium has been shown as income and accounts of the other companies have been credited with their share of the premium collected.*

- ***Cancellation & Refund***
  - ***Cancellation***

    *The auditor should also check that in case of **cancellation** of policies/cover notes issued, no risk has been assumed between the date of issue and subsequent cancellation thereof.*

  - ***Refund***

    *Where premium originally received has been **refunded,** the auditor should verify whether the agency commission paid on such premium has been adjusted.*

(CNO--GIC.100) AUDIT OF COMMISSION (QNO-495.000)

- ***Commission:***
  - ***Definition of Commission & Its 2 types***

    The commission is the consideration payable for getting the insurance business. The term 'commission' is used for the payment of consideration to get Direct business. Commission received on amount of premium paid to a re-insurer is termed 'Commission on reinsurance ceded and is reduced from the amount of commission expenditure.

  - ***Internal Control Over Commission***

    The internal control with regard to commission is aimed at ensuring that commission is paid in accordance with the rules and regulations of the company and in accordance with the agreement with the agent, commission is paid to the agent who brought the business and the legal compliances, for example, tax deduction at sources, GST on reverse charge mechanism and provisions of the Insurance Act, 1938 have been complied with.

- ***Role of Auditor:***

  The auditor should, inter alia, do the following for verification of commission:
  - *Ensure that the agent **is not blacklisted by IRDAI** and is not terminated for fraud etc.*
  - *Ensure that commission is paid to the **agent/broker who has solicited** the business*
  - *Ensure that commission is **paid as per rates** with the agent and rates filed with IRDAI*
  - *Test check **correctness of amounts** of commission allowed.*
  - *Check whether the **vouchers are authorized by the officers-in-charge** as per rules in force and income tax is deducted at source, as applicable.*
  - *Ensure that commission is **not paid in excess** of the limits specified by IRDAI*
  - ***Vouch disbursement entries** with reference to the disbursement vouchers with copies of commission bills and commission statements.*
  - *Check whether commission outgo for the period under audit been **duly accounted.***

Scrutinize **agents' ledger and the balances,** examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.

(CNO--GIC.120) AUDIT OF CLAIM (QNO-495.020/ 495.070)

- **Claims Provisions –**

  - **Verification**

    The auditor should satisfy himself that **the estimated liability provided** for by the management is adequate with reference to the relevant claim files/dockets, keeping in view the following:

    - that **intimation of loss** is received within a reasonable time and reasons for undue delay in intimation are looked into.

    - that due provision has been made in respect of **claims lodged at any office** of the company other than the one from where the policy was taken, e.g., a vehicle insured at Mumbai having met with an accident at Chennai necessitating claim intimation at one of the offices of the company at Chennai.
    - that provision has been made for only such claims for which the company is **legally liable,** considering particularly, (a) that the risk was covered by the policy, if in force, and the claims arose during the currency of the policy; and (b) that claim did not arise during the period the company was not supposed to cover the risk, e.g., where the premium was not paid or where cheques covering premium have been dishonored (refer section 64VB of the Insurance Act, 1938) or where a total loss under a policy has already been met/settled. (c) the loss event or the nature of loss is not excluded from the policy coverage (d) the person who has incurred the loss is the policyholder
    - Insurance companies normally have an 'initial provision' or '**default provision**' based on a pre-determined formula or on a primary assessment of the damage by a surveyor. The auditor would need to review the pre-determined formula to ensure that initial reserving made is adequate

      In certain circumstances, the claims are incurred by the insurance company but are not reported at the balance sheet date by the insured. Such claims are known as claims incurred but not reported (IBNR) or claims incurred but not enough reported(IBNER).

      The auditor should check the records for subsequent periods to ascertain that adequate provision has been created for such claims also. Calculation of IBNR & IBNER is done by the Appointed Actuary of the insurance company based on probability weighted estimations and statistical models approved by the Actuarial Standards.

    - that in determining the amount of provision, the '**average clause**' has been applied in case of under-insurance by parties.

    - that the provision made **is net of payments** made 'on account' to the parties wherever such payments have been booked to claims.
    - that the claims are provided for net of **estimated salvage,** wherever applicable
    - that in case of **co-insurance** arrangements, the company has made provisions only in respect of its own share of anticipated liability (II) that provision has been made for all unsettled claims as at the year-end on the basis of claims lodged/communicated by the parties against the company. The date of loss (and not the date of communication

as attributable to a particular year.

- that the provision made is normally not in excess of the amount insured except in some categories of claims where matters may be sub-judices in legal proceedings which will determine the quantum of claim, **the amount of provision should also include survey fee and other direct expenses.**

(Year End)

- that provision has been made for **all unsettled claims** as at the yearend on the basis of claims lodged/communicated by the parties against the company. The date of loss (and not the date of communication thereof) is important for recording/ recognizing the claim as attributable to a particular year.
- that **the claims status reports** recommended to be prepared by the Divisional Manager on large claims outstanding at the year-end have been reviewed with the contents of relevant files or dockets for determining excess/short provisions. The said report should be complete as to material facts to enable the auditor to take a fair view of the provision made.
- that wherever **legal advice** has been sought or the claim is under litigation, the provision is made according to the legal advisor's view and differences, if any, are explained.
- that provisions have been retained as at the year-end in respect of **guarantees** given by company to various Courts for claims under litigation.
- that in the case of amounts purely in the **nature of deposits with courts** or other authorities, adequate provision is made, and deposits are stated separately as assets and provisions are not made net of such deposits.
- that in determining the amount of provision**, events after the balance sheet date** have been considered, e.g., (a) claims settled for a materially higher/lower amount in the post -audit period; (b) claims paid by other insurance companies during the year under audit and communicated to company after the balance sheet date where other companies are the leaders in co-insurance arrangements; and (c) further reports by surveyors or assessors & (d), re-insurance cover available is considered.
- that wherever an **unduly long time has elapsed** after the filing of the claim and there has been no further communication and no litigation or arbitration dispute is involved, the reasons for carrying the provision have been ascertained.
- that **no contingent liability** is carried in respect of any claim intimated in respect of policies issued.

(Special Points)

- ***Consolidated Figures***

  The outstanding liability at the year-end is determined at the divisions/branches where the liability originates for outstanding claims. Thereafter, based on the total consolidated figure for all the divisions/branches, the Head Office considers a further provision in respect of outstanding claims

- ***Obtain information and Sampling***
  *The auditor should obtain from the divisions/branches, the information for **each class of business**, categorizing the claims **value-wise** before commencing verification of the claim's provisions, so that appropriate statistical sampling techniques may be applied, to ensure that representative volume of claims is verified for each class of business. The auditor should determine the total number of documents to be checked giving due importance to claim provisions of higher value.*

- ***Material Differences***
  *In cases of **material differences** in the liability estimated by the management and that which ought to be provided in the opinion of the auditor, the same must be brought out in the auditor's report after obtaining further information or explanation from the management. For determining the adequacy of the provisions in respect of any category of business, the auditor may resort to the method of testing the actual payments, wherever made, with the provisions made earlier for that category of business. Whether such liability has been estimated in the past on a fair and realistic basis can, thus, be examined by looking into current year's payments against provisions of the earlier year.*

- ***Claims Paid (QNO-495.070)***
  The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows:

  - *that **claims are not paid if the premiums are not received** as per Section 64 (VB) of the Insurance Act.*
  - *that the claims payments have been duly **sanctioned** by the authority concerned and the payments of the amounts are duly acknowledged by the claimants;*
  - *that payment made against claims **partially settled** have been duly vouched. In such cases, the sanctioning authority should be the same as the one which has powers in respect of the total claimed amount;*
  - *that in case of final settlement of claims, the claimant has given an **unqualified discharge note**, not involving the company in any further liability in respect of the claim; and*
  - *that payments have been made within 30 days of the receipt of the last document received. In case, there are delays, **interest on such delays** have to be paid as per IRDAI regulation*
  - *that the **salvage** recovered has been duly accounted for in accordance with the procedure applicable to the company and a **letter of subrogation** has been obtained in accordance with the laid down procedure;*

Special Points

- *that in case of **co-insurance** arrangements, claims paid have been booked only in respect of company's share and the balance has been debited to other insurance companies;*
- *that the figures of claims, wherever communicated for the year by the Division to the Head Office for purposes of **reinsurance claims,** have been reconciled with the trial balance-figure.*
- *that in case of claims paid on the basis of **advices** from other insurance companies (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company. Such claims which have been communicated after the yearend for losses which occurred prior to the year-end must be accounted for in the year of audit; that the amounts of the nature of **pure advances/deposits** with Courts, etc., in matters under litigation/arbitration have not been treated as claims paid but are held as assets till final disposal of such claims. In such cases, full provision should be made for*

outstanding claims;

- that necessary claims have been made to the re-insurer for all such claims paid. In certain facultative re-insurance arrangements, prior approval of the re-insurer has been obtained before the claim has been paid.

(CNO--GIC.140) UNEXPIRED RISK RESERVE (QNO-503.000)

Meaning

It is created in respect of policies that do not expire on Balance Sheet date and extends beyond that date into the following year during which coverage of risks continue.

Computation

According to the requirements of the Insurance Act, 1938, for the purpose of maintaining solvency margin, it is sufficient if: -

- The provision is made for unexpired risks at 50 per cent for Fire, Marine Cargo and Miscellaneous Business
- For Marine Hull which has to be 100 per cent.

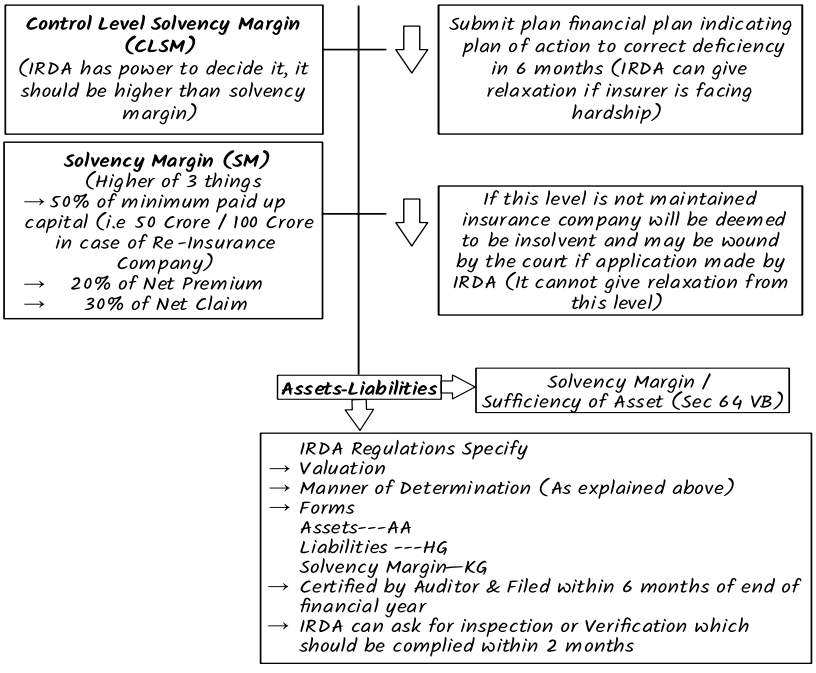
  Provision of IT act/ 1961 and IT rules, 1962 permits deduction of above Reserve at the prescribed rates.

(CNO--GIC.160) OUTSTANDING PREMIUM & AGENT BALANCES (QNO-502.000)

Meaning

- The following are the audit procedures to be followed for verification of outstanding premium and agents' balances:
  - **Check age-wise, sector-wise analysis** of outstanding premium.
  - Verify whether outstanding premiums have since been **collected.**
  - Inquire reasons for long outstanding credit balances in outstanding premium accounts and examine the reasons for policies not being issued or the outstanding premium not adjusted against amounts due.
  - Check the availability of adequate **bank guarantee or premium deposit** for outstanding premium.
  - Examine **inoperative balances** and treatment given for old balances with reference to company rules.
  - Enquire into the reasons for retaining the **old balances**
  - Scrutinise and review **control account debit balances** and their nature should be enquired into.
- Verify old debit balances which may require **provision or adjustment**. Notes of explanation may be obtained from the management in this regard.

(CNO--GIC.180) SOLVENCY MARGIN (Sufficiency of assets) (QNO 506.000) (Incs.04.1 / Incs.11.4/ 58.3)



*Control Level Solvency should be 150% of minimum solvency margin

(CNO--GIC.200) TRADE CREDIT INSURNCE (QNO-507.000)

Meaning

"**Trade credit insurance**" **means** insurance of suppliers against the risk of non-payment of goods or services by their buyers who may be situated in the same country as the supplier **(domestic risk)** or a buyer situated in another country **(export risk)** against non-payment as a result of **insolvency** of the buyer or non-payment after an agreed number of months after due date **(protracted default)** or non-payment following an event outside the control of the buyer or the seller **(political risk cover)**. Political risk cover is available only in case of buyers outside India and in countries agreed upon at the proposal stage.

Requirements of Trade Credit Insurance

- Policyholder's loss is non-receipt of trade receivable arising out of a **trade of goods or services.**
- Policyholder's trade receivable does not arise **out of factoring or reverse factoring** arrangement or any other similar arrangement.
- Policyholder is a supplier of goods or services in consideration for a **fair market value.**
- Policyholder has a customer (i.e. Buyer) who is **liable to pay a trade receivable** to the policyholder in return for the goods and services received by him from the policyholder, in accordance with a policy document filed with the insurer.
- Policyholder **undertakes to pay premium for the entire Policy Period.**
- **Any other requirement** that may be specified by the Authority from time to time.

(CNO—GIC.220) ACCOUNTING SYSTEM MODULES

The system of recording, classifying and summarizing the transactions in insurance companies, is, in substance, no different from other entities. However, in case of insurance companies, the ledger accounts specially those of premiums, claims, commissions, etc. need to be given greater attention. The functions of accounting system in general insurance business under IT environment may be based on:

- Premium receipting & issuance of policies based on Underwriting done. 2
- Claims module3
- Agency management module1
- Accounts module6
- Investment module4
- Reinsurance module5

Every insurer, in respect of insurance business transacted and in respect of shareholder's funds, is required to prepare a Balance Sheet, a Profit and Loss Account (in respect of transactions of the shareholders, in their capacity as shareholders), a separate Account of Receipts and Payments, a Revenue Account (in respect of transactions with policy holders on account of insurance) for each year in accordance with the Regulations as may be specified. Every insurer should keep separate accounts relating to funds of shareholders and policyholders.

REQUIREMENTS OF SCHEDULE B TO THE IRDA (PREPARATION OF FINANCIAL STATEMENTS AND AUDITORS' REPORT OF INSURANCE COMPANIES) REGULATIONS, 2002.

(CNO—GIC.240) PART I: ACCOUNTING PRINCIPLES FOR PREPARATION OF FINANCIAL STATEMENTS (Only Relevant Points Covered)

Applicability of Accounting Standards

- Every Balance Sheet, Receipts and Payments Account [Cash Flow statement] and Profit and Loss Account [Shareholders' Account] of the insurer shall be in conformity with the Accounting Standards (AS) issued by the ICAI, to the extent applicable to the insurers carrying on general insurance business, except that:
  - Accounting Standard 3 (AS 3) – Cash Flow Statements – Cash Flow Statement shall be prepared only under the Direct Method.
  - Accounting Standard 13 (AS 13) – Accounting for Investments, shall not be applicable.
  - Accounting Standard 17 (AS 17) - Segment Reporting – shall apply irrespective of

whether the securities of the insurer are traded publicly or not. The minimum segments are prescribed by IRDAI.

Income & Expenses

- **Premium**
  - Premium shall be recognised as income over the contract period or the period of risk, whichever is appropriate. Unearned premium as well as premium received in advance, both of which represent premium income not relating to the current accounting period, shall be disclosed separately in the financial statements.
  - A reserve for Unearned Premium, may be created as the amount representing that part of the premium written which is attributable and to be allocated to the succeeding accounting periods.
  - Premium Received in Advance, which represents premium received prior to the commencement of the risk, shall be shown separately under the head 'Current Liabilities' in the financial statements.
  - Unearned premium shall be shown separately under the head 'Provisions' and appropriate disclosures regarding management's basis of assessment shall be made in the financial statements.
  - Premium received in advance shall not be included in the unearned premium and shall be shown separately.
- **Premium Deficiency**
  - Premium deficiency shall be recognised if the sum of expected claim costs, related expenses and maintenance costs exceeds related unearned premiums.
    For contracts exceeding four years, once a premium deficiency has occurred, future changes to
  - the liability shall be based on actuarial/technical evaluation
- **Acquisition Costs**
  - Acquisition costs, if any, shall be expensed in the period in which they are incurred. Acquisition costs are those costs that vary with, and are primarily related to, the acquisition of new and renewal insurance contracts. The most essential test is the obligatory relationship between costs and the execution of insurance contracts (i.e. commencement of risk).
- **Claims**
  - The components of the ultimate cost of claims to an insurer comprise the claims under policies and claims settlement costs. Claims under policies comprise the claims made for losses incurred, and those estimated or anticipated under the policies.
    - A liability for outstanding claims shall be brought to account in respect of both direct
  - business and inward reinsurance business. The liability shall include: -
    - Future payments in relation to unpaid reported claims;
    - Claims Incurred but Not Reported (IBNR) including inadequate reserves (sometimes referred to as Claims Incurred but Not Enough Reported (IBNER)).

Procedure to determine the value of investments (QNO 499.000)

An insurer shall determine the values of investments in the following manner: -

- **Real Estate –Investment Property–**

  Investment Property shall be measured at historical cost less accumulated depreciation and impairment loss, residual value being considered zero and no revaluation being permissible.

  The Insurer shall assess at each balance sheet date whether any impairment of the investment property has occurred.

  An impairment loss shall be recognized as an expense in the Revenue/Profit and Loss Account immediately.

  Fair value as at the balance sheet date and the basis of its determination shall be disclosed in the

- ***Debt Securities-***
  Debt securities including government securities and redeemable preference shares shall be considered as "held to maturity" securities and shall be measured at historical cost subject to amortization.

- ***Equity Securities and Derivative Instruments that are traded in active markets***
  Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value as at the balance sheet date. For the purpose of calculation of fair value, the lowest of the last quoted closing price of 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.

  An active market shall mean a market, where the securities traded are homogenous, availability of willing buyers and willing sellers is normal, and the prices are publicly available. Unrealized gains/losses arising due to changes in the fair value of listed equity shares and derivative instruments shall be taken to equity under the head 'Fair Value Change Account' and on realization reported in Profit and Loss Account. The 'Profit on sale of investments' or 'Loss on sale of investments', as the case may be, shall include accumulated changes in the fair value previously recognized in equity under the heading Fair Value Change Account in respect of a particular security and being recycled to Profit and Loss Account on actual sale of that listed security.

  For the removal of doubt, it is clarified that balance, or any part thereof shall not be available for distribution as dividends. Also, any debit balance in the said Fair Value Change Account shall be reduced from the profits/free reserves while declaring dividends.

  The insurer shall assess, at 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 remeasured 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 market will be measured at historical costs. Provision shall be made for diminution in 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 it 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 its trading volume does not exceed ten thousand units in any trading session during the last twelve months.

Actuarial Valuation of claim liability- in some cases

- *Estimate of claims made in respect of contracts exceeding four years shall be recognised on an actuarial basis, subject to regulations that may be prescribed by the Authority. In such cases, certificate from a recognised actuary as to the fairness of liability assessment must be obtained. Actuarial assumptions shall be suitably disclosed by way of notes to the account.*
- *Necessary provision for unexpired risk shall be made subject to any minimum, statutorily required*

PART II: DISCLOSURES FORMING PART OF FINANCIAL STATEMENTS (Not Important)

PART III: GENERAL INSTRUCTIONS FOR PREPARATION OF FINANCIAL STATEMENTS (Not Important)

PART IV: CONTENTS OF MANAGEMENT REPORT

Discussion

- There shall be attached to the financial statements, a management report containing, inter alia, the following duly authenticated by the management:

  - Confirmation regarding the continued validity of the registration granted by the Authority;
  - Certification that all the dues payable to the statutory authorities have been duly paid;
  - Confirmation to the effect that the shareholding pattern and any transfer of shares during the year are in accordance with the statutory or regulatory requirements;
  - Declaration that the management has not directly or indirectly invested outside India the funds of the holders of policies issued in India;
  - Confirmation that the required solvency margins have been maintained;
  - Certification to the effect that the values of all the assets have been reviewed on the date of the Balance Sheet and that in his (insurer's) belief the assets set forth in the Balance sheets are shown in the aggregate at amounts not exceeding their realizable or market value under the several headings – " Loans", " Investments", "Agents balances", "Outstanding Premiums", "Interest, Dividends and Rents outstanding", "Interest, Dividends and Rents accruing but not due", "Amounts due from other persons or Bodies carrying on insurance business", " Sundry Debtors", " Bills Receivable", " Cash" and the several items specified under "Other Accounts";
  - Certification to the effect that the no part of the life insurance fund has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investment of the life insurance funds;
  - Disclosure with regard to the overall risk exposure and strategy adopted to mitigate the same;
  - Operations in other countries, if any, with a separate statement giving the management' estimate of country risk and exposure risk and the hedging strategy adopted;
  - Ageing of claims indicating the trends in average claim settlement time during the preceding five years;
  - Certification to the effect as to how the values, as shown in the balance sheet, of the investments and stocks and shares have been arrived at, and how the market value thereof has been ascertained for the purpose of comparison with the values so shown;
  - Review of asset quality and performance of investment in terms of portfolios, i.e., separately in terms of real estate, loans, investments, etc.

  - A responsibility statement indicating therein that:
    - in the preparation of financial statements, the applicable accounting standards, principles and policies have been followed along with proper explanations relating to material departures, if any;
    - the management has adopted accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the operating profit or loss and of the profit or loss of the company for the year;
    - the management has taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the applicable provisions of the Insurance Act 1938 (4 of 1938) / Companies Act, 1956 (1 of 1956), for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
    - the management has prepared the financial statements on a going concern basis;
    - the management has ensured that an internal audit system commensurate with the size and nature of the business exists and is operating effectively

(CNO—GIC.260) PART V: PREPARATION OF FINANCIAL STATEMENTS (Not Important)

- **Format & Segment Information**
  An insurer shall prepare the Revenue Account, Profit and Loss Account [Shareholders' Account] and the Balance Sheet in Form B-RA, Form B-PL, and Form B-BS, or as near thereto as the circumstances permit. It may be noted that an insurer shall prepare Revenue Account separately for fire, marine, and miscellaneous insurance business.

- **Cash Flow Statement**
  An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in AS 3 – "Cash Flow Statement" issued by the ICAI.

Unique question	
QNO 497.000	Claim (Audit Register & Records)
QNO 504.000	Contingent Liabilities

Part – 3 LIFE INSURANCE COMPANIES

(CNO—LIC.020) TYPES OF LIFE INSURANCE POLICIES

Life Insurance Industry in India has witnessed varied product designs during last 5 decades.
Based on the peculiarities involved, Life Insurance Products can broadly be categorized as follows:

Term / Protection	➢ **Pays if Death Occurs during Policy Period** Term Insurance covers the policy holder for specific period and pays the death benefits only if the policy holder dies during the policy period. ➢ **For Income Requirements** Term life Insurance is traditional form of Life Insurance Product. Term Insurance generally takes care of pure income replacement needs rather than Capital appreciation requirements.
Whole Life Insurance Product	➢ **Term Insurance + Covers whole life and not few years** It provides cover through the lifetime of the person. Unlike Endowment plans they do not carry any maturity value and sum assured is paid to the family in case of unfortunate death of the policyholder.
Endowment/ Pure Endowment	➢ **Death & Maturity Benefits** Endowment policies cover the risk for a specified period and at the end of the policy the sum assured is paid back to the policyholder along with all bonus accumulated during the policy term.
Unit Linked Insurance Plan (ULIP)	➢ **Example LIC New Endowment Plus** (Money Invested in Underlying Assets + Value changes as per Underlying Assets + Protection Against Downfall) The Premium paid is used for the purchase of units in Investment assets. Unit Linked Insurance Plans are such Insurance plans where the value of the policy changes as per the underlying Investment Assets. It allows protection and flexibility in Investment.
Money Back Plan	➢ **Example LIC NEW Money Back Plan 20 Years** (Type of Endowment Policy with Periodic Payments of Partial Benefits) Money Back policies are type of Endowment policies which provides periodic payments of partial benefits during the term of policy so long as the policy holder is alive. ➢ **Full death benefits no deduction of particle payments made before** Peculiar nature of these policies is that, in event of death at any time during policy term, the death claim would comprise of full sum assured without deduction of any survival benefit amounts. Also, bonus is calculated on sum assured.
Pension or Retirement Plans	➢ **Example LIC's New Jeevan Nidhi** (Decide retirement age and pay till time of retirement, then get regular income) A pension plan is retirement solution where policyholder decides the age retirement age and agrees to pay premium till the time of the retirement and thereafter he has option to commute a part of his fund value and take an annuity for the balance. Pension plan provides Income protection as well as the Life Cover.
Annuities	➢ **Example LIC's Jeevan Akshay 6 Pension Plan** (First periodical payments, till fixed date then periodical receipts after Fixed date) Annuity is a contract where Insurer in return for the payment at regular intervals till fixed date make series of agreed payments at regular intervals from fixed date.

Group Insurance

- **Example LIC's Group Credit Life Insurance**
  (Sum assured is paid, if there is death of any group member)
  Group Insurance is an insurance that covers a group of people, who are the members of the societies, employees of an organization or professionals in common group.

REQUIREMENTS OF SCHEDULE A TO THE IRDA (PREPARATION OF FINANCIAL STATEMENTS AND AUDITORS' REPORT OF INSURANCE COMPANIES) REGULATIONS, 2002.

(CNO—LIC.040) PART-I: ACCOUNTING PRINCIPLES FOR PREPARATION OF FINANCIAL STATEMENTS (Only Relevant Parts Covered) (QNO-499,500)

Applicability of Accounting Standards

- Every balance sheet, Revenue Account (Policy holders account), Receipts and Payments account (Cash flow statement) and Profit and Loss account (Shareholder's account) of an insurer shall be in conformity with the Accounting standards (AS) issued by the ICAI, to the extent insurers carrying on life insurance business, except that:
  - Accounting standard 3 (AS 3) – Cash flow statements – Cash flow statement shall be prepared only under the direct method.
  - Accounting standard 17 (AS 17) – Segment Reporting – shall apply to all insurers irrespective of the requirements regarding the listing and turnover mentioned therein.

Incomes & Expenses

- Premium: Premium shall be recognized as income when due. For linked business the due date for payment may be taken as the date when the associated units are created.
- Acquisition Costs: Acquisition costs if any shall be expensed in the period in which they are incurred. Acquisition costs are those costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts. The most essential test is the obligatory relationship between costs and the execution of insurance contracts (i.e. commencement of risks)
- Claims: The ultimate cost of claims shall comprise the policy benefit amount and specific claims settlement costs, wherever applicable.

Procedure to determine 'Value of Investments'

An insurer shall determine value of investments in the following manner:

- **Real estate investment property –**
  - **Historical Cost + Revaluation Once in 3 Years Transfer Profit to Revaluation Reserve**
    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. Gains/losses arising due to changes in the carrying amount of real estate shall be taken to equity under 'Revaluation Reserve'.
  - **Disclosure of revaluation in notes to accounts**
    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.
  - **Assess whether impairment has happened**
    The insurer shall assess at each balance sheet date whether any impairment of the property has occurred.
  - **Treatment of Impairment Loss**
    An impairment loss of 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.

- **Profit / Loss on Sale of Investment= Profit / Loss as per Book Value + Balance in 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.

- **Debt Securities –**
  - Historical Cost Subject to Amortization
    Debt securities, including government securities and redeemable preference shares, shall be considered as 'held to maturity' securities and shall be measured at historical cost subject to amortization.

- **Equity Securities and Derivative Instruments that are traded in markets –**
  - **Fair value on Balance Sheet Date**
    Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value on the balance sheet date.

  - **Fair Value = Last Quoted Closing Price**
    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.

  - **Meaning of Active Market**
    An active market shall mean a market, where the securities traded are homogenous, availability of willing buyers and willing sellers is normal, and the prices are publicly available.

  - **Treatment of Unrealized Gain = Fair Value Change Account**
    Unrealized 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'.

  - **Profit / Loss on Sale of Investment**
    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.

  - **Treatment of Fair Value Change Account by Authority**
    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.

  - **Assess for impairment on each balance sheet date**
    The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.

  - **Treatment of Impairment Loss**
    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–**
  - **Historical Cost**
    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 for diminution in value of investment**
    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 it carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost.
  - **Meaning of not Actively Traded = Thinly Traded as per SEBI**
    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".
  - **Thinly Traded as per SEBI**
    Equity / equity-related security shall be considered to be thinly traded when the value of the trades of that security in a month is less than Rs. 5 lacs by value and the total volume of the trades in that security is less than 50,000 shares. In order to determine whether a security is thinly traded, the volumes traded in NSE and BSE shall be considered.

Actuarial valuation

- **Liability for Life Policies**
  The estimation of liability against life policies shall be determined by the appointed actuary of the insurer pursuant to his annual investigation of the life insurance business. Actuarial assumptions are to be disclosed by way of notes to the account.

  The liability shall be so calculated that together with future premium payments and investment income, the insurer can meet all future claims (Including bonus entitlements to policyholders) and expenses.

Linked (ULIP) Business

- **Separate Set of Financial Statements**
  The accounting principles used for valuation of Investments are to be consistent with principles as Enumerated above. A separate set of financial statements, for each segregated fund of the linked business should be annexed.
- **Income Gain / Loss = Policy Holders**
  Segregated funds represent funds maintained in accounts to meet specific investment objectives of policy holders who bear the Investment risk. Investment income/ gains and losses generally directly accrue to the policy holders.

PART II: DISCLOSURES FORMING PART OF FINANCIAL STATEMENTS (Details not important)

PART III: GENERAL INSTRUCTIONS FOR PREPARATION OF FINANCIAL STATEMENTS (Details not important)

PART IV: CONTENTS OF MANAGEMENT REPORT (Details not important)

(CNO—LIC.060) PART V PREPARATION OF FINANCIAL STATEMENTS

Format & Segment Information	An insurer shall prepare the Revenue Account [Policyholders' Account], Profit and Loss Account [Shareholders' Account] and the Balance Sheet in **Form A-RA, Form A-PL** and **Form A-BS,** as prescribed in this Part, or as near thereto as the circumstances permit. Provided that an insurer shall prepare Revenue Account for the undermentioned businesses separately and to that extent the application of AS 17 shall stand modified: ➢ Participating policies and Non-participating policies; ➢ Linked, Non-Linked, and Health Insurance; ➢ Business within India and Business outside India.
Cash Flow Statement	An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in **AS 3 – "Cash Flow Statement"** issued by the ICAI.

SPECIAL / PECULIAR AREAS OF AUDIT IN LIFE INSURANCE COMPANIES

(CNO—LIC.080) ACTUARIAL PROCESS (QNO-S07.030) (MCQ-IC.5)

➢ **Change in Role from Supervision to Certification**
Actuaries in Life Insurance business have gained tremendous importance. The role of Actuary in life insurance has shifted from supervising compliance to certify whether products and financial reports are in accordance with the general regulatory guidelines.

➢ **Affects Pricing &Valuations**
The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk. The actuarial department is calculating and modelling hub of the Company. Within the department fundamentals of Insurance business is determined from pricing to policy valuations techniques.

Role of Auditor

➢ **Certification of Actuarial Valuation**
Auditors in the Audit report are required to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India in concurrence with the IRDA.

➢ **Certificate of Actuary & Evaluation of Actuaries Work**
Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.

Work of Actuarial Department

Actuarial department broadly concentrates following key areas of Insurance business:

➢ **Initially**
- Business Planning.

➢ **Regular Reports**
- Management reporting on various business valuations and profitability models of the Life Insurance business.

➢ **New Policies**
- Product Development/ Pricing and Experience analysis.
- Model Development.

➢ **Statutory Requirements**
- Statutory Valuations and reserving.

(CNO—LIC.100) UNDERWRITING

- **Definition of Underwriting**

  A proposal is an application for an insurance cover. The process of verifying the level of risk in each new entrant is called 'selection' or 'underwriting'. The underwriters may either decline the risk or may provide a quotation in which the premiums have been loaded or in which various exclusions have been stipulated, which restrict the circumstances under which a claim would be accepted and paid.

- **Premium Determination and Risk Selection**

  The underwriter assesses the risk and determines the premium to be charged. The function of the underwriter is to acquire-or to "write"-business that will bring money to the insurance company, and to protect the company's business from risks that they feel will make a loss.

Role of Auditor

- **IRDA Act & Regulation / Policy / Internal Control System**

  While verifying the process of underwriting, the objective of the Audit should be to review the process of acceptance of risk through the underwriting process and evaluate and test the effectiveness of internal controls in place to ensure timely and accurate Insurance policy, adherence to the IRDA Act and Rules and regulations made thereunder.

(CNO—LIC.120) FREE LOOK CANCELLATION (FLC) (QNO-507.045)(MCQ – Incs.39.3)

15 Days Limit

- (Policy holder can ask for cancellation within 15 Days)

  As per clause 6(2) of IRDA (Protection of Policyholders Interest) Regulations, 2002, "the insurer shall inform by the letter forwarding the policy that he has a period of 15 days from the date of receipt of the policy document to review the terms and conditions of the policy and where the insured disagrees to any of those terms or conditions, he has the option to return the policy stating the reasons for his objection, when he shall be entitled to a refund of the premium paid, Accordingly, FLC is an option provided to the policyholder wherein he has a period of 15 days from the date of receipt of the policy document to review the Terms & Conditions of the policy and in case of disagreement to any of the terms & conditions, he/ she has the option to return the policy stating the reason for policy's cancellation.

- **(Allowed Deductions)**

  Subject only to a deduction of a proportionate risk premium for the period on cover and the expenses incurred by the insurer on medical examination of the proposer and stamp duty charges".

FLC refund is calculated as follows:	
FLC premium paid	XXX
(Less) - proportionate risk premium	(XXX)
(Less)-medical charges. If any, by the insurer.	(XXX)
(Less)-stamp duty	(XXX)

- **Modes Allowed**

  FLC requests can be received through any mode –e-mail, fax and letters depending on insurer's policy. In case of written letters, the signature of the policy holder should be matched with the original proposal form.

- **Reasons – Not Satisfied with terms & Conditions**

  FLC request is processed only when the policy holder is not satisfied with the terms and conditions of the policy document and not for any other reasons. FLC refund is paid either by cheque or in case the policy holder wants direct credit, then consent for direct credit along with cancelled cheque for bank account details is submitted.

Role of Auditor

- ***Signature Verification / Accounting Entries***

  The primary objective of the audit is to check and confirm that FLC requests are received within 15 days from receipt of policy document by the policy holder, verification of signatures of the policy holder and processing of FLC request within TAT (Turn Around Time) defined by the insurer. Also checking of appropriate accounting entries are recorded for refund.

(CNO—LIC.140) POLICY LAPSE AND REVIVAL (QNO-507.050)

- ***How to keep Policy "In Force"***

  In order to keep a life insurance policy "in force" the policy holder is required to pay premiums when due (either monthly/ quarterly/annual/bi-annual).

- ***Grace Period***

  If payment is missed, the insurer allows a period of 15/30 day from the premium due date for making the payment. This period is termed as "grace period". If the policy holder does not make the payment within the grace period, the policy gets "lapsed". Thus, a payment within the grace period is deemed to be a payment on the due date.

- ***Lapse not defined but its treatment is defined***

  "Lapse" is the discontinuance of the policy owing to non-payment of premium dues. The term "lapse" is not defined in the insurance legislation, except stating that "a policy which has acquired a surrender value shall be kept alive to the extent of the paid-up sum assured (Proportionate Sum Assured)" - vide section 113(2) of the Insurance Act,1938. (Policy acquires surrender value when premiums for full 3 years is paid to insurance company)

- ***Affects Stakeholders***

  Lapsation affects all the stakeholders – the policy holder, agents and the insurer. A lapsed policy ceases to provide insurance protection to the insured. It forfeits the benefits under the policy and cost of new policy is higher. Agents do not get renewal premium commission if the policy is lapsed.

- ***Revival***

  The terms and conditions of the policy stipulate, that where the premium is not paid within the grace period, the policy lapses but may be revived during the lifetime of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy and that it would be better to take out a fresh policy.

- ***Monitoring Renewal Premiums***

  The insurer should have taken persistent measures for monitoring receipt of renewal premium within the due dates. In case of most of insurers, policy lapsation is tracked over the PMS (Policy Management System), wherein premium due dates are monitored by the system once initial data of the policy is entered in the system.

Role of Auditor

- ***Monitoring / Lapsed & Revival Treatment***

  The primary objective of the audit is to check and confirm that due dates are recorded and monitored properly and polices are marked as "lapsed" on non -receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy.

(CNO—LIC.160) POLICY SURRENDER

Details

- ***Meaning***

  Surrender of an insurance policy refers to the voluntary termination of the insurance contract before the expiry of the term of the contract. The process of surrender is initiated by the policy holder.

- ***Eligibility***

  A policy becomes eligible for surrender on completion of 3 years from the commencement of the policy provided that 3 years premium have been paid within the due dates.

- ***Process***

  The policy holder has to submit surrender request form duly signed off by him at branch/processing centre along with the original policy document and the discharge voucher. Eligibility for surrender is mentioned in the policy document. The policy can be surrendered only when the insured person is alive.

Role of Auditor:

- ***Authenticity of Surrender Requests / Surrender Amount Computation***

  The primary objective of the audit is to check and confirm that surrender requests are received from the policy holder only, and that adequate controls are in place to ensure proper verification process for checking of request, whether premiums are paid on regular basis. Check whether surrender amount is paid only to the policy holder and is paid only as per terms and conditions mentioned in the policy document and appropriate accounting entries are passed.

(CNO—LIC.165) PREMIUM ACCOUNTING / PREMIUM RECOGNITION

Discussion

- *Premium accounting refers to recognizing the premium earned by the insurer as income in the accounting system.*

  Income is recognized as:
  - *New business premium – premium received for the first policy year and*
  - *Renewal premium – premium received for subsequent policy years.*
- *Premium received but not identifiable against any policy would be treated as 'unallocated premium' / 'suspense amount'.*
- *Further following points should be noted while recognizing the premium:*
  - *When the new policy is issued by the Insurer, new business premium is recognised on the realisation of premium. Generally, Policy is underwritten only after the receipt of the first premium. However, in certain cases, policies are issued awaiting realisation of premiums, for e.g. policies are issued subject to realisation of cheques issued by the Insured. Auditors are required to check these cases and ensure proper accounting of the same.*
  - *Renewal income is recognized*
    - *on realization of the premium amount or*
    - *when premium is due but not received up to the end of grace period.*
  - *Auditors should also evaluate various sub-processes, employed by the Insurance Companies in accounting of premiums like collection of premium from the policy holders, booking of premium, banking, accounting and reconciliation of the same.*

(CNO—LIC.170) AUDIT OF PREMIUMS (QNO-507.040)

Discussion

- *Collection of Premium:*
  - *The premium collections are credited to separate bank account and no withdrawals are normally permitted from that account for meeting general expenditure.*
  - *Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.*
  - *Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.*
- *Calculation of Premium:*
  - *Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly.*
  - *Check that system employed as such is equipped to calculate all types of premium modes correctly.*

- Recognition of Income:
  - Check that premium is recognized only on the basis of 'Issued Policies' and not on underwriting dates.
  - Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies.
  - Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.
- Accounting of 'Advance Premium':
  - Check, whether system has capability to identify regular and advance premium.
  - Check whether there is a process of applying advance premium to a contract when premium is due.
- Reporting of Premium figures to IRDA/ Management:
  - Check the methodology for generation of MIS from the system and there is no manual intervention.
  - Check the procedure for Maker/ Checker before finalizing the MIS.
  - Check whether there is a reconciliation process between premium Income as per financials and as reported.
- Other Areas:
  - Check whether there are appropriate SOPs developed by the Companies and are strictly followed by all the departments/ branches of the Company.
  - Ensure duly approved Delegation of Authority parameters matrix already in place for authorization limits.
  - Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel.
  - Check that the Company conducts premium reconciliation on daily basis.
  - Check the robustness of interface between administration and accounting system.

(CNO—LIC.175) AUDIT OF CLAIMS

Discussion

- Auditor should review the standard policy document template to ensure that the policy document prescribes the minimum documentary evidence needed to support a claim.
- Ensure that the Insurer maintains a register or record of claims, in which every claims entered along with the date of the claim and date on which the claim was discharged.
- In case the claims are rejected, the reasons for the rejections should be closely reviewed.
- Check whether all claims received are registered and enter into the system.
- It should be ensured that there is a system of collecting appropriate KYC documents, as required, and discrepancies, if any, are intimated to the policyholders within 15 days of intimation.
- It should be ensured that all the processed claims are accounted into the system properly.
- It should be ensured that appropriate provisioning has been carried out, in the cases of all the claims intimated but not paid.
- It should be ensured that Claims cost includes the Claims settlement Cost.
- In case of living/ survival/ maturity / annuity benefits it should be ensured that liability is automatically triggered.
- It should be ensured that there is system of regular reconciliation is carried out between claims management system and General ledger.
- Liability of claims should be booked net of reinsurance.

(CNO—LIC.178) AUDIT OF COMMISSION (QNO - S07.070)

Discussion

- Insurance business is generally solicited by the Insurance agents. The remuneration of agent is paid by way of commission which is calculated by applying percentage to premium collected by him. Agency commission contributes towards significant portion of expenses incurred by the Insurance Commission. Commission is payable towards generation of new business and towards settlement of

	renewal premium ➢ Role of Auditor: The Auditor during his review of Commission paid to Agents should mainly consider the following: ▪ Review the system established by the Insurer with respect to calculation of commission to eligible agents accurately and processing the same in timely manner. ▪ Review the commission payment system is in sync with the premium collection system. ▪ Check whether commission paid is within the limit prescribed under Insurance Act. ▪ Check whether commission is clawed-back on the cancelled policies. ▪ Check the completeness of commission processing system.

(CNO—LIC.180) OPERATING EXPENSES RELATED TO INSURANCE BUSINESS (EXPENSES OF MANAGEMENT)

(QNO - 507.055)

Covered in Revenue Accounts	In so far as financial statements are concerned, this Schedule is part of the Revenue Account to be prepared for insurance business.
Division in 14 Heads	All the administrative expenses in an insurance company are broadly classified under 14 heads as mentioned in Schedule 3 forming part of Financial Statements given under Schedule A to the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002.
Separate Disclosure	Any other expenses are required to be disclosed under the head 'Others'. Any major expenses (5 lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately.
Role of Auditor	➢ **First Aggregate & Then Allocate** 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. ➢ **Disclose Policy of Allocation** 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.

(CNO—LIC.200) INVESTMENTS (QNO-507.060) (MCQ - Incs.39.1)

Shareholders' Investment Vs Policyholders Investment	The Investment portfolio of Life Insurance companies comprise of Shareholders' funds and Policyholders' funds.
Categories of Policyholders Fund	Policyholders' funds can further be segregated as linked and non - linked. Investment regulations are however prescribed separately for the following investment categories: ➢ Linked Funds ➢ Pension and Annuity Funds ➢ Controlled Funds
Effective Governance / Internal Controls System / Financial Transparency	As Insurers essentially manage the funds for policyholders it becomes imperative for the insurer to have adequate systems and processes that should not only ensure robust internal controls, financial transparency and equity but also bring effective governance so as to serve the interests of the management, stakeholders, consumers and the society, at large.

Pattern of Investment

IRDA (Investment) regulations, 2000 gives details of the pattern in which Funds of the Life Insurance business, should be kept invested at any given point of time.

Independent Sub Functions in Investment Function

The overall functioning of the Investment function should include the following independent functions:

- Investments front office / dealing desk
- Treasury – Cash Management, Deal settlement, Broker empanelment, Custody
- Investment accounting – Fund accounting, NAV computation and declaration.

Investments mid office – Compliance, Risk Management, Reporting, Reconciliations.

Role of Auditor

The Auditor during his review of Investment Department should mainly consider the following:

Regulation & Split

- **Compliance with Regulations**

  Compliance of all Investment regulations, various other circulars specified by IRDA and other regulations specified in the Insurance Act, 1938

- **Split**

  Ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life (Participating & Non-Participating), Pension & Group (Participating & Non-Participating) and Unit Linked Fund

Policy Related Points

- **Investment Policy**

  Review of insurer's Investment policy

- **Risk Management Policy**

  Insurer's risk management policies and processes to manage investment risk such as Market risk, Liquidity risk, Settlement risks, etc.

- **Accounting & Valuation Policy**

  Review and check insurer's Investment Accounting and valuation policy and the controls around this process

Structure & Control Related Points

- **Investment Committee**

  Review of functioning and scope and minutes of Investment Committee.

- **Investment Management Structure**

  Review the Investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office

- **SOPs**

  Review of insurer's Standard Operating Procedures which are prescribed by the IRDA Regulations and are required to cover the entire gamut of investment related processes and policies

- **Policy Management System Vs Investment System**

  Flow of data from PMS to the Investment Accounting system

- **Controls over Interfaces**

  Controls over various system interfaces such as Seamless integration of data, between front office and back office, in the Investments accounting system

- ***Access Controls, Authorization Process & Deal Execution***
  Review of access Controls, authorization process for Orders and Deal execution, etc.

- ***Cash Management System***
  Review of insurer's Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer's system should be able to determine the amount of Investible surplus

- ***Control over Outsourcing***
  Determine the extent of activities outsourced and the controls over such activities

- ***Controls Over NAV Computation***
  Controls over NAV computation and declaration

Reconciliation related Points

- ***Fund wise Reconciliation***
  Review of fund wise reconciliation with Investment Accounts, Bank, and Custodian records.

- ***Reconciliation between holdings & custodian***
  Review the arrangements and reconciliations of holdings with the insurer's custodian.

Other Points

- ***Disaster Recovery etc.***
  Review of insurer's Disaster Recovery, Backup and Contingency Plan

- ***Monitoring***
  Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments.

- ***Personal, Insider Trading, Front Running Avoidance***
  Controls around personal dealings, insider trading and front running.

UNIQUE MCQS	
MCQ No.	IC.1
MCQ No.	IC.3
MCQ No.	IC.4
MCQ No.	IC.6
MCQ No.	Incs.02.5

Students Notes

11 AUDIT OF NON-BANKING FINANCIAL COMPANIES

(CNO—NBFC.020) WHAT IS NBFC? CRITERIA FOR NBFC? HOW IT IS DIFFERENT FROM BANK? (MCQ-NBFC.3 /NBFC.8)

Definition

A Non-Banking Financial Company (NBFC) is a company: -

- Registered under the Companies Act, 2013,
- It may receive deposits under any scheme or arrangement in one lump sum or in instalments.
- Its principal business is lending, investments in various types of shares /stocks /bonds /debentures / securities, leasing, hire-purchase, insurance business, chit business etc. and

However, a Non-Banking Financial Company does not include any institution whose principal business is agricultural activity, industrial activity, trading activity or sale/purchase/construction of immovable property.

How to test whether principal business is finance? (QNO - S13.500 / S13.800 / S13.900)

Further, 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 financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and 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.

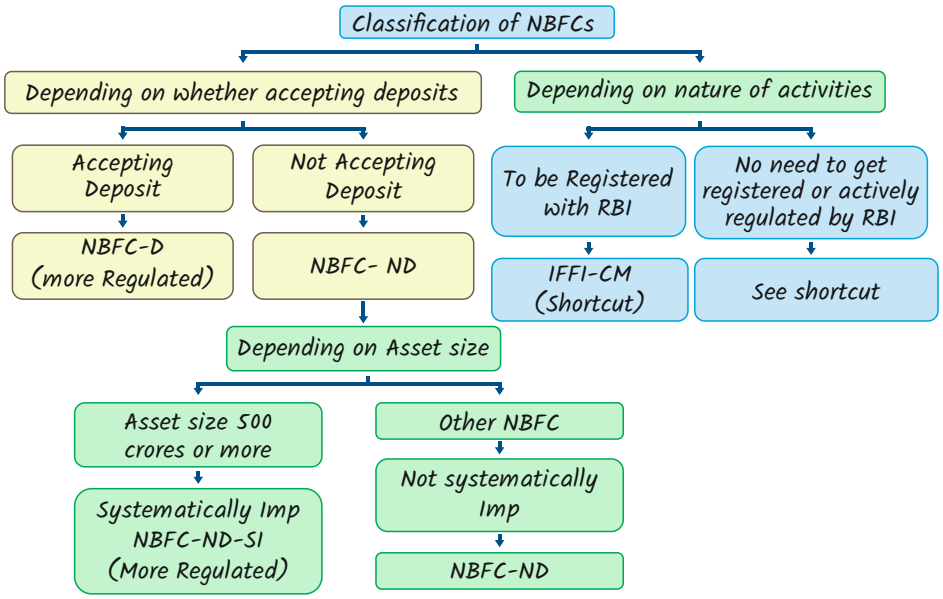
Difference between Bank and NBFC

- **Source of Finance**
  1. FDI limit is 100% as against 74% in Banks
  2. Demand deposits: bank can accept the demand deposits, but NBFC can't
- **Facilities**
  3. Cheque/Demand Drafts: bank can issue the cheque, but NBFS can't
  4. Deposit insurance: it is a policy taken by the Bank to insure the deposits received, against the contingencies like stolen of deposit money. This facility is not available in the case of NBFC.
- **Obligations & Powers**
  5. Compulsory lending to priority sector is not applicable to NBFC
  6. NBFC do not have power under SARFAESI or DRT Law

(CNO—NBFC.040) Registration of NBFC (QNO - S14.500)

- Under Section 45-IA of the **Reserve Bank of India (Amendment) Act, 1997, no non-banking financial company is allowed to commence or carry on the business** of a non-banking financial institution without
  - obtaining a certificate of registration issued by the Reserve Bank of India.
  - having a net owned fund (NOF) of **Rs 2 crore** not exceeding Rs 100 crore, as the RBI may, by notification in the Official Gazette, specify.
  - ·As on today RBI has prescribed Rs 2 crore as minimum (NOF)

(CNO—NBFC.060) TYPES OF NBFCs



(CNO—NBFC.065) CLASSIFICATION OF NBFC (QNO-514.300)

Chart

AMENDMENTS

NBFC-SCALE BASED REGULATIONS

Applicable from 1st OCT 2022

NBFC classified in 4 layers

	Base	Middle	Upper	Top
Deposit condition	Non-Deposit taking NBFC + Asset size not exceeding 1000cr	• Deposit Taking • Non Deposit taking + Asset size exceeding 1000 cr	-	• Ideally empty • Substantial Increase in potential Systematic Risk of upper layer NBFC
Other	PAN[2] P- Peer to peer lending A- Account Aggregator N- Non-operating Holding co N- Not Availing public funds & Not having customer Interface Always in Base layer	Shakal is Coming Hide Immediately S- Stand Alone Primary dealer I- Infra Debt Fund (Always in Middle layer) C- Core Investment Co H- Housing finance Co I- Infra structure financial co (Middle or Upper)	• Top 10 as per Asset size (Always in Upper Layer) • Set of Parameters as per RBI	

**Govt Owned NBFC's Shall be placed in Either BASE/MIDDLE Layer

REVISED CLASSIFICATION OF NBFC

Pursuant to the announcement of Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs on 22 October 2021 to be effective from 01 October 2022, RBI has revised different facets of existing NBFC Classification and regulation like Capital Requirements, Governance Standards, Prudential Regulations, etc. based on four layers that are defined based on their size, activity, and perceived riskiness.

These **four layers** are

- NBFC – Base Layer (NBFC-BL)
- NBFC- Middle Layer (NBFC-ML)
- NBFC Upper Layer (NBFC-UL)
- NBFC – Top Layer (NBFC-TL).

The **Top layer** is ideally expected to be **empty** and will be filled by RBI based on required need. Details of NBFCs populating the various layers is mentioned below:

Base Layer

The Base Layer shall comprise of

(a) non-deposit taking NBFCs below the asset size of ₹1000 crore and

(b) NBFCs undertaking the following activities-

- NBFC-Peer to Peer Lending Platform (NBFC-P2P),
- NBFC-Account Aggregator (NBFC-AA),
- Non-Operative Financial Holding Company (NOFHC) and
- NBFCs not availing public funds and not having any customer interface.

Middle Layer

The Middle Layer shall consist of

(a) all deposit taking NBFCs (NBFC-Ds), irrespective of asset size,

(b) non-deposit taking NBFCs with asset size of ₹1000 crore and above and

(c) NBFCs undertaking the following activities

- Standalone Primary Dealers (SPDs),
- Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs),
- Core Investment Companies (CICs),
- Housing Finance Companies (HFCs) and
- Infrastructure Finance Companies (NBFC-IFCs).

Upper Layer

The Upper Layer shall comprise of those NBFCs which are **specifically identified by the Reserve Bank** as warranting enhanced regulatory requirement **based on a set of parameters and scoring methodology** as provided in the Appendix to this circular. The top ten **(10)** eligible NBFCs in terms of their **asset size** shall always reside in the upper layer, irrespective of any other factor.

Top Layer

The Top Layer will **ideally remain empty**. This layer can **get populated** if the Reserve Bank is of the opinion that there is a **substantial increase in the potential systemic risk** from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

Categorisation of NBFCs

Categorisation of NBFCs carrying out specific activity

As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs

a) NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the **Base Layer** of the regulatory structure.

b) NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the **Middle** Layer.

c) The remaining NBFCs, viz.,

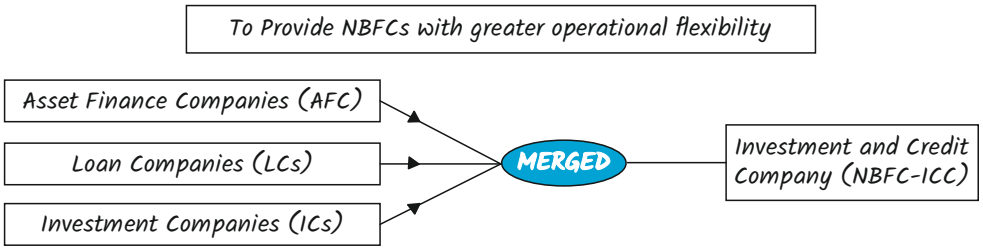
- Investment and Credit Companies (NBFC-ICC),
- Micro Finance Institution (NBFC-MFI),
- NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC)

could lie in **any of the layers** of the regulatory structure depending on the parameters of the scale based regulatory framework.

d) **Government owned NBFCs** shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice.

(CNO—NBFC.080) COMPANIES WHICH NEED REGISTRATION WITH RBI (QNO-514.000)

Recent Amendment



Classification

Currently, NBFCs registered with RBI are being classified as:

IFFI inaugurated by **CM** sponsored by **NBFCs**

- Investment and Credit Company (ICC)
- Non-Operative Financial Holding Company - (NOFHC)
- Non-Banking Financial Company - Factors (NBFC-Factors)
- Infrastructure Finance Company (IFC) (Only 9 such companies in India, L&T Infrastructure Finance Company Ltd)&Infrastructure Debt Fund- Non- Banking Financial Company (IDF-NBFC) (Only 4 such companies in India, L&T Infra Debt Fund Ltd)
- Core Investment Company (CIC) &Systemically Important Core Investment Company (CIC-ND-SI)(For financing of a particular business group, TATA Capital Limited)
- Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI). (Bandhan Financial Services Limited)

(CNO—NBFC.100) COMPANIES WHICH NEED REGISTRATION WITH RBI(EXPLANATION)

Systematically Important

Systematically Important NBFCs

NBFC-ND-SI means

- a Nonbanking financial company
- **Not accepting /holding public deposits and**
- **having Total Assets of Rs 500 crore and above** as shown in the last audited balance sheet.

Categorywise Explanation

Investment and Credit Company ' (ICC)

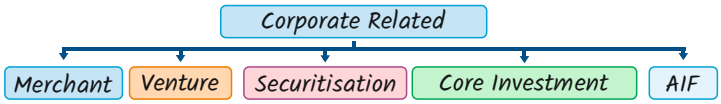
Investment and Credit Company means any company which is a financial institution carrying on as its principal business –

- asset finance,
- the providing of finance whether by making loans or advances or

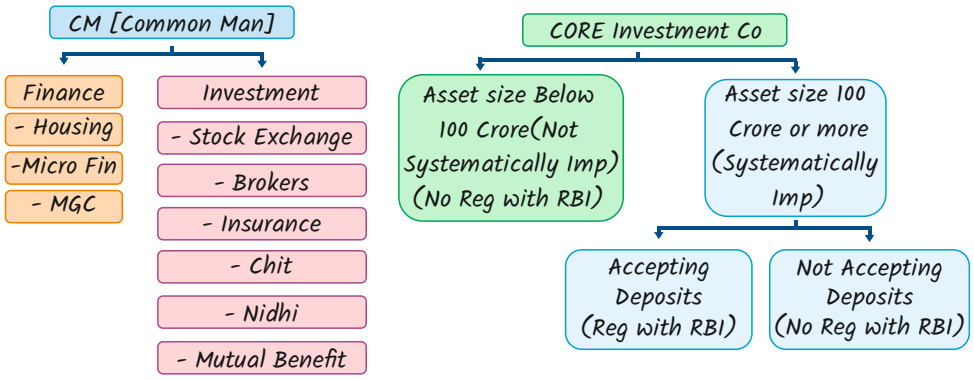
	➢ otherwise for any activity other than its own and the acquisition of securities; and is not any other category of NBFC as defined by the RBI in any of its Master Directions.
NBFC – Factors	➢ **Factoring** Factoring business refers to the **acquisition of receivables** by way of assignment of such receivables or financing, there against either by way of loans or advances or by creation of security interest over such receivables **but does not include normal lending by a bank against the security of receivables etc.** ➢ **Conditions** NBFC-Factor is a **non-deposit** taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least **50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.**
Non-Operative Financial Holding Company (NOFHC)	Means a **non-deposit** taking NBFC referred to in the "**Guidelines for Licensing of New Banks in the Private Sector**", issued by the RBI, which holds the **shares of a banking company and the shares of all other financial services companies** in its group, whether regulated by the RBI or by any other financial regulator, to the extent permissible under the applicable regulatory prescriptions.
IFC & IDF-NBFC	➢ **IFC** A company which has ▪ Net owned funds of at least Rs 300 crore ▪ Deployed 75% of its total assets in Infrastructure loans ▪ Provided it has credit rating of A or above ▪ CRAR of 15% (with a minimum Tier I capital of 10 percent). ➢ **IDF-NBFC** Means a non-deposit taking Non Banking Financial Company that has: ▪ net owned funds of Rs 300 crore or more; and ▪ which invests only in Public Private Partnerships(PPP) and post commencement operations date (COD) infrastructure projects which have completed at least one year of satisfactory commercial operation and becomes a party to a Tripartite Agreement.
Core Investment Company & CIC-NDSI	Core Investment Companies (CIC) having **total assets of not less than RS 100 crores** either individually or in aggregate along with other CICs in the group and which **raises or holds public funds** are called as Systemically Important Core Investment Companies (CICs-D-SI).

CNO—NBFC.120) COMPANIES EXEMPTED FROM REGISTRATION UNDER RBI (MCQ – Incs.50.1)

Companies that do financial business but are regulated by other regulators are given specific exemption by the Reserve Bank from its regulatory requirements for avoiding duality of regulation.
Following NBFCs have been exempted from the requirement of registration under Section 45 -IA of the RBI Act, 1934 subject to certain conditions



Continue on next Page...



- Housing Finance Institutions (regulated by National Housing Bank);
- Merchant Banking Companies (regulated by securities and Exchange Board of India);
- Stock Exchanges (regulated by securities and Exchange Board of India);
- Companies engaged in the business of stock-broking /sub-broking (regulated by securities and Exchange Board of India);
- Venture Capital Fund Companies(regulated by securities and Exchange Board of India);
- Nidhi Companies (regulated by Ministry of Corporate Affairs, Government of India);
- Insurance Companies (regulated by Insurance Regulatory and Development Authority);
- Chit Companies (as defined in clause (b) of Section2 of the Chit Funds Act, 1982 (Act 40 of 1982))
- Micro Finance Companies
- Securitisation and Reconstruction Companies
- Mutual Benefit Companies
- Mortgage Guarantee Companies
- Core Investment Companies i.e. a non-banking Financial Company being a core investment Company referred to in the core Investment Companies (Reserve bank) Directions, 2016,which is not a Systemically Important Core Investment company, as defined in sub- paragraph (XXV) of paragraph 3 of the Core Investment Companies (Reserve Bank)Direction, 2016.
- Alternative Investment (AIF) Companies

It may also be mentioned that Mortgage Guarantee Companies have been notified as Non-Banking Financial Companies under Section 45 I(f)(iii) of the RBI Act, 1934.

Core Investment Companies with asset size of less than ₹ 100 crore, and those with asset size of ₹ 100 crore and above but not accessing public funds are exempted from registration with the RBI.

(CNO—NBFC.140) GENERAL AUDIT PROCEDURES (QNO - 515.300)

Registration with the RBI

- Section 45-IA inserted by the RBI Act, w.e.f. 9th January 1997, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds (NOF) of Rs 2 Crore.

Ascertaining the Business of the company

- **From MOA / AOA**
  The first step in carrying out the audit of a NBFC is to scan through the Memorandum and Articles of Association of the company, to acquaint oneself with the type of business that the company proposes to engage itself in. The Memorandum of Association of any company would be very wide. Companies generally lend to specialise in and focus on a few select activities.

- **From Business Policy**
  An auditor should therefore make a careful study of the business policy of the company so as to ascertain its principal business activities.

- **From Minutes**
  An auditor may also scan through the minutes of the Board/Committee Meetings and hold discussions with the top-level management to ascertain the corporate business plan/strategy which would give him a clear picture as to the principal objects of the company.
- **Independent Corroboration**
  An auditor should then independently corroborate his findings with the actual business done by the company, as reflected by the company's financial results.

Evaluation of Internal Control System

- **Responsibility with Management**
  The responsibility of maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of its business vests with the management.
- **Sound system will prevent fraud & help in smooth decision making**
  A sound internal control system would enable an organisation to plug loopholes in its workings, particularly in the detection of frauds and would also aid in timely decision making.
- **Auditor should obtain understanding**
  An auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures.
- **Determine whether ICS is working effectively**
  An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed.

NBFC Public Deposit Directions

- **Board Resolution Regarding Deposits**
  In the case of NBFCs not accepting/holding public deposits, check whether a board resolution has been passed by the NBFC to the effect that it has neither accepted any public deposits, nor would it accept any public deposits during the year.1
- **Deposit Limit depends on Credit Rating**
  The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. Obtain a copy of the credit rating assigned to NBFC and check whether the public deposits accepted/held by it are in accordance with the level of credit rating assigned to it. In the event of a downgrading of credit rating, the auditor should bear in mind that the NBFC will have to reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame.2
- **Written Applications for Deposits**
  Ascertain whether the NBFC has accepted or renewed any public deposit only after a written application from the depositor in the form to be supplied by the company and shall contain all particulars specified in the Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977.3
- **Deposit Register**
  Verify the deposit register maintained by a NBFC and test check the particulars that have been entered therein in respect of each depositor with supporting receipts issued to the depositors. Also, check whether the NBFC is regularly paying its deposits on due dates and in the case of a delay/default, the reasons for the delay/default and the actual date of payment.4
- **Liquid Investments**
  Check whether the investments made in approved liquid assets by a NBFC holding public deposits have been lodged in safe custody with a designated scheduled commercial bank as required by the NBFC Public Deposit Directions. Obtain a certificate from the bank to that effect.5
- **Interest Calculations**
  Test checks the interest calculations in respect of public deposits mobilised by a NBFC to ascertain

that the NBFC has not paid interest in excess as per specification. Likewise, test check the brokerage calculations with the bills and vouchers for reimbursement of out of pocket expenses submitted by a broker to ascertain that the NBFC has not paid brokerage in excess by way of reimbursement of expenses to brokers.6

- **Filling of Annual Return**
  Check whether the NBFC has filed its annual return as specified in the First Schedule before the 30th June with reference to its position as on the 31st March of each year.7
- **Submission of Accounts / Audit Report / Directors Report**
  In the case of NBFCs accepting/holding public deposits ascertain whether audited statement of accounts together with a copy of the auditor's report and director's report thereon have been submitted within prescribed time limit from the date of holding the Annual general meeting.8

NBFC Prudential Norms Directions

Note: Content of this part is replaced as per recent answer by ICAI (QNO-515.000)

- **The auditor has to verify the compliance of prudential norms relating to**
  - **Policy Formation**
    The auditor shall ensure that Board of the NBFC shall frame a policy for granting demand/call loans and implement the same.
  - **At the time of giving advances / investment**
    - Prohibition on loans and investments for failure to repay public deposits and
    - Prohibition of granting loans against its own shares;
    - Norms for concentration of credit etc.
      In case of Investment Company, NBFC Prudential Norms stipulates that NBFCs should not lend more than 15% of its owned funds to any single borrower and not more than 25% to any single group of borrowers. The ceiling on investments in shares by a NBFC in a single entity and the aggregate of investments in a single group of entities has been fixed at 15% and 25% respectively. Moreover, a composite limit of credit to and investments in a single entity/group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC. Verify that the credit facilities extended, and investments made by the concerned NBFC are in accordance with the prescribed ceiling.
  - **After the giving advances / investment**
    - **Income recognition (Advances);**
      Auditor should ensure that unrealized income from non-performing assets has not been taken to Statement of Profit and Loss.
    - **Income from investments;**
      NBFC prudential norms directions require dividend income on shares of companies and units of mutual funds to be recognized on cash basis.
    - **Asset classification**
      - The auditor should verify the classification of advances and loans as standard/ substandard/doubtful/loss and that proper provision has been made in accordance with the directions.
      - The auditor should check all NPAs of the previous years to verify whether during the current year any payments have been received or still they continue to be NPA during the current year also.
    - **Provision for bad and doubtful debts;**
    - **Capital adequacy norm;**
    - **Investment Valuation**
      Check whether the investments have been valued in accordance with the NBFC

	Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
Core Investment Company	➢ ***Board Resolution regarding Investment*** In the case of Group Holding Investment Companies, check whether the NBFC has passed a board resolution to the effect that the company has invested or would invest/hold its investments in share and securities of group companies specifying the names of the companies. In addition to the above, group holding investment companies are required to give a further undertaking that it would not trade in such shares/securities and that it has neither accepted, nor would it accept any public deposits during the year.

AUDIT OF INVESTMENT AND CREDIT COMPANY

(CNO—NBFC.160) INVESTMENT BUSINESS RELATED POINTS (QNO-517.000 ,520.050)

Buying & Selling	➢ Verify the ***Board Minutes for purchase and sale of investments.*** Ascertain from the Board resolution or obtain a management certificate to the effect that the ***investments so acquired are current investments or Long-Term Investments.*** ➢ Test ***check bills/contract notes*** received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
Conditions while Purchasing	➢ Obtain a list of subsidiary/group companies from the management and verify the ***investments made in subsidiary/group companies*** during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares. ➢ Check whether ***investments in unquoted debentures/bonds*** have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
Dividend & Interest	➢ Verify that ***dividend income wherever declared*** by a company, has been ***duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for.*** ➢ NBFC ***Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis.*** ➢ However, the NBFC has an ***option to account*** for dividend income ***on accrual*** basis, if the same has been ***declared by the body corporate in its Annual General Meeting*** and its right to receive the payment has been established. ➢ ***Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.***
Verification / Confirmation / Valuation	➢ ***Physically verify*** all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified. ➢ In respect of shares/securities held through a depository, obtain a ***confirmation from the depository*** regarding the shares/securities held by it on behalf of the NBFC. ➢ Check whether the investments have been ***valued in accordance with the NBFC Prudential Norms*** Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions. ➢ An auditor will have to ascertain whether the ***requirements of AS 13 "Accounting for Investments"*** (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
Securities Lending / Borrowing	➢ Verify ***charges received or paid*** in respect of securities lend/borrowed. ➢ ***Obtain a confirmation*** from the approved intermediary regarding securities deposited with/ borrowed from it as at they earned. ➢ Verify that securities of the ***same type or class are received back*** by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.)

(CNO—NBFC.180) LOAN COMPANY RELATED POINTS	(QNO-520.000)
(Own Shares)	➢ Check whether the NBFC has not advanced any loans against the security of its **own share**.
(Internal Control System)	➢ An auditor should verify whether the NBFC has an **adequate system of proper appraisal and follow up of loans and advances.** In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.
(Sanction & Conditions Attached)	➢ An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc. Check whether the NBFC has not lent/invested **in excess of the specified limits** to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.
(Security & Agreement)	➢ An auditor should verify the **security obtained and the agreements entered into,** if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower / guarantor to determine the extent to which an advance could be considered realisable.
(Classification)	➢ Check the **classification of loans and advances** (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, doubtful assets and loss assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.
(Confirmation)	➢ Obtain **balance confirmations** from the concerned parties. (2 Special Lending)
(Bill Discounting)	➢ As regards bill discounting, verify that **proper records/documents** have been maintained for every bill discounted/rediscounted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.

(CNO—NBFC.200) AUDIT CHECK-LIST FOR HIRE PURCHASE FINANCE COMPANY	(QNO-518.000)
	➢ **Internal Control System** Ascertain whether the NBFC has an **adequate appraisal system** for extending hire purchase finance. The system of appraisal is basically concerned with obtaining information regarding the **credit worthiness** of the hirer, his experience in the field, assets owned, his past track record and future projections of his income. ➢ **Acquisition of Asset** Verify that the **payment for acquiring an asset** should be made directly to the supplier/dealer and that the original invoice has been drawn out in the name of the NBFC. ➢ **Registration Certificate** If the hire purchase finance is against vehicles, check **whether the registration certificate contains an endorsement** in favour of the hire purchase company. ➢ **Insurance** Verify that the assets given on hire purchase have been **adequately insured** against. ➢ **Installation &Valuation Report** In the case of high value hire purchase items relating to machinery/equipment, an auditor should ascertain whether **the valuation reports and installation reports are called** for. In case of some high value items, he should also physically verify the asset in possession of the hirers, particularly in a situation where he has any doubts as regards the genuineness of the transaction.

- ***Installments***

  *Check whether **hire purchase instalments are being received regularly** as and when they fall due. Check whether adequate provision has been made for overdue hire purchase instalments as required by the NBFC Prudential Norms directions.*

- ***Method of Accounting***

  *Examine the **method of accounting followed by the hire purchase finance company** for appropriation of finance charges over the period of the hire purchase contract. Ascertain that there is no change in the method of accounting as compared to the immediately preceding previous year.*

- ***Verification***

  *The auditor should verify whether the NBFC has a system in place for **verifying the hire purchase assets periodically** to ensure that the hirers have not sold the assets or otherwise encumbered them.*

(CNO—NBFC.220) AUDIT CHECK-LIST FOR EQUIPMENT LEASING FINANCE COMPANY (QNO-519.000)

- ***Internal Control System***

  Ascertain whether the NBFC has an adequate appraisal system for extending equipment leasing finance.

- ***Agreement***

  Verify the lease agreement entered into with the lessee in respect of the equipment given on lease.

- ***Insurance***

  Ascertain whether the NBFC has an adequate system for monitoring whether the assets have been adequately insured against and regular maintenance of the leased assets is being carried out by the lessee.

- ***Installation &Valuation Report***

  The auditor should verify whether there is an adequate system in place for ensuring installation of assets and their periodical physical verification. In respect of some major transactions, an auditor should arrange for physical verification of the leased assets so as to dispel any doubts that equipment leasing finance was not extended without the corresponding assets being created.

- ***Accounting***

  An auditor should verify whether the AS issued by the Institute of Chartered Accountants of India in respect of "Accounting for Lease" has been compulsorily followed.

(CNO—NBFC.240) CLASSIFICATION OF FRAUDS (NBFC) (QNO-524.000)

Disclosures

Classification of Frauds by NBFC (RBI Circular July 2015)

In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

*(a) Misappropriation and criminal **breach of trust.***

(b) Negligence and cash shortages.

*(c) **Fraudulent encashment** through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.*

*(d) **Unauthorized credit facilities** extended for reward or for illegal gratification.*

*(e) **Cheating and forgery.***

*(f) Irregularities in **foreign exchange** transactions.*

*(g) **Any other type** of fraud not coming under the specific heads as above.*

*Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (b) and (f) above are to be reported as fraud if the **intention to cheat/ defraud is suspected/** proved.*

However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, **will be treated as fraud** and reported accordingly:

(a) cases **of cash shortages more than Rs 10,000/-** and

(b) cases of **cash shortages more than Rs 5000/-** if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the prescribed format and procedures.

(CNO—NBFC.260) REPORTING OF FRAUDS TO THE RBI AS PER MASTER DIRECTION – MONITORING OF FRAUDS IN NBFC (RESERVE BANK) DIRECTIONS, 2016

Removed from Course, Corresponding MCQs are also not relevant now.

(CNO—NBFC.280) AUDIT REPORT To BOD (MCQ-NBFC.5/ NBFC.6/ Incs-56.1)

Introduction

- **Reporting to BOD / RBI**

  The recent RBI regulations have **considerably increased the responsibility of auditors** of NBFCs. A very **onerous task of reporting to the Board of Directors** on certain specified matters **and to the RBI on an exception basis** has been imposed upon him. This reporting requirement is **in addition to the normal reporting requirements to the shareholders under section 143 of the Companies Act, 2013.** Auditors will thus have to be very careful whilst carrying out audits of NBFCs to ensure that all matters which they are required to take into consideration for the purposes of reporting to the RBI have been taken due care of.

- **RBI issued NBFC AR Directions 2016**

  The Reserve Bank of India (RBI) has issued Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 (the Directions) to auditor of every nonbanking financial companies.

- **Duty of Auditor**

  The Directions shall apply to every auditor of a non-banking financial company as defined in section 45 I(f) of the Reserve Bank of India Act, 1934. Auditors to submit additional Report to the Board of Directors: In addition to the Report made by the auditor under Section 143 of the Companies Act, 2013 examined for every financial year ending on any day on or after the commencement of these Directions, the auditor shall also make a separate report to the Board of Directors of the Company on the matters specified in paragraphs 3 and 4 below.

Matters to be Included (QNO-522.000)

Material to be included in the Auditor's report to the Board of Directors: The auditor's report on the accounts of a non-banking financial company shall include a statement on the following matters, namely –

- **All NBFCs**

  In the case of all Non-Banking Financial Companies

  - **Principal Business Test**

    In case of a company holding CoR issued by the Bank, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.

  - **COR**

    Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the Bank is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the Bank's press release dated April 08, 1999, and directions issued by

	auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the Bank. ▪ **Net Owned Fund** Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non- Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016. E.g. Systematically Important if Asset Size above 500 Crore Non-Systematically Important & Non-Deposit taking NBFC (ND-NBFC) Systematically Important & Not Deposit taking NBFC (SI-ND-NBFC) Systematically Important & Deposit taking NBFC (SI-D-NBFC) ▪ **Certificate from Statutory Auditor** Note: Every non-banking financial company shall submit a **Certificate from its Statutory Auditor** that it is engaged in the business of non-banking financial institution requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act and is eligible to hold it. A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the nonbanking financial company is registered, **within one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year.** The format of Statutory Auditor's Certificate (SAC) to be submitted by NBFCs has been issued by RBI.
➢ **NBFCs holding Deposits**	In the case of a non-banking financial companies accepting/holding public deposits. Apart from the matters enumerated in (A) above, the auditor shall include a statement on the following matters, namely- ▪ **Rating** In respect of non-banking financial companies referred to in clause (iii) above, whether the credit rating, for each of the fixed deposits schemes that has been assigned by one of the Credit Rating Agencies listed in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 is in force; and ▪ **MIGR** Whether the non-banking financial company is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency as per the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; ▪ **Limit as per Credit Rating Agency** whether the aggregate amount of deposits outstanding as at any point during the year has exceeded the limit specified by the such Credit Rating Agency;

- ***Deposits within the limit?***

  Whether the public deposits accepted by the company together with other borrowings indicated below viz.

  from public by issue of ***unsecured non-convertible debentures/bonds;***

  from its ***shareholders (if it is a public limited company);*** *and*

  which are not excluded from the definition of 'public deposit' in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, ***are within the limits admissible to the company as per the provisions of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;***

- ***Regularization of Deposits***

  Whether the public deposits held by the company in excess of the quantum of such deposits permissible to it under the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are regularized in the manner provided in the said Directions;

- ***Computation of CAR***

  Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the Non-Banking Financial Company-Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein;

- ***Liquidity Norms***

  Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45 IB of the RBI Act and whether the details of the designated bank in which the +6communicated to the office concerned of the Bank in terms of NBS 3; Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;

- ***Default of Interest***

  Whether the company has defaulted in paying to its depositors the interest and/or principal amount of the deposits after such interest and/or principal became due;

- ***Compliance with Prudential Norms***

  Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/ investments as specified in the Directions issued by the Bank in terms of the Master Direction Non-Banking Financial Company Systemically Important No deposit taking Company and Deposit taking Company (Reserve Bank) Directions,2016;

- ***Return of Deposit***

  Whether the company has furnished to the Bank within the stipulated period the return on deposits as specified in the NBS 1 to – Non- Banking Financial Company Returns (Reserve Bank) Directions, 2016;

	▪ ***Quarterly Report*** *Whether the company has furnished to the Bank within the stipulated period the quarterly return on prudential norms as specified in the Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;* ▪ ***Violation of Public Deposit Direction*** *Whether the company has violated any restriction on acceptance of public deposit as provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;* ▪ ***New Branches (Different Point)*** *Whether, in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/ offices or in the case of appointment of agent, the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions,2016.*
➢ ***NBFCs Not Accepting Deposits***	*In the case of a non-banking financial company not accepting public deposits Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matters, namely: -* ▪ ***Board Resolution*** *Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;* ▪ ***Acceptance of Deposit*** *Whether the company has accepted any public deposits during the relevant period/year;* ▪ ***Classification*** *whether the non-banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI) as defined in the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.* ▪ ***Systematically Important NBFC*** *In respect of Systemically Important Non-deposit taking NBFCs as defined in Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016:* *Whether the* ***capital adequacy ratio*** *as disclosed in the return submitted to the Bank in form NBS- 7, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the Bank;* *Whether the company has furnished to the Bank the* ***annual statement*** *of capital funds, risk assets/exposures and risk asset ratio (NBS-7) within the stipulated period. 4* ▪ ***Prudential Norms*** *Whether the company has complied with the prudential norms relating to*

		income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of Non-Banking Financial Company – No Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016; 5
	➢ **NBFC not required COR**	In the case of a company engaged in the business of non-banking financial institution not required to hold CoR subject to certain conditions Apart from the matters enumerated in (A)(I) above where a company has obtained a specific advice from the Bank that it is not required to hold CoR from the Bank, the auditor shall include a statement that the company is complying with the conditions stipulated as advised by the Bank.

Reasons

Reasons to be stated for unfavorable or qualified statements Where, in the auditor's report, the statement regarding any of the items referred to in paragraph 3 above is unfavorable or qualified, the auditor's report shall also state the reasons for such unfavorable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred to in paragraph 3 above, his report shall indicate such fact together with reasons therefor.

Exception Report (QNO-S23,000)

➢ **Obligation of auditor to submit an exception report to the Bank**
Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is unfavorable or qualified, or in the opinion of the auditor the company has not complied with: (Various Regulations)

- The provisions of Chapter III B of RBI Act (Act 2 of 1934); or
- Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
- Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

➢ It shall be the obligation of the auditor to make a report containing the details of such unfavorable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Nonbanking Supervision of the Bank under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

➢ The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (I) and such report shall not contain any statement with respect to compliance of any of those provisions

CAPITAL & ASSET CLASSIFICATION

(CNO—NBFC.300) PRUDENTIAL NORMS (Study from MCQ Point of View)

Capital Requirements

➢ Every NBFC shall maintain a capital ratio consisting of **Tier I and Tier II capital** of its aggregate risk weighted assets on-balance sheet and of risk adjusted value of off-balance sheet items, which shall **not be less than 15%.**

➢ **The Tier I** capital in respect of applicable NBFCs (other than NBFC-MFI and IDF-NBFC), at any point of time, shall not be less than 10%. (MFI – Micro Finance Institution & IDF – Infrastructure Debt Fund)

	➢ NBFCs primarily engaged **in lending against gold Jewelry** shall maintain a minimum **Tier I capital of 12%.**
Income Recognition	➢ The income recognition shall be based on recognized **accounting principles.** ➢ **In case of NPA,** income including interest/discount/hire charges/lease rentals etc. shall be recognized only when it is **actually realized.** ➢ **In case of NPA,** any income recognized before the asset became NPA and remaining **unrealized shall be reversed.**
Non-Performing Assets	➢ **General** an asset, in respect of which, interest has remained overdue for a period of **3 months or more;** ➢ **Term Loan** a term loan inclusive of unpaid interest, when the instalment is overdue for a period of **3 months or more** or on which interest amount remained overdue for a period of **3 months or more;** ➢ **Short term Loans & Advances** the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short-term loans/advances, which facility remained overdue for a period of **3 months or more;** ➢ **Bill Purchased** a bill which remains overdue for a period of **3 months or more;** ➢ **Demand Loan** a demand or call loan, which remained overdue for a period of **3 months or more** from the date of demand or call or on which interest amount remained overdue for a period of **3 months or more;** ➢ **Other Income & Reimbursement of Expenses** any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of 3 months or more; ➢ **Lease / HP** the lease rental and hire purchase instalment, which has become overdue for a period of **3 months or more;** ➢ **Borrower Wise** in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes nonperforming asset.
Asset Classification	Every NBFC shall, after taking into account the **degree of well-defined credit weaknesses and extent of dependence on collateral security for realization,** classify its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes, namely: **(a)** Standard assets; **(b)** Sub-standard assets; **(c)** Doubtful assets; and **(d)** Loss assets. ➢ **Standard Assets** The asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem or carry more than normal risk attached to the business. ➢ **Sub-standard Assets** ▪ An asset which has been classified as NPA for a period not exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

- An asset where the terms of the agreement regarding interest and/or principal have been **renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms;**

- **Doubtful assets**
  - An Asset which remains a sub-standard asset for a period exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

Loss Assets

- An asset identified as loss asset by the applicable **NBFC or its internal or external auditor or by the Bank** (RBI) during the inspection of the applicable NBFC, to the extent it is not written off by the applicable NBFC; and
- An asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower.

(CNO—NBFC.320) PROVISIONING REQUIREMENTS (MCQ-NBFC.11)

Assets	% of provision required
Standard Assets	0.35 by end of March 2017 [0.40% by the end of March 2018]
	Note: For those "NBFC – ND", STANDARD ASSETS FOR WHICH 0.25% CONTINUES.
Sub-standard Assets	10
Secured Portion of doubtful debts	20
– one year to 3 years	30
– more than 3 years	50
Unsecured portions of doubtful debts	100
Loss assets	100

Standards Assets The provision towards standard assets need not be netted from gross advances but shall be shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.

IMPACT OF IND AS

(CNO—NBFC.340) APPLICABILITY OF INDIAN ACCOUNTING STANDARDS (IND- AS) ON NBFCS (QNO-S25.000)

Accounting periods beginning 1 April 2018: Listed and unlisted NBFCs having a net worth of Rs 500 crore or more and holding, subsidiary, joint venture or associate companies of such NBFCs;

(CNO—NBFC.360) APPLICABILITY OF INDIAN ACCOUNTING STANDARDS (IND- AS) ON NBFCS
(MCQ-NBFC.4/NBFC.7) (QNO-S25.000)

- **Accounting periods beginning 1 April 2019:All other listed NBFCs, unlisted NBFCs having a net worth of Rs 250 crore or more but less than Rs 500 crore** and holding, subsidiary, joint venture or associate companies of such NBFCs.

  The **net worth** shall be calculated in accordance with the standalone financial statements of the NBFCs as on **31st March 2016** or the first audited financial statements for accounting period which ends after that date.

- **Format for preparation of financial statements by NBFCs under Ind- AS** – The Ministry of

	Corporate Affairs (MCA) vide notification dated October 11, 2018 introduced **Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs complying with Ind-AS has been prescribed.**

(CNO—NBFC.380) DIFFERENCES BETWEEN DIVISION II (IND- AS- OTHER THAN NBFCS) AND DIVISION III (IND- AS- NBFCS) OF SCHEDULE III	(QNO-S25.000) (MCQ-NBFC.10)
	The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:
Classification & Order in Balance Sheet	NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.
Material Items Disclosure	An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or Rs10 lakhs, whichever is higher.
Separate Disclosures	➢ NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member. ➢ Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired. ➢ The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.
Common Point	NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of as part of the notes.

UNIQUE MCQS	
MCQ NO.	NBFC.1

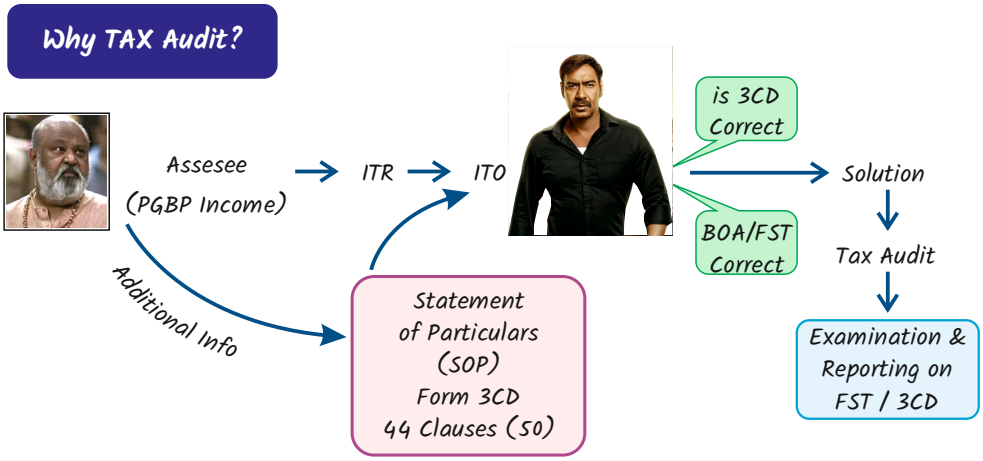
UNIQUE Question	
QNO S15.600	Audit of Deposit Mobilisation in NBFC

Students Notes

12 AUDIT UNDER FISCAL LAWS

(CNO—TAXAUD.020) SECTION 44AB

Applicability of Tax Audit (QNO- 528.000, 528.500)



SEC 44 AB- APPLICABILITY OF TAX AUDIT

- Business TO >1 Crore [Big Business]
- Prof. Receipts > 50 Lakhs [Big Professionals]
- Business Covered under 44 AE (Small Transporter) → 44 BB (Non Resident in Mineral Oil Exploration) → 44BBB (Foreign Company in Construction of Power Turnkey Projects) → If these assessee don't want to follow presumptive tax audit will get applicable
- SEC 44 ADA (small Prof.) → Individual, HUF, Partnership (Except LLP) → Specified Professionals Receipts not > 50 Lakhs → Declaring income less than 50% of Receipts → If they don't want to follow presumptive basis tax audit will be applicable → If actual income is below basic exemption limit then no tax audit
- Sec 44AD (Small Business) Individual, HUF, Partnership (Except LLP) → T.O. Not > 2 Crores → Declaring income less than 8% / 6% of T.O.
  - for 6% income receipt through banking channel / electronic mode
  - If they don't want to follow presumptive basis tax audit will be applicable → If actual income is below basic exemption limit then no tax audit

***Secton 44AD not applicable to Commission/Brokerage/Agency Business

***If benefit of Sec 44 AD is taken then continue on presumption basis for next 5 A.Y., If not taken (Shifted to actual) no benefit for 5 A.Y. after default (No benefit under 44AD)

Conditional Increase in to limit of 44AB Clause(a)

1 Crore to 10 Crore

$$\frac{\text{Receipts (Capital+Revenue \& Banking Channel)}}{\text{Total Receipts (All, not just sales)}} \times 100 \rightarrow 95\% \text{ or more}$$

&

$$\frac{\text{Payments (Capital+Revenue \& Banking Channel)}}{\text{Total Payments(All, not just purchase)}} \times 100 \rightarrow 95\% \text{ or more}$$

Every person –

- ***Business***

  (a) carrying on business shall, if his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds 1 crore rupees in any previous year.

- ***Profession***

  (b) carrying on profession shall, if his gross receipts, in profession exceeds 50 lakhs rupees in any previous year,

- ***Deemed Profits 44AE / 44BB / 44 BBB***

  (c) carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AE or section 44BB or section 44BBB as the case may be, and he has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, as the case may be, in any previous year,

  44AE- Plying / Hiring / Leasing Goods Carriage (For Small Transporters)
  44BB- Business of Exploration etc. of Mineral Oils (For Non-Resident Mineral Oil Explorers)
  44BBB-Foreign Companies Engaged in Business of Civil Constructions

- ***Deemed Profits 44ADA***

  (d) carrying on the profession shall, if the profits and gains from the profession are deemed to be the profits and gains of such person under section 44ADA, and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his profession and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year, or
  (Sec 44ADA: - For professionals where gross receipts doesn't exceed 50 lakhs, they can pay tax on presumptive profit of 50% under 44ADA)

- ***Deemed Profits 44AD***

  (e) carrying on the business shall, if the provisions of sub-section (4) of section 44AD are applicable in his case and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year,
  (Sec 44AD: - For Individual / HUF / Partnership (Excluding LLP) where business turnover is not exceeding 2 crores, they can pay tax on presumptive basis of 8% / 6% if receipt through banking channels under 44AD)

  - What if turnover is above 1 crore up to 2 crores?
    Individual / HUF / Partnership (Excluding LLP) – either go on presumptive basis or get your books audited under clause (e), (Interpretation rule, specific overrides general, not using presumptive basis when it is eligible will be covered in 44AD)

    Others-- Company / Co-Operative etc. – Tax Audit under clause (a)

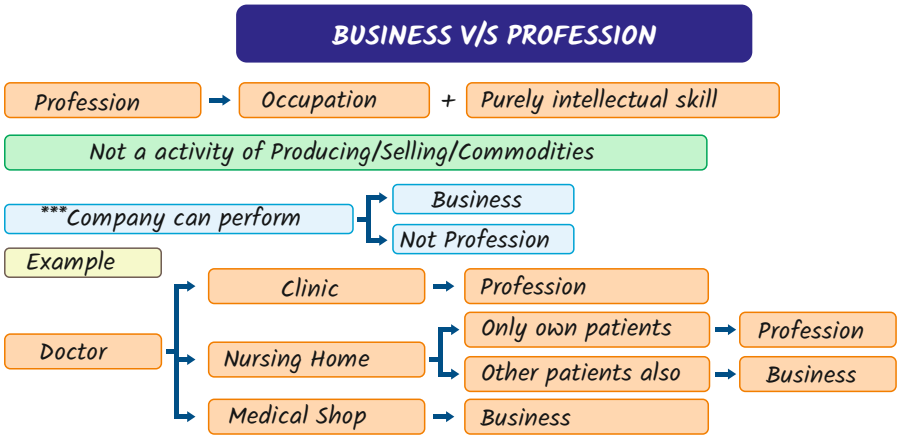
- Commission Income
  Section 44AD is not applicable in case of commission income

- Continuity Concept
  If assessee wants to claim presumptive income under Sec 44AD then, he should do it for next 5 years continuously also, if he doesn't do it for next 5 years, and go for actual any basis in these 5 years then he will be banned from using option of deemed profits for next 5 years from year in which actual basis was adopted.

Conditional Increase In To Limit

- With effect from assessment year 2022-23, the threshold limit, for a person carrying on business, has been increased from Rs 1 crore to Rs 10 crores in case when cash receipts and payments made during the year does not exceed 5% of total receipt or payment, as the case may be. In other words, 95% or more of the business transactions should be done through banking channels.

Business V/S Profession



- **Definition of Profession**
  Whether a particular activity can be classified asbusiness' or Rsprofession' will depend on the facts and circumstances of each case. The expression "profession" involves the idea of an occupation requiring purely **intellectual skill or manual skill controlled by the intellectual skill of the operator, as distinguished from an operation which is substantially the production or sale or arrangement for the production or sale, of commodities.** - CIT Vs. Manmohan Das (Deceased) [1966] 59 ITR 699(SC).

- **Nursing home – Business or Profession?**
  When nursing-home income should be treated as professional income?
  If the doctors are carrying on the activities of a nursing home (polyclinic) for the purpose of treating their own patients, the income from the nursing home must be treated as their professional income. But if any business activity is carried on by the nursing home such as running of a drug store for selling drugs to patients or others, admitting patients and charging fee such as room fees, etc. it may be considered to be a business and that part of the income would be in the nature of business income [CIT v K.K. Shah (1982) 135 ITR 146(Guj)].

- **Can company perform profession?**
  Q. Mr. A is architect working as a proprietor with annual collection of 10 lakhs in FY 18-19, then he converted his business in company. Now in financial year 19-20 it increased to 75 lakhs. Whether tax audit is applicable to both the years?

  Answer
  In FY 18-19 he is operating as proprietor and proprietor can perform profession for Sec 44AB so limit

applicable will be 50 lakhs, as turnover is within 50 lakhs tax audit is not applicable.

In FY 19-20 business is operated in the form of company, and company cannot be said to be engaged in profession for Sec 44AB, so it will not be considered as profession, but it will be considered as business so limit applicable will be 1 crore, and again it is within limit so tax audit not applicable.

Examples -- Applicability of Tax Audit

- **DB Pvt. Ltd. has total turnover of Rs 125 lacs for the FY 2017-18.**
  Section 44AD is not applicable to company assessee, hence Limit of Rs 2 crore is not applicable to DB Pvt. Ltd and it has to conduct the Audit of Books of Accounts under section 44AB of the Act for the FY 2017-18 as turnover exceeds Rs 1 crore.

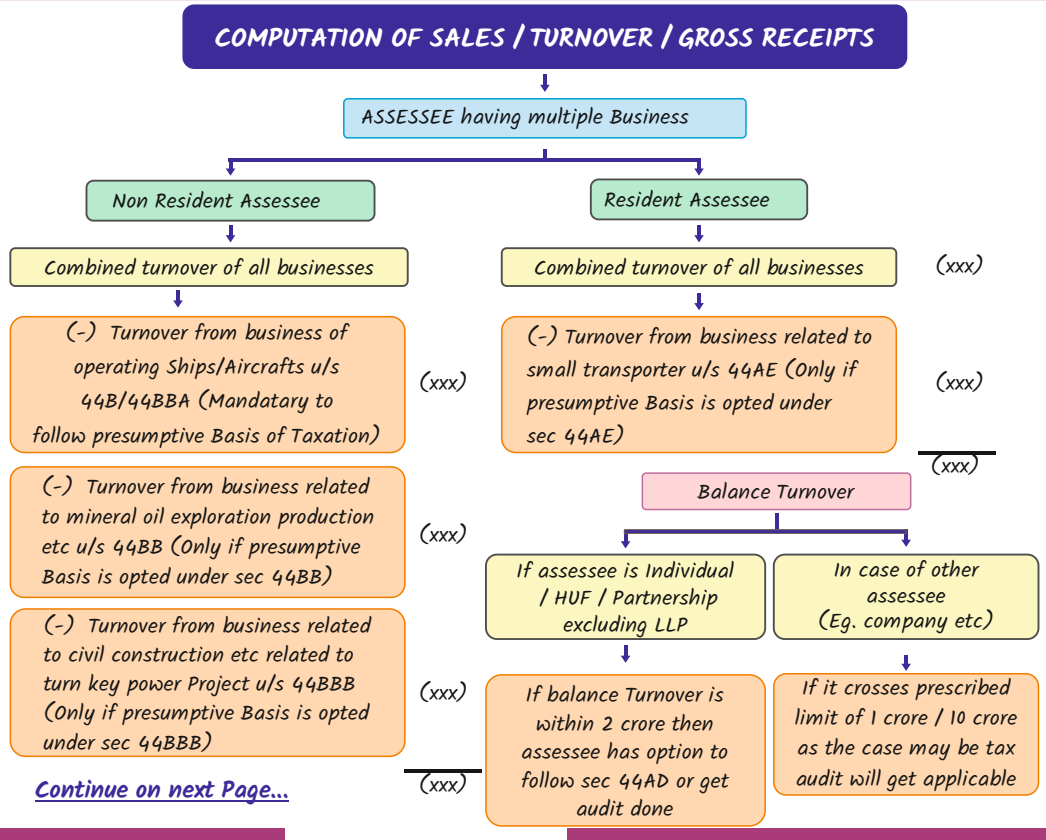
- **ABC & Co. (a partnership firm) engaged in trading of electronic goods having a turnover of Rs 165 lacs for the FY 2017-18.**
  Section 44AD is applicable to Partnership Firm. Thus, ABC & Co. can declare the minimum profit @ 8% of the turnover as its turnover during the PY 2017-18 does not exceed Rs 2 crores. If the firm do not opt for presumptive income scheme under section 44AD, it has to get books of accounts audited u/s 44AB of the Act.

- **Mr. Anand Khater, a Commission Agent has commission receipts of Rs 137 lacs during the FY 2017-18.**
  Though Section 44AD is applicable to an Individual, it is not applicable to Commission income. In the given case, since, Mr. Anand earns the commission income, he cannot take the benefit of section 44AD. His total turnover during the FY 2017-18 in respect of commission income exceeds Rs 1 crore, he has to get his books of accounts audited u/s 44AB of the Act.

- **Mr. Vishal Raka, owning an Agency of Samsung Mobile for the city of Pune and makes the turnover of Rs 87 lacs during the FY 2017-18.**
  Though Section 44AD is applicable to an Individual, it is not applicable to Commission income. In the given case, since, Mr. Vishal earns the commission income, he cannot take the benefit of section 44AD. His total turnover during the FY 2017-18 in respect of commission income does not exceeds Rs 1 crore, therefore, he need not to get his books of accounts audited u/s 44AB of the Act.

(CNO—TAXAUD.040) COMPUTATION OF SALES / TURNOVER / GROSS RECEIPTS (QNO-526.000 / 526.500) (MCQ-FL.13)

Chart (QNO-526.600)



Continue on next Page...

Balance Turnover
↓
If it crosses prescribed limit of 1 crore/ 10 crore as the case may be tax audit will get applicable

If balance Turnover is more than 2 crore then Audit is Mandatory, subject to conditional increase of T.O. to 10 crores

NOTE:- For Assessees involved in profession
1) If professional receipts exceeds 50 Lacs Then Tax Audit will get applicable
2) If professional receipts are below 50 lacs Then individual/HUF/Partnership (Excluding LLP) will have option to follow presumptive basis taxation or get audit done

Q. Doctor is running clinic on ground floor, he has nursing home on 1st floor with 50 beds open for patients of other doctors also and there is a medical in basement.

Money Collection during the year at:- Clinic 15 lakhs, Nursing Home 60 lakhs, Medical 30 lakhs, Business whose income is charged on presumptive basis 20 lakhs

Is Tax Audit applicable to him?

Answer

Professional Receipts 15 lakhs
Business Turnover 60 + 30 = 90 Lakhs
As professional receipts are not exceeding 50 lakhs and business turnover is not exceeding 1 crore.
Tax Audit is not applicable.

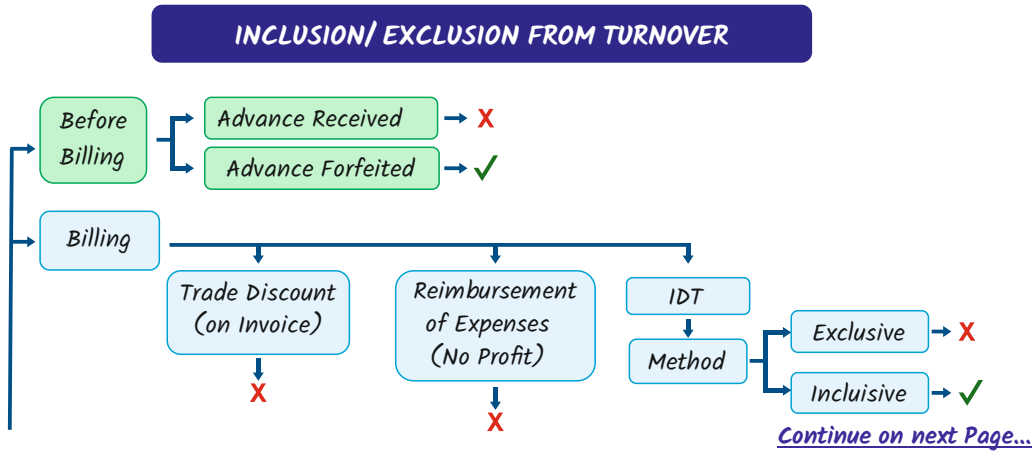
Important Learnings

- We cannot add professional receipts & business turnover.
- We have to add turnover of all business and all profession to see applicability.
- Now if in case of non-presumptive businesses or profession if for any one business or profession prescribed limit is crossed then audit will be done for all businesses or professions

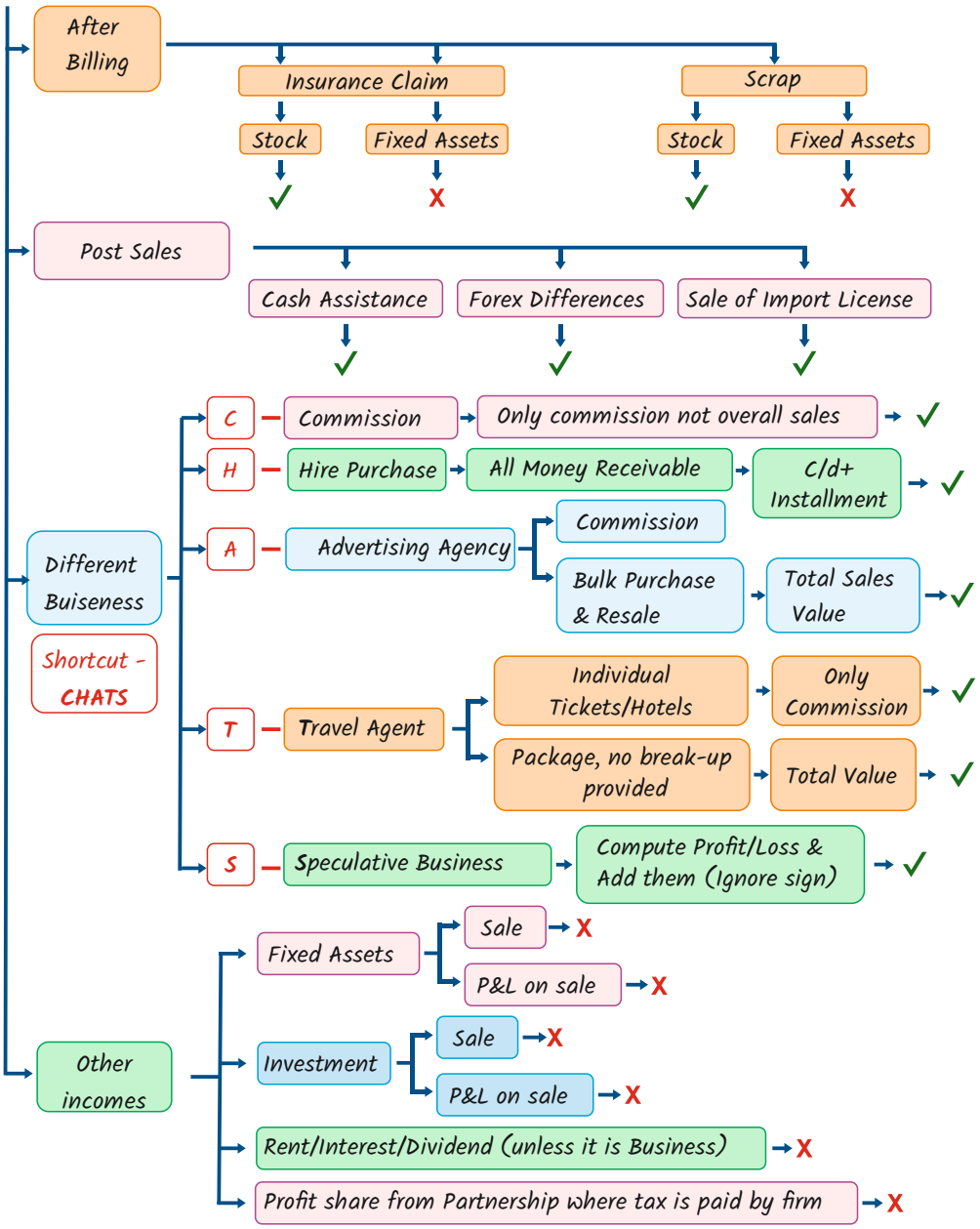
- Turnover from business which are covered under following sections which deal with presumptive taxation shall be excluded
  - Clause (c) -- 44AE / 44BB / 44BBB
  - Clause (d) -- 44ADA
  - Clause (e) -- 44AD
  - Not in any Clause -- 44B / 44BBA
    - Exclusion is as per proviso to Sec 44AB. Further Sec 44B is for non-residents in shipping business & 44BBA is for non-resident in business of operating aircraft in these sections' income charged on presumptive basis and there is no option with assessee to claim lower income.

If assessee goes for presumptive basis of taxation, then no audits for those businesses and if they don't go for presumptive, audit will be done only for such businesses, with respect to other businesses and profession it depends on whether prescribed limit is exceeded.

Inclusions / Exclusions from Turnover



Continue on next Page...



- ***Advance Received***

  The amount received by way of advance for which goods or services are yet to be rendered will not form part of the receipts, as such advances are the liabilities of the assessee and cannot be treated as his receipts till the goods or services are rendered.

  But if advance is forfeited and there is no liability to return it then it will be included in turnover.

- ***Discount***

  Discount "Appearing in Sales Invoice", it is given at the time of sale, so from start we know it will never be received so it is not counted in turnover. It can be name of bulk discount / turnover discount / loyalty discount / referral discount etc. It should be reduced from turnover.

- ***Reimbursement of expenses***

  *If the assessee is merely **reimbursed for certain actual expenses incurred,** the same will not form part of his gross receipts. But in the case of charges recovered, which are not by way of reimbursement of the actual expenses incurred, they will form part of his gross receipts.*
  *Reimbursement of expenses incurred (e.g. packing, forwarding, freight, insurance, travelling etc.) and if the **same is credited to a separate account in the books,** only the net **surplus** on this account should be added to the turnover for the purposes of Section 44AB;*

C&B A/c Dr 120
To Sale A/c 100
Transport Charges Payable A/c 20

Similarly, Reimbursement of customs duty and other charges collected by a clearing agent will be excluded.

- **Indirect Taxes**
  - **Inclusive Method of Accounting**
    If indirect taxes are not separately accounted and included in sales account, latter they are segregated and tax paid then it will be counted in turnover.

    Sale Entry

    C&B A/c Dr 112
    To Sales 112

    Tax Payable Entry
    Sales Dr 12
    To IDT Payable 12

  - **Exclusive Method of Accounting**
    If Indirect Taxes are accounted separately at the time of sale. Then IDT won't be counted.

    Sales Entry

    C&B A/c Dr 112
    To Sales A/c 100
    IDT Payable A/c 12

- **Insurance Claim**
  Insurance claims - except for fixed assets will be included

- **Scrap Sale** – Included even if shown under miscellaneous income

- **Post Sales Receipts**
  - **Cash Assistance**
    Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India will be included
  - **Exchange Rate Difference**
    The net exchange rate difference on export sales will be included
  - **Sale of Import License**
    Profits on sale of a licence granted (import) will be included.

- **Different Business**
  - **Speculative Business**

    Q. Mr. A trader in share market to take benefit of price movements (Speculation). He bought shares for 30 lakhs and sold them for 50 lakhs. Then he purchased shares for 80 lakhs and sold them for 20 lakhs. How his turnover will be computed?

    Answer: -
    We should compute profits or losses in the speculative transactions. Add these profits & losses to determine total turnover.
    1st Trade 50 – 30 = 20 lakhs profit
    2nd Trade 20 – 80 = (60) lakhs loss.
    Turnover = 20 + 60 = 80 lakhs

- *Commission Agents (Agency Business)*
  Only commission will be counted in turnover

- ***Travel Agents***
  *In the case of a travelling agent, the amount received from the clients for payment to the airlines, railways etc. where such amounts are received by way of **reimbursement of expenses incurred on behalf of the client** will be excluded. If, however, the travel agent is conducting a **package tour and charges a consolidated sum** for transportation, boarding and lodging and other facilities, then the amount received from the members of group tour should form part of gross receipts*

- ***Advertising Agents***
  *In the case of an advertising agent, the amount of advertising charges recovered by him from his clients provided these are by way of **reimbursement should be excluded.** But if the advertising agent books the advertisement **space in bulk and recovers the charges** from different clients, the amount received by him from the clients will not be the same as the charges paid by him and in such a case the amount recovered by him will form part of his gross receipts*

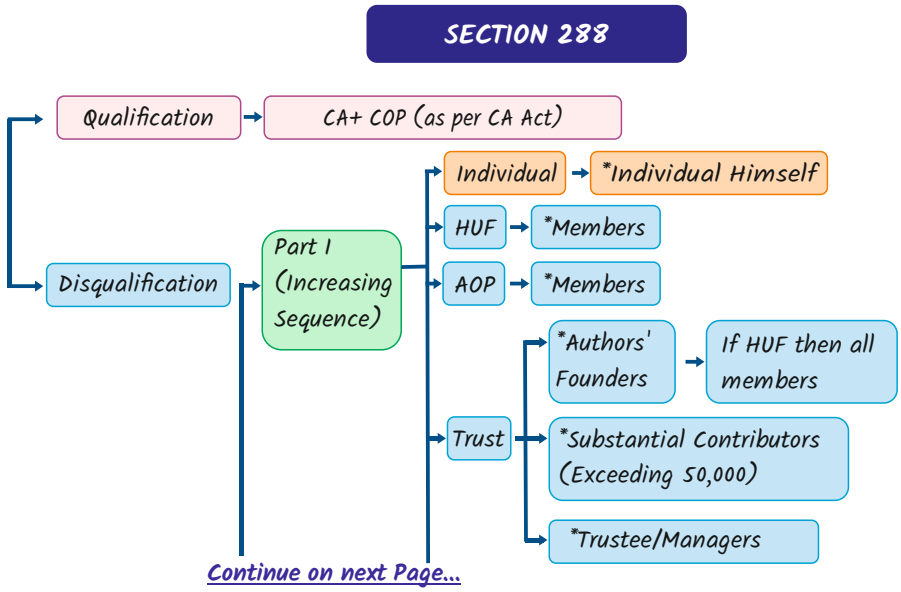
- ***Share Market Brokers***
  - *Similarly, in case of brokers only brokerage will be counted*
  - *In case of personal sale of Broker "Sale value" will be counted in turnover*

➢ ***Hire Purchase***
Hire charges and instalments received in the course of hire purchase will be included.

➢ ***Exclusions***
Following shall not be included because this is not regular business income
- *Sale Proceeds of Fixed Assets / Investment Property (It is not business)*
- *Profit / Loss on sale of investments (Include sale value if it is a business)*
- *Interest / Dividend / Rent if it is not business*
- ***Tax Already Paid***
  Share of profit of a partner of a firm in the total income of the firm excluded from his total income under section 10(2A) of the Income Tax Act, 1961.

(CNO—TAXAUD.060) QUALIFICATIONS & DISQUALIFICATIONS OF TAX AUDITOR (SEC 288) (MCQ-Incs.52.1)

Chart



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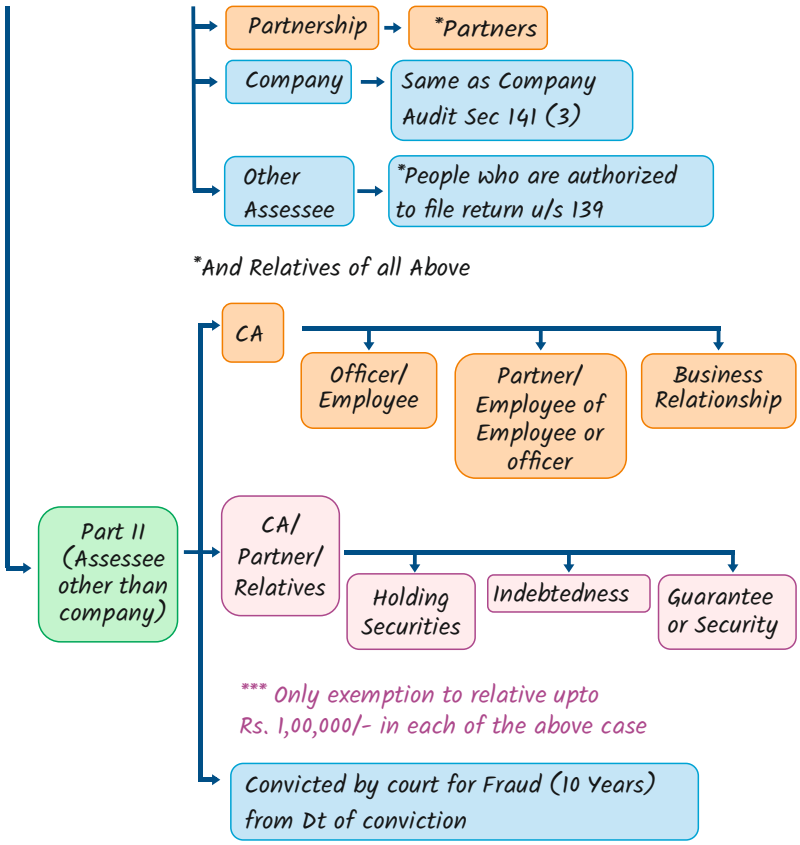
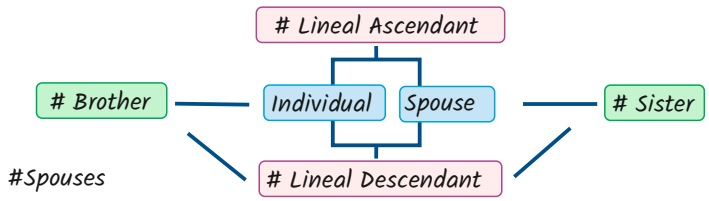


Chart on Definition of Relative



Qualifications

Chartered Accountant

Disqualifications (QNO-556.000)

- ***Individual***
  Assesses Himself***
- ***HUF***
  Family member of HUF***
- ***AOP***
  Member of AOP***
- ***Trust /Institution***
  - Author / Founder ***
  - If author / founder is HUF, then members of HUF***
  - Substantial Contributor i.e. exceeding Rs 50,000***
  - Trustee or Manager***
- ***Firm***
  Partner of firm***
- ***Company***
  Who is disqualified to do statutory audit under Sec 141 (3)?

- **For Assesses other than those covered above**

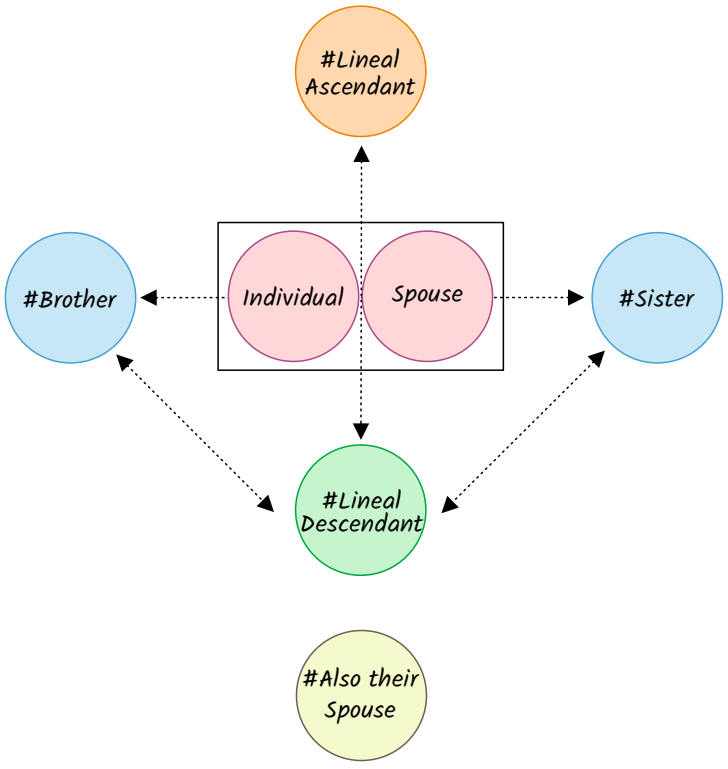
  Who can verify return u/s 139*** (Mentally Ill – Guardian, Political Party- CEO, Other- Power of Attorney Holder etc.)

- **All Assesses (Other Than Company)**
  - (All points below are similar to company audit disqualifications but there are changes so be careful)
    - Officer or employee of Assessee
    - Partner or Employee of Employee or Officer
    - Direct / Indirect Business Relationship with assessee
    - Convicted by court for fraud, 10 years from date of conviction
    - @ Holding any Security or Interest in assessee (Only Relative exempt up to FV 1,00,000)
    - @ Indebted to assessee for any amount (Only Relative exempt up to Rs 1,00,000)
    - @ Guarantee or Security of assessee for third party for any amount (Only Relative exempt up to Rs 1,00,000)

    *** Including Relatives

    @ By individual or His partner or His Relative

- **Chart on Definition of Relative**



(CNO—TAXAUD.080) ELIGIBILTY OF CONSULTANTS & INTERNAL AUDITOR

Eligibility of Tax Consultant



A chartered accountant/firm of chartered accountants, who is appointed as tax consultant of the assessee, **can conduct tax audit under section 44AB.**

Eligibility of Internal Auditor

But an internal auditor of the assessee cannot conduct tax audit if he is an employee of the assessee. Further the Council of ICAI has decided that an internal auditor of an assessee, **whether working with the organisation or independently practicing chartered accountant or a firm of chartered accountants, cannot be appointed as his tax auditor.**

(CNO—TAXAUD.100) STATUTORY AUDITOR NOT APPOINTED OR AUDIT REPORT IS NOT AVAILABLE FOR ANY REASON

(QNO 562.000)

Practical Problem

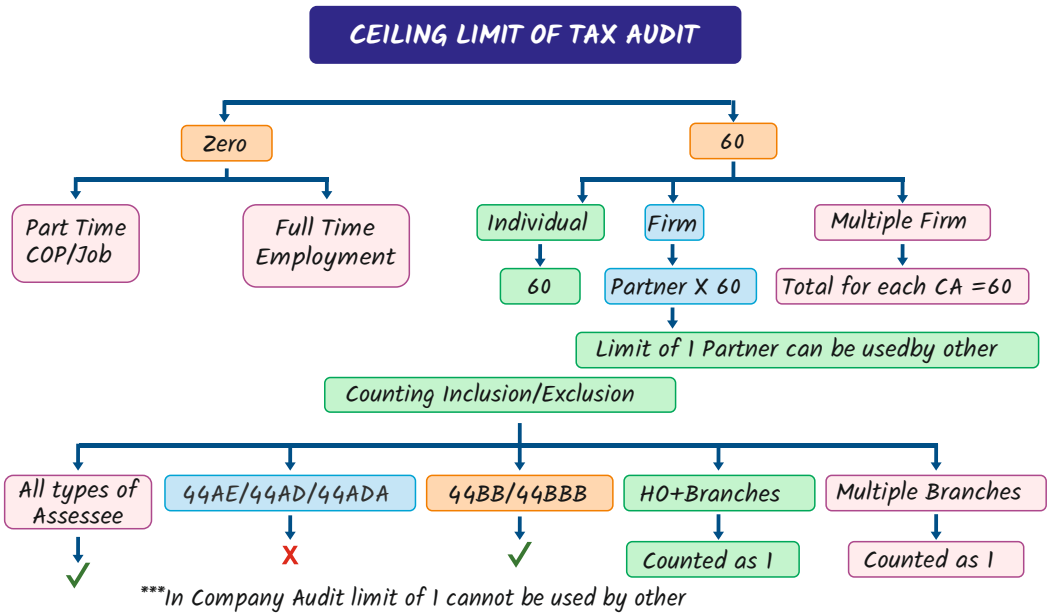
A question may arise in the case of a **public sector company or any other company** where the **statutory auditor has not been appointed** by the authorities concerned as to whether the tax auditor appointed under section 44AB can complete his audit without waiting for statutory audit report on the accounts audited by the statutory auditors. It may be noted that Form No. 3CA requires the tax auditor to enclose a copy of the audit report conducted by the statutory auditor or the auditor of the financial statements as the case may be.

Solution

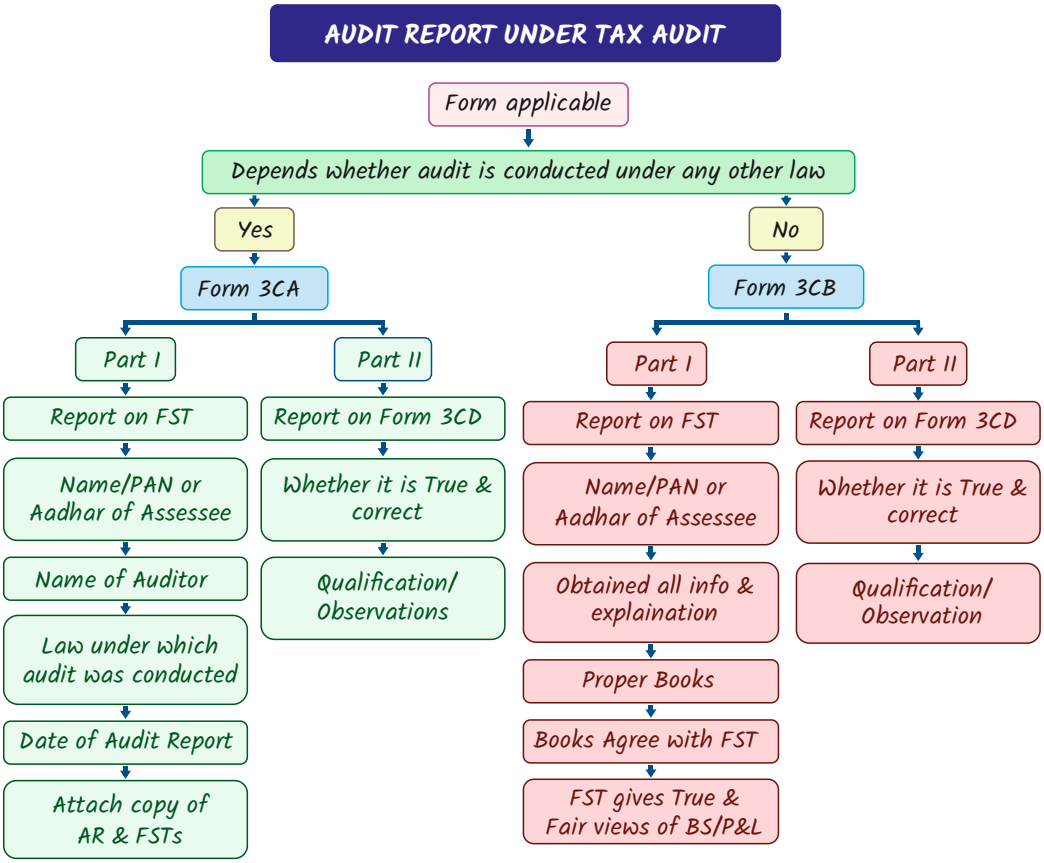
Where a **statutory auditor has not been appointed by the authorities concerned or where the report of the statutory auditor is not available for whatever reasons,** it will be possible for the tax auditor to **give his report in Form No. 3CB and to certify the relevant particulars in Form No.3CD.** This is **particularly important in those cases where the assessee concerned has suffered losses in the relevant accounting year.** It may, however, be noted that the tax auditor in such cases willhave to conduct the **financial audit as well in order to enable him to certify whether or not the accounts reported upon by him give a true and fair view of the state of affairs of the assessee whose accounts are audited by him under section 44AB.**

(CNO—TAXAUD.120) CEILING LIMIT OF TAX AUDIT (QNO-529.000/529.050) (MCQ – FL.1/ FL.2)

Chart



- Ceiling limit per CA is 60 (Council Guidelines 2008)
- In case of CA Firm 60 x Number of Partners
- In case of partnership in multiple firms then in totality it should not exceed 60 per CA
- One partner can sign on behalf of other
- Limit for part time COP is Zero
- Audit u/s 44AE / 44AD / 44ADA shall be excluded
  (From Clause (c) 44BB& 44BBB not excluded as these are big audits of non-residents)
- Only for audit under section 44AB
- Corporate non-corporate both are included
- Branches and HO will be counted as one.



Situation where Form 3CB will be applicable, even where audit is applicable under other

1. Different Year:- Audit was conducted for the year Different from F.Y April-March
2. Auditor not appointed or conducted or report not available for any other reason

Audit report: Section 44AB requires the tax auditor to submit the audit report in the prescribed form and setting forth the prescribed particulars. Sub-rule 1 of rule 6G provides that the report of audit of accounts of a person required to be furnished under Section 44AB shall –

Applicability of Form 3CA / 3CB / 3CD

- in the case of a person who carries on business or profession and who is **required by or under any other law to get his accounts audited,** be in **Form No. 3CA;** (Companies Act / Banking Act / Insurance Act / Co-Operative Society Act etc.)
- in the case of a person who carries on business or profession, **but not being a person referred to in clause (a),** be in Form No. 3CB.

Sub-rule (2) of Rule 6G further provides that the particulars which are required to be furnished under Section 44AB shall be in Form No. 3CD.

Details of Form 3CB

It may be noted that the audit report in Form No.3CB is in two parts.

- **First Part on Financial Statements**
  The first part requires the tax auditor to give his opinion as to whether or not the accounts audited by him give a **true and fair view:**
  - in the case of the **balance sheet** of the state of affairs as at the last date of the accounting year.
  - in the case of the **profit and loss account** of the profit or loss of the assessee for the relevant accounting year.

- **Second Part on Statement of Particulars in Form 3CD**
  The second part of the report states that the **statement of particulars** required to be furnished under section 44AB is annexed to the audit report in Form No. 3CD. The tax auditor is required to **give his opinion whether the prescribed particulars furnished by the assessee are true and correct** subject to

observations and qualifications, if any.

- **Wordings for Financial Statements VsWordings of Form 3 CD**

  In paragraph 3 of Form No. 3CB the auditor has to report that the **financial statements** audited by him give a **'true' and fair view.**

  The requirement in paragraph 3 of Form No. 3CA and paragraph 5 of Form No. 3CB relating to particulars in Form No. 3CD is that the auditor should report that these particulars in **Form No. 3CD are "true and correct".** The terminology "true and fair" is widely understood though not defined even under the Companies Act, 2013. On the other hand, the words **"true and correct" lay emphasis on factual accuracy** of the information.

- **Factual Accuracy Subject to Materiality**

  In this context reference is invited to AS-1 and OLD AS(IT)-1 relating to disclosure of accounting policies. These standards recognize that the major considerations governing the **selection and application of accounting policies are (i) prudence, (ii) substance over form and (iii) materiality.** Therefore, while giving particulars in Form No.3 CD these aspects should be kept in view. In particular, considering the nature of particulars to be given in Form No. 3CD, the **aspect of materiality** should be considered. **In other words, particulars should be given in the respect of material items and the auditors should ensure factual accuracy relating to these particulars.**

Details of Form 3CA

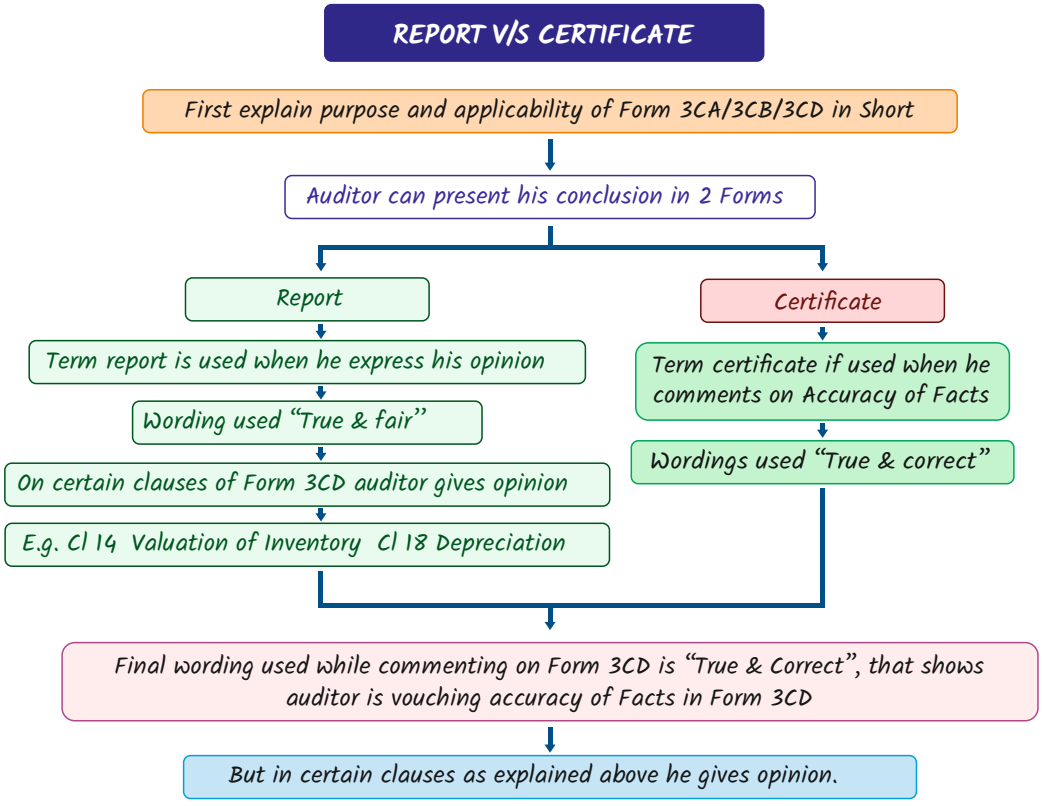
In the case of a person whose accounts of the business or profession have been audited under any other law, it is not required for the tax auditor appointed under section 44AB to give his **opinion, as to whether or not the accounts give a true and fair view** as indicated herein above.

It would only be necessary for him to **annex a copy of the audited accounts as well as a copy of the audit report given by the statutory auditor with his report in Form No. 3CA along with Form No. 3CD.**

Different Accounting Year

In the case of "person" having their accounting year which is different from the financial year, accounts of the financial year are required to be prepared and audited. **The audit report shall be in Form 3CB.**

(CNO—TAXAUD.160) REPORT VS CERTIFICATE (QNO-530.000)



Section 44AB of the Income Tax Act, 1961 requires the auditor to submit the audit report in the prescribed form and setting for the prescribed particulars. The statement of particulars as required in Form 3CD are required to be annexed to the main audit report. **The audit report is in two parts. The first part requires the auditor to give his opinion as to whether or not the accounts audited by him give a true and fair view and the second part of the report is in the form of an "Annexure" containing statement of particulars in respect of certain specified matters. The tax auditor has to report whether particulars are true and correct.**

Report Vs Certificate

In this context, it is important to appreciate the distinction between the term's "report" and "certificate". Briefly speaking, the term "certificate" is used where the auditor verifies the accuracy of facts while the term "report" is used in case the auditor is expressing an opinion. Strictly speaking, having regard to the usage of the word true and correct, these particulars require definitive information compiled from the books of account. **Hence, it can be said that an auditor conducting tax audit 'certifies" the information contained in the statement of particulars.**

However, having regard to the distinction, it is significant to examine whether all 50 clauses included in the statement of particulars are capable of being simply certified on the basis of books of account or there are some clauses in respect of which different auditor(s) may hold different opinion.

Examples of Some clauses In Form 3CD where is judgment is applied and opinion is given

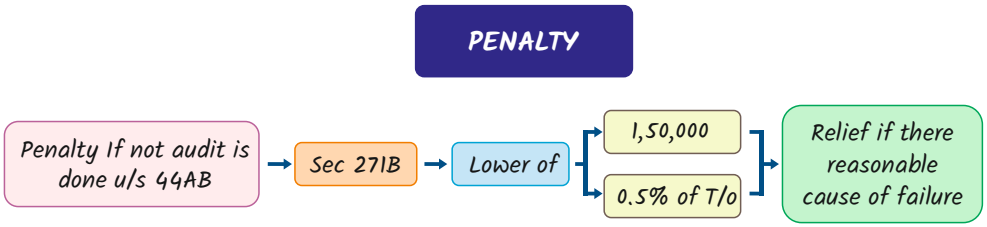
For instance, Clause 14 dealing with valuation of closing stock would require the auditor to examine and opine on the basis adopted for ascertaining the cost and, thus, to ensure that method followed for valuation of stock results in disclosure of correct profits and gains. Similarly, **Clause 18 relating to depreciation would require the auditor to exercise judgement** having regard to the facts and circumstances of the case, etc. **Thus, there are several matters on which the auditor is required to exercise judgement while giving his report on various amounts included in the statement of particulars.** No doubt that the auditor obtains the statement of particulars in FormNo.3CD duly authenticated by the assessee, it does not merely involve checking the corresponding figures with the documents and books of account but requires the auditor to exercise his judgement which may at times lead to different figures by different persons reporting thereon. There can also be situations leading to difference of opinion between the tax auditor and the assessee.

Conclusion

Therefore, it can be said that an auditor conducting tax audit **"reports" on certain information, apart from certifying certain factual information** contained in the statement of particulars annexed to the tax audit report under section 44AB of the Income-tax Act, 1961.

(CNO—TAXAUD.180) PENALTY FOR NOT GETTING THE ACCOUNTS AUDITED AS REQUIRED U/S 44AB

AO can Impose Penalty



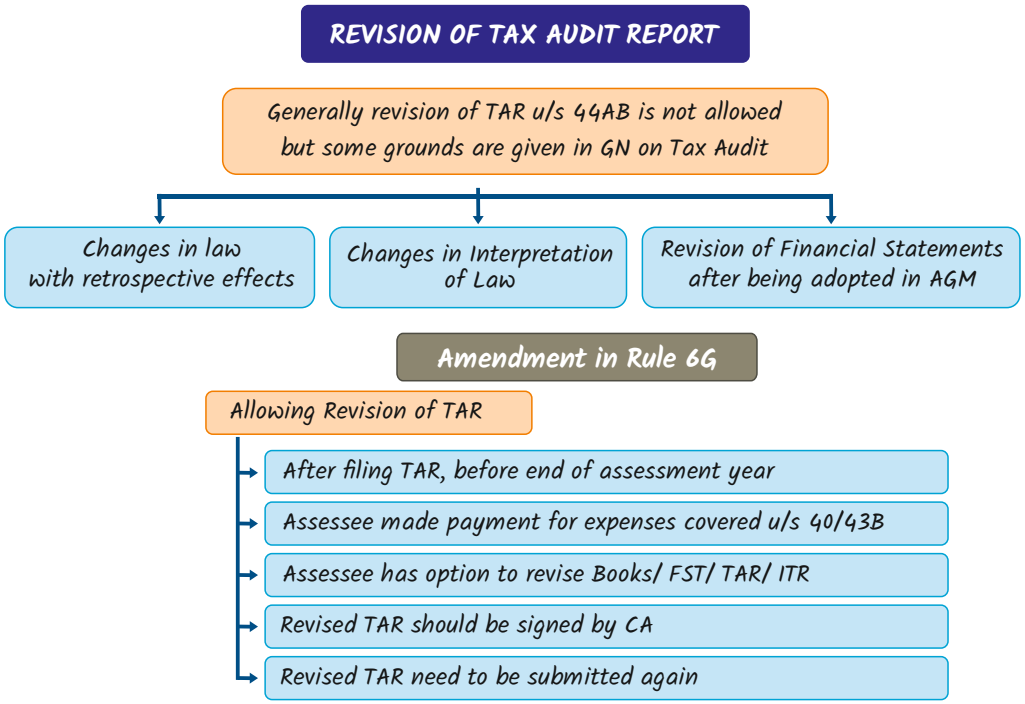
According to section 271B, if any person who is required to comply with section 44AB fails to get his accounts audited in respect of any year or years as required under section 44AB, the Assessing Officer may impose a penalty.

The penalty **shall be lower** of the following amounts:

- **0.5%** of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such year or years.
- **Rs 1,50,000.**
- **Relief**

  However, according to section 273B, no penalty shall be imposed if reasonable cause for such **failure** is proved

(CNO—TAXAUD.200) REVISION OF TAX AUDIT REPORT (QNO-558.010) (MCQ - Incs.13.4)



Normally, the report of the tax auditor cannot be revised later.

However, when the **accounts are revised** in the following circumstances, the tax Auditor may have to revise his Tax audit report also.

- **Change in law** with retrospective effect.
- **Change in interpretation of law** (e.g.) CBDT Circular, Notifications, Judgments, etc.
- **Revision of accounts** of a company after its adoption in the annual general meeting.(Fraud, Error or Change in Accounting Policy, Change in Significant Estimate)

The Tax Auditor should state it is a revised Report, clearly specifying the reasons for such revision with a reference to the earlier report.

Recent Change

- **Rule 6G is for Report of Audit of Accounts to be furnished under Section 44AB**

- **Amendment in Rule 6G**
  - The **report of audit furnished under this rule may (option) be revised**
  - by the person (assessee) **by getting revised report of audit from an accountant,** duly signed and verified by such accountant, and
  - furnish it **before the end of the relevant assessment year** for which the report pertains,
  - **if there is payment by such person after furnishing of report under subrule (1) and (2) which necessitates recalculation of disallowance under section 40 or section 43B.**

- **Specified Date**
  - For assesses not requiring audit, it is 31st July
  - For assesses requiring audit it is 31st Oct
  - These dates get extended by government as per situations.

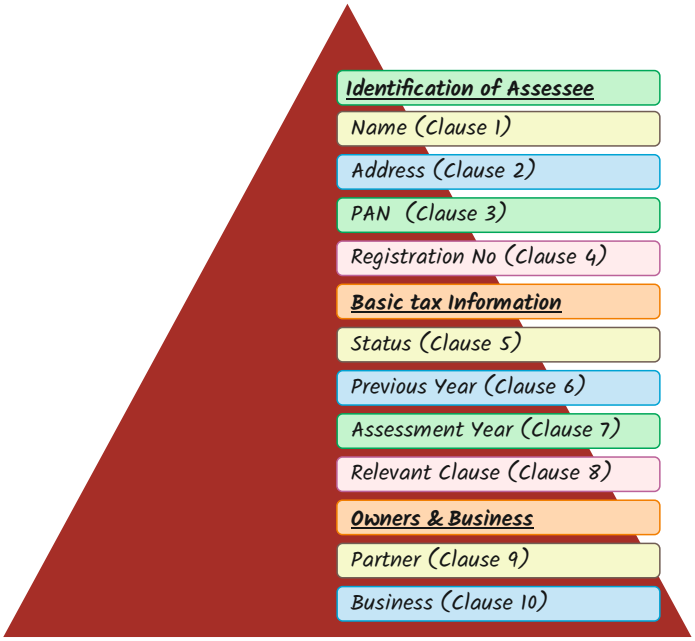
- **Analysis with Example**
  - 15th Sept – Date on which Audit Report submitted by assessee, expenses of 50 lakhs were disallowed because no payment was made as per Sec 40 / Sec 43B.
  - 10th Oct – Payment to the tune of Rs 30 lakhs was made from above expenses.

- Because of these calculations of disallowance changed under Sec 40 & 43B, assessee will have to revise financial statements because of these changes, revise income tax return and get revised audit report from auditor.
- As per amendment such revised audit report can be filed under Rule 6G on income tax portal
- Earlier Guidance Note on tax audit specified conceptual discussion regarding revision on tax audit report but there was not practical facility to upload revised audit report, but not in specific circumstances assessee and auditor will get facility to upload revised audit report
- So assesses use to delay returns & tax audit report so that they can arrange funds, make payments, take benefits and then file returns. This use to lead to last minute rush, now such things wont happen.
- Not covered by AS or Ind AS because it is event happening after finalisation of financial statement and audit report. Further not covered as per SA 560 also because it, 560 covers facts after signing audit report and not events after signing audit report.

(CNO—TAXAUD.220) AUDIT REPORT UNDER TAX AUDIT

SHORTCUT OF TAX AUDIT

Basic Information.





BAHUBALI
Books of Accounts



PARMANU
Presumptive Income



MARY KOM
Method of Accounting



VICKY DONOR
Valuation of CI Stock



CHENNAI EXPRESS
Capital Asset Conversion



POKEMON
P&L Not Credited



TOM N JERRY
Transfer of Property



DOREAMON
Deprecation



ALLADIN
Admissible Amount



BHEEM
Bonus & Commission



DEAD POOL
Debited But Not Allowed



IRON MAN
Interest Under MSMED



PREDATOR
Payment To Relatives



DR STRANGE
Deemed Income



CAPTAIN AMERICA
Chargeable Sec 41



PARRIKAR
Payment Basis (Sec 43B)



CHIDAMBARAM
Cenvat Credit



SMRITI IRANI
Shares received



SONIA GANDHI (2)
Shares Issued



HILLARY CLINTON (3)
Hundi



LION
Loans & Deposit



LEOPARD
Losses



DOG
Deductions



TORTOISE
TDS



GOAT
Goods Quantity



DOLLAR (1)
Dividend Distribution Tax



CANADIAN DOLLAR
Cost Audit Report



EURO
Excise Audit Report



SHILLING
Service Tax Audit Report



RUPEE
Ratio



DEUTSCHE BANK
Demands & Refunds



SYNDICATE BANK
Statement in 61/61A



RBL BANK
Report U/s 286



BANDHAN BANK
Breakup of Expenditure

FORM 3CD 50 CLAUSES

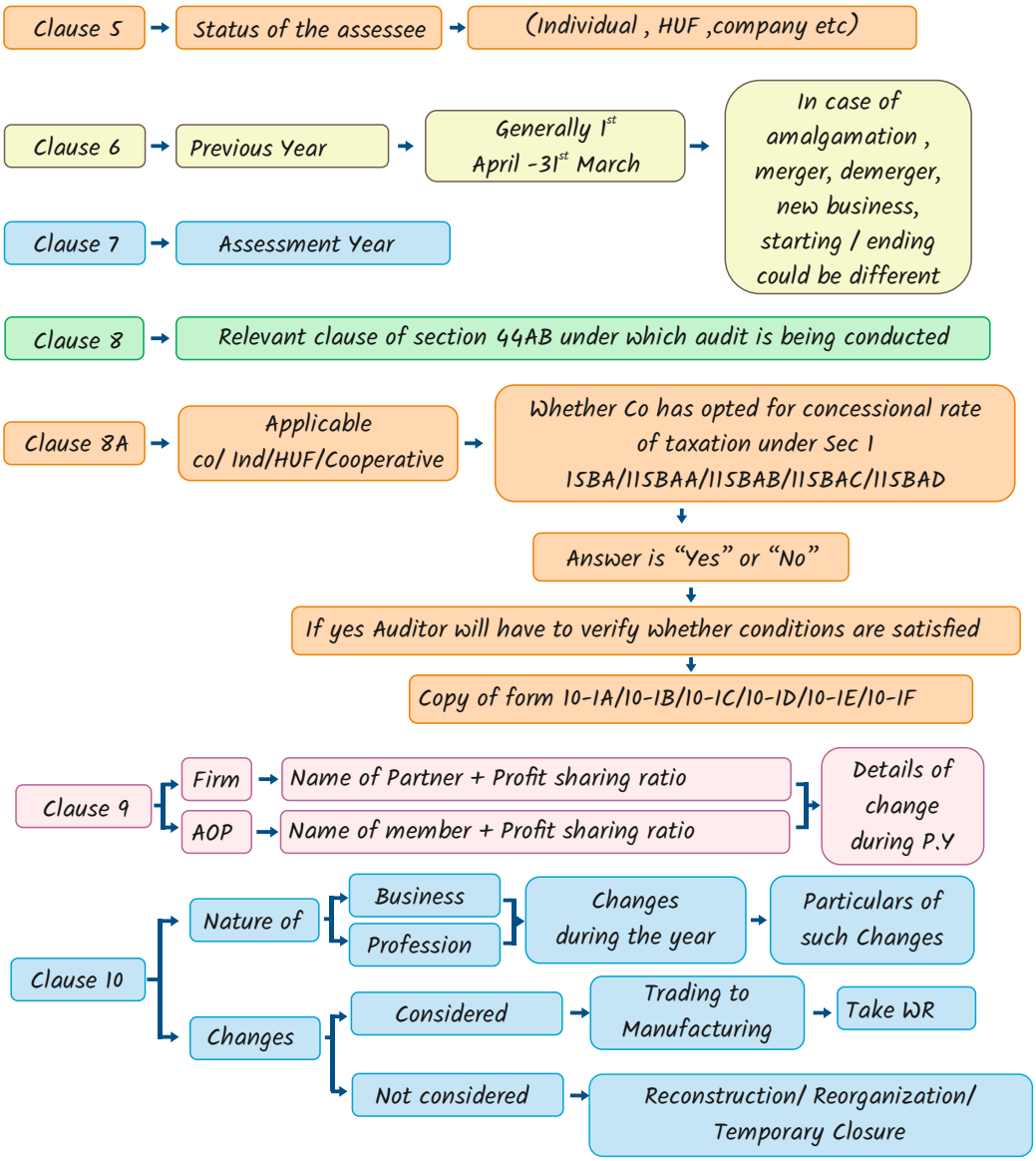
(CNO—TAXAUD.240) Statement of particulars required to be furnished under Section 44AB of the Income Tax Act, 1961.

PART 'A'

CLAUSE 1 TO 10

- Clause 1 → Name of the assessee
- Clause 2 → Address as communicated to tax department
- Clause 3 → Pan Card Details
- Clause 4 → Liable to pay indirect taxes? → If yes → Provide Registration number

Continue on next Page...



Clause 1.

- ***Text – Name of the Assessee:***
- ***Notes*** – Branch Name along with Assessee name in case of Tax Audit of Branch

Clause 2.

- ***Text – Address:***
- ***Notes*** – As communicated to ITO for assessment, in case of company also mention registered office if itis different

Clause 3.

- ***Text – Permanent Account Number:***
- ***Notes*** – Mandatory in e-filling, as per the FAQ available at department's site, in case PAN is not available for foreign director, one need to enter FFFPF9999F

Clause 4. (QNO-531.000)

- ***Text – Whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, goods and service tax, customs duty, etc. if yes, please furnish the registration number or GST number or any other identification number allotted for the same.***
- ***Notes*** – All the GSTIN numbers allotted to the assessee need to be mentioned.

Clause 5.

- ***Text – Status:***
- ***Notes***
  - If there is any change in these 5 clauses in previous year mention both
  - Ensure that the status is quoted as per section 2(31) of the Act. It should not be confused with the residential status of the assessee. Further, in case of a proprietorship concern status shall be quoted as individual

Clause 6.

- ***Text – Previous year ended: 31" March _____***
- ***Notes –***
  - The period of the previous year has to be stated. Since the previous year under the Act now

uniformly begins on 1st April and ends on 31st March, the relevant previous year should be mentioned.

- In case of amalgamations, demergers, reconstitution, new business, closure of existing business etc. the date of beginning/ ending of the previous year may be different, the auditor may accordingly, mention the relevant date of beginning and ending of the previous year in this clause. Hence, the tax auditor has to apply his professional judgement depending on the facts and circumstances of the same.

Clause 7.

- **Text –Assessment Year**

Clause 8.

- **Text – Indicate the Relevant clause of section 44AB under which the audit has been conducted.**
  Notes – Audit under clause (a) and (b) is much more important than (c) & (d) & (e).

Clause 8A

- **Clause**
  Clause (8A), The new clause inserted in part A of the form 3CD requires the assessee to state **whether the assessee has opted for taxation** under any of the sections 115BA, 115BAA, 115BAB, **115BAC and 115BAD**

  Sec 115BA – Old section relevant till FY 19-20
  Sec 115BAA – Any Manufacturing Domestic Company – 22%
  Sec 115BAB – Any Domestic Company – 15%
  Sec 115BAC – Individual & HUF – 7 Slabs, After 15 lakhs 30%
  Sec 115BAD – Resident Co-operative Society – 22%

  Surcharge & Higher Education Cess will also be applicable.

- **The reply to the above clause can either be a "yes" or "no".**

  - **If Answer is No**
    If the assessee has not opted for any concessional rates as provided under the sections 115BA, 115BAA, 115BAB, 115BAC and 115BAD, of the Act, then, the tax auditor is not required to take any further steps and no further audit procedure is required to be followed. The answer to such question as per the clause in such case can be given as "No" only.

  - **If Answer is Yes**
    However, if the assessee informs that it has opted for the confessional rate of taxation as per the provisions of sections 115BA, 115BAA, 115BAB, **115BAC and 115BAD** of the Act, then the audit approach is required to be modified.

    - **Audit checklist for practical understanding:**
      - If yes, whether the assessee has opted for taxation regime under section 115BA, 115BAA, 115BAB, 115BAC and 115BAD and report accordingly.

- If yes, whether the copy of Form 10-IB / 10-IC / 10-ID / 10-IE / 10-IF filed online has been obtained from the assessee?

PART B

Clause 9
(MCQ. FL.21)

Text –

(a) If firm or Association of Persons, indicate names of partners/ members & their profit-sharing ratios.

(b) If there is any change in the partners of members or in their profit-sharing ratio since the last date of the preceding year, the particulars of such change.

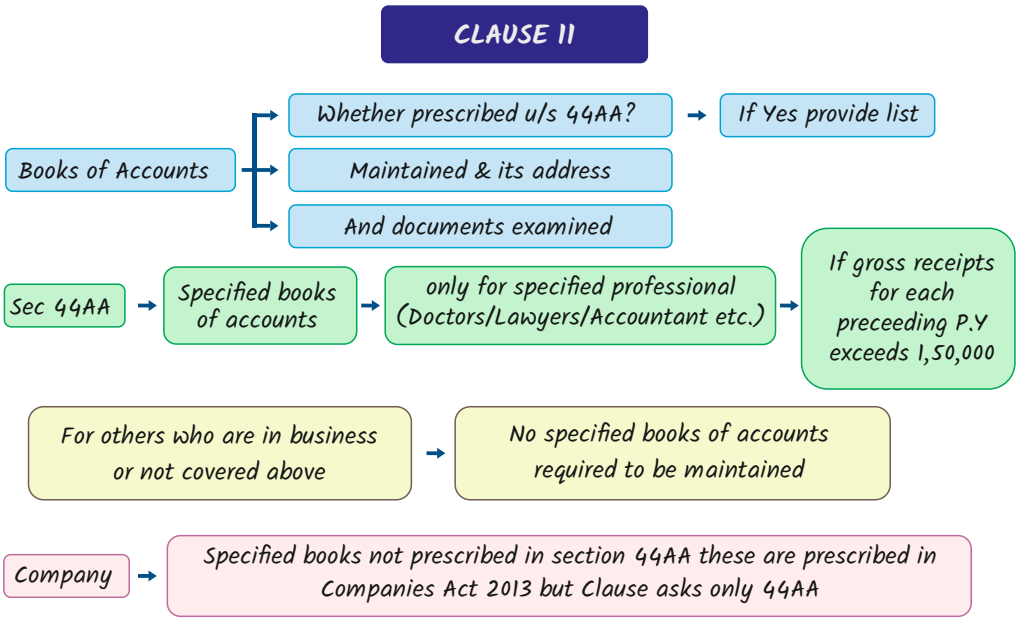
Notes –

- *If person is partner / member in representative capacity, then details of beneficial partner / member should be given.*
- *Also, give details of LOSS Sharing Ratio*
- *Give details of changes (all changes)*
- *Confirm from partnership deed or any document supporting AOP*
- *If share in AOP is not determined specify it (Section 167B will get applicable, charging at maximum marginal rate)*

Clause 10.

- **Text –**
  - **(a) Nature of business or profession (if more than one, nature of every business or profession).**
  - **(b) If there is any change in the nature of business or profession, the particulars of such change.**
- **Notes –**
  - *Mention Sector / Sub Sector*
    Mention Code (as per list of IT department)
    Example Professionals Chartered Accountants, Auditors, etc. A0601
  - *Details of each business*
  - *Changes in nature of business (Trading to Manufacturing)*
    Take management representation for change
  - *Reorganization / Reconstruction is no change in nature of business*
    Temporary closure of business is no change in nature of business

Clause 11 (QNO-532.000)



- **Text –**
  - **(a) Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.**
  - **(b) List of books of account maintained and the address at which the books of account are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of accounts are not kept at one location, please furnish the addresses of locations along with the details of books of accounts maintained at each location.)**
  - **(c) List of books of account and nature of relevant documents examined.**
- **Notes –**

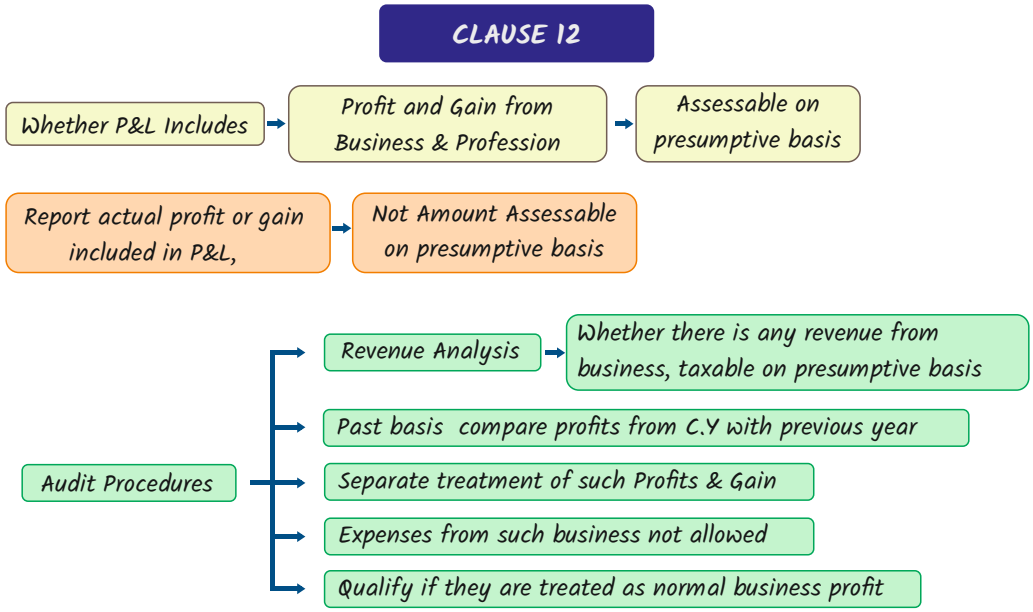
Check that the books of accounts have been maintained as required by law:

- *In case of **professionals,** requirements of section 44AA read with rule 6F of the Income Tax*

Rules, 1962, should be kept in mind.

- **Rule 6F read with section 44AA** has prescribed books of account to be maintained by professionals. In case the assessee is a professional then only inquiry under clause 11(a) will be answered in the affirmative and list of the books prescribed will have to be given.
- In case of assessee **engaged in business,** no such books have so far been prescribed;hence this question will be answered in the negative.
- In case of **corporate assessee**, the books of accounts required to be maintained are contained in the relevant statute.

Clause 12 (MCQ – Incs.30.4)



- **Text –**
  Whether the profit and loss account include any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant section (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First schedule or any other relevant section)

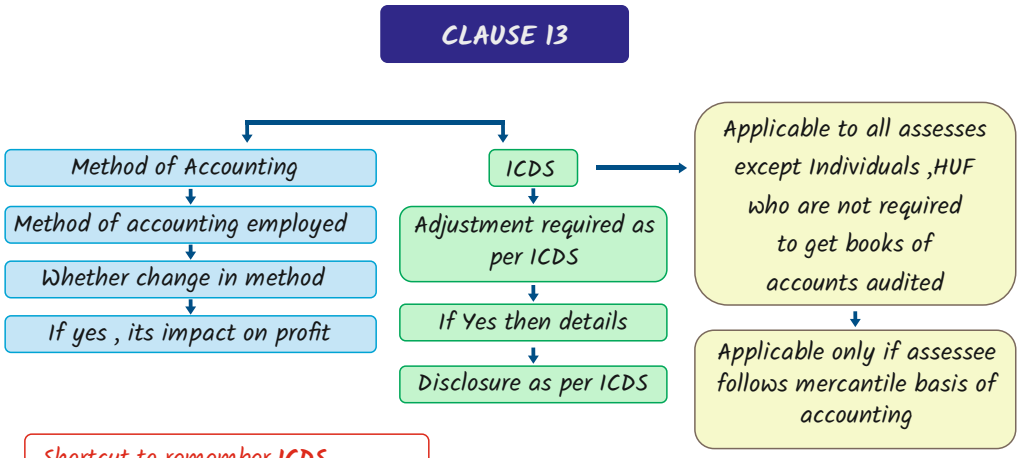
- **Notes –**
  - **Not Applicable:** – If the profit and loss account does not include profit assessable on presumptive basis, then, there is no requirement to furnish the particulars under this clause.
  - **P&L Amount & Not Assessable Amount:** – The amount to be mentioned under this clause means the amount included in the profit and loss account. **The tax auditor is not required to indicate as to whether such amount corresponds to the amount assessable under the relevant section relating to presumptive taxation.** As such, the reporting requirement gets satisfied if the amount as per profit and loss account is reported.
    The auditor should keep in mind the prescribed guidance while furnishing information under this clause in the format provided in the e-filing utility.
  - **Past Basis:** – Go through the past assessment records to find out the basis at which such income was assessed in the past.
  - **Revenue Analysis:** – Go through the profit and loss account and make out a revenue analysis in order to determine whether turnover includes any revenue from any business which is assessable on presumptive basis under section 44AD, 44ADA, 44AE, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G or any other relevant section.
  - **Not entitled to claim expenditure & depreciation: – If the income is taxed on presumptive basis then the assessee is not entitled to claim any expenditure under sections 30 to 38 except the salary and interest to partners in case of a firm. The auditor should ensure that the assessee does not claim any such expenditure.**

Further written down value of any asset used for the purpose of such a business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of depreciation for each of the relevant assessment years. The auditor shall ensure that the written down value of any asset used for such business is correctly determined.

- ***Qualify Report:*** *– Qualify the report if there is included any turnover from such business in the gross turnover because income from such business is to be computed on presumptive basis and if it is computed under normal provisions of the Act then the accounts are to be audited.*

Clause 13
(QNO-534.000/535.000/537.500/557.010/)

(MCQ – FL.17)



Shortcut to remember **ICDS**	
Ajay Devgan white colour ki	ICDS I-Accounting Policy
Van leke	ICDS II-Valuation of Inventory
Construction site pe pahuch tha hai. Waha ke logo se puch tha hai kitna	ICDS III-Construction contract
Revenue kamte ho. fir bolta hai jinke pass	ICDS IV-Revenue recognition
Fixed assets nahi hai aur	ICDS V-Tangible Fixed Assets
Foreign exchange nahi unki list banao. List le jata hai aur	ICDS VI-Changes in Foreign Exchange Rate
Government grant mangta hai, jab tak government grant nahi deti khudka ghar as	ICDS VII-Governemnt grants
Security jama karta hai	ICDS VIII-Securities
Borrowing cost aur	ICDS IX-Borrowing cost
Provision khud bear karta hai	ICDS X-Provisions, Contingent liabilities and Contingent Assets

- ***Text –***

(a) Method of accounting employed in the previous year.

(b) Whether there had been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.

(c) If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss

Serial Number	Particulars	increase in profit (Rs.)	ICecarese in profit (Rs.)

(d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)

(e) If answer to (d) above is in the affirmative, give details of such adjustments:

		Increase in profit	Decrease in profit	Net effect
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS v	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
	ICDS X Provision, Contingent, Liabilities and contingent assets			
	Total			

Shortcut to Remember ICDS

Ajay *devgan* ***Van*** *leke* ***Construction site*** *pe pahuchtha hai. Wahake logo se puchtha hai kitna* ***Revenue*** *kama te ho. Fir bolta hai jinke paas* ***Fixed Assets*** ***aur Foreign Exchange*** *nahi hai unki list banao. List lejaata hai for* ***Government grant,*** *jab tak government grant nahi deti khudka ghar as* ***Security*** *jama karata hai,* ***Borrowing costaur Provisions*** *khud bear karta hai.*

Ajay *devgan white colourki (Accounting Policy)*
Van *leke (Valuation of Inventory)*
Construction site *pe pahuchthahai. Wahake logo se puchthahaikitna (Construction Contracts)*
Revenue *kama te ho. Fir boltahaijinkepaas (Revenue Recognition)*
Fixed Assets *nahihaiaur (Tangible Fixed Assets)*
Foreign exchange *nahi unki list banao. List lejaatahaiaur (Changes in Foreign Exchange Rate)*
Government grant *mangtahai, jab tak government grant nahidetikhudkaghar as (Government Grants)*
Security *jama karata hai (Securities),*
Borrowing cost *aur (Borrowing Cost)*
Provisions *khud bear kartahai. (Provisions, Contingent Liabilities and Contingent Assets)*

(f) **Disclosure as per ICDS:** (2 ICDS not included Foreign Exchange & Securities)

(I)	ICDS I-Accounting Policies
(II)	ICDS II-Valuation of Inventories
(III)	ICDS III-Construction Contracts
(VI)	ICDS VI-Revenue Recognition
(V)	ICDS V-Tangible Fixed Assets
(VI)	ICDS VII-Governments Grants
(VII)	ICDS IX- Borrowing Costs
(VIII)	ICDS X- Provision Contingent Liabilities and Contingent Assets

- **Notes –**

ICDS: – Income Computation and Disclosure Standards (ICDS):

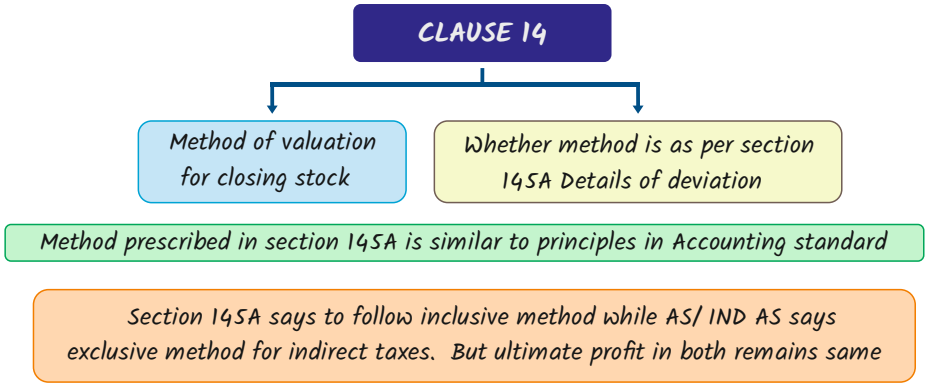
Section 145 of the Income Tax Act, 1961 deals with the method of accounting.

- Under section **145(1)**, income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with **either the**

cash or mercantile system of accounting *regularly employed by the assessee.*

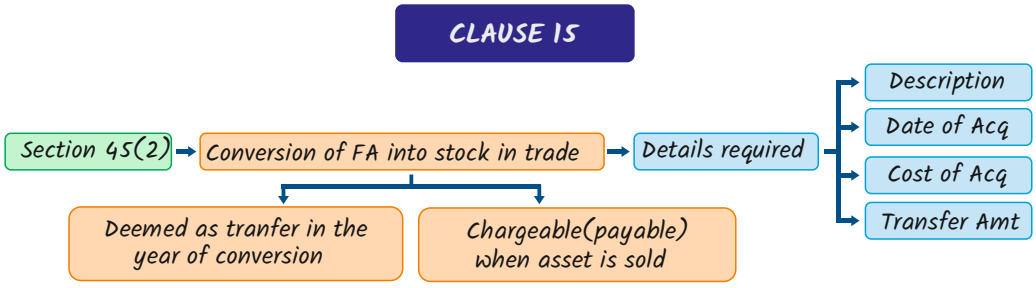
- *Section* ***145(2)*** *empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income.*
- *Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by* ***all assesses (other than an individual or a HUF who is not required to get his accounts of one previous year audited in accordance with the provisions of section 44(AB)),*** *following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or " Income from other sources", from the A.Y. 2017-18.*
- *All the notified ICDSs are applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.*
- *In the case of conflict between the provisions of the Income.tax Act, 1961 and the notified ICDSs, the provisions of the Act shall prevail to that extent.*

Clause 14
(QNO-535.010)



- ***Text –***
  - ***Method of valuation of closing stock employed in the previous year.***
  - ***Details of deviation, if any, from the method of valuation prescribed under Section 145 A and the effect thereof on the profit or loss.***
- ***Notes –***
  - *Accounting Standard mentions Exclusive Method& 145A mentions Inclusive Method*
  - *Impact of such change is NIL (Explained under Guidance Note)*

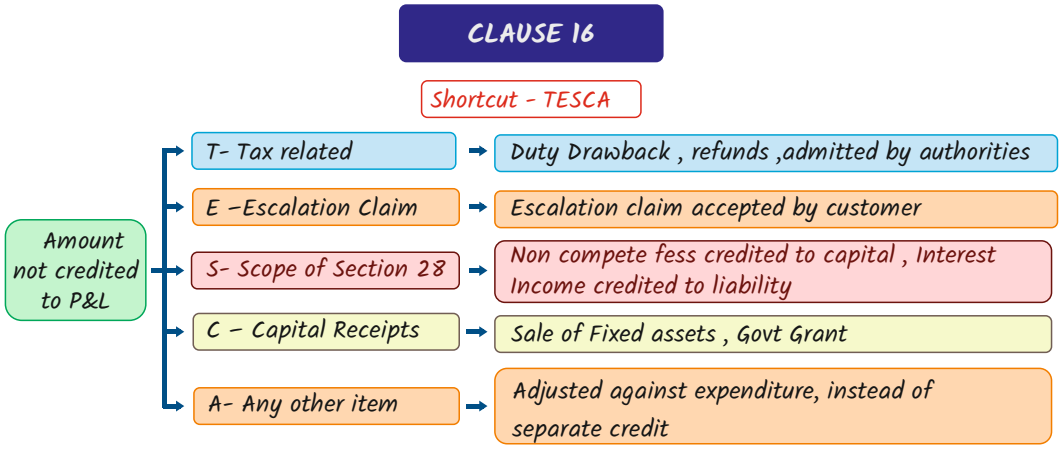
Clause 15



- ***Text –***
  Give the following particulars of the capital asset converted into stock-in-trade –
  (a) Description of capital asset;
  (b) Date of acquisition;
  (c) Cost of acquisition;
  (d) Amount at which the asset is converted into stock-in-trade.
- ***Notes –***
  - *Under section 45(2) such a conversion or treatment of capital asset into stock-in*

*trade, will be **deemed to be a transfer of the previous year in which the asset is so converted or treated as stock-in-trade.** However, the capital gains arising from such a transfer will become chargeable in the **previous year in which such converted asset is sold or otherwise transferred.***

Clause 16
(QNO-536.000/ 537.000/ 537.500, 537.600)
(MCQ – FL.20)



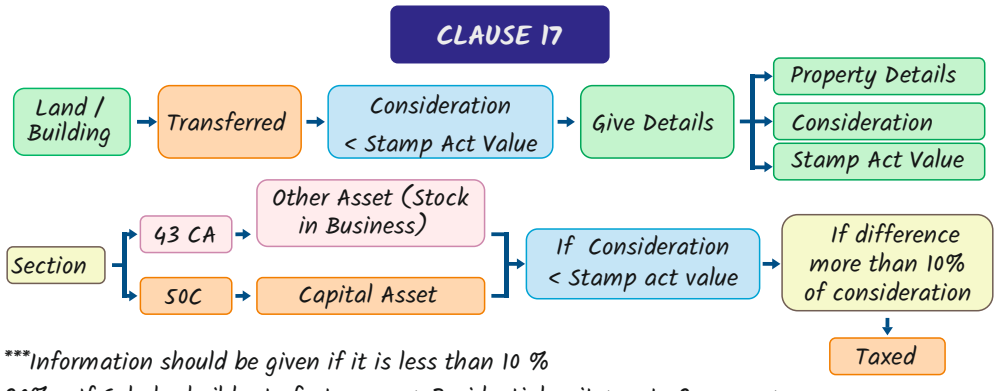
- ***Text –***

Amounts not credited to the profit and loss account, being, –

(a) the items falling within the scope of section 28;
(b) the proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;
(c) escalation claims accepted during the previous year
(d) any other item of income;
(e) capital receipt, if any

- ***Notes –***
  - ***Profit on sale of fixed assets/investments*** *to the extent not credited to the profit and loss account.*
  - ***Government grant*** *in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.*
  - ***No compete fees*** *directly credited to reserves for sub clause*
  - ***Interest incomes*** *received treated as liability*
  - *Where such amounts have not been credited in the profit and loss account but **netted against the relevant expenditure/income heads,** such fact should be clearly brought out.*
  - *The tax auditor may obtain a **management representation** in writing from the assessee in respect of all items falling under this clause.*

Clause 17
(QNO-539.000)



***Information should be given if it is less than 10 %
20% - If Sale by builder to first owner + Residential unit + unto 2 crores + 20th Nov 20 to 30th Jun 21
In Last Column = Specify whether 20% benefit taken Yes / No*

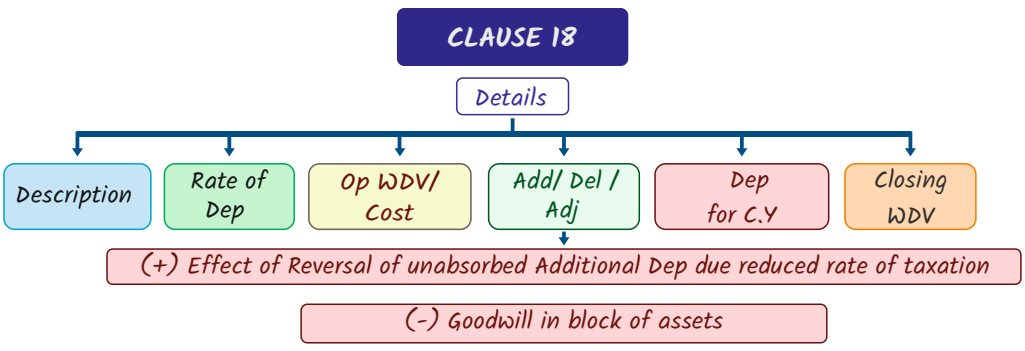
- **Text –**

  Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in Section 43CA or 50C, please furnish: –

Details of Property	Consideration received or accrued	Value adopted or assessed or assessable	Whether provisions of second proviso to sub-section (1) of section 43CA or fourth proviso to clasue (x) of sub-section (2) of section 56 applicable? [Yes/No]

- **Rate**
  - Under Sec 43CA (Transfer of Business Asset) & Sec 50C (Transfer of Capital Asset), if consideration goes below stamp act value then also we will deem stamp act as consideration.
  - But such deeming fiction will apply only if stamp act value is exceeding 110% of consideration. So difference should be more than 10% of consideration.
    - Till FY 20-21 this rate was 5%
    - From 1st April 21 rate was changed to 10% (Finance Act 2020) – Finance Act 2020 is applicable for May & Nov 21 Exams
    - There is 1 more change, which is introduced by Finance Act 2021, which is logically not applicable, but Form 3CD clause 17 has its reference in newly introduced last coloumn.
    - As per this change there is conditional increase is above rate. Rate is increased to 20% if following conditions are satisfied
      - If residential unit is transferred first time to any person
      - Consideration not exceeding 2 crores
      - Between time period 12th Nov 2020 to 30th June 2021

Clause 18
(QNO – 549.500)



Particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form: -

(a) Description of asset / block of assets.
(b) Rate of depreciation.
(c) Actual cost or written down value, as the case may be
(ca) Adjustment made to the written down value under section 115BAC / 115BAD (for assessment year 2021-2022 only) .
(cb) Adjustment made to written down value of Intangible asset due to excluding value of good will of a business or profession
(cc) Adjusted written down value
(d) Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of -
  (i) Central Value Added Tax credits claimed and allowed under the Central Excise Rules,1944, in respect of assets acquired on or after 1st March,1994.
  (ii) Change in rate of exchange of Currency, and
  (iii) Subsidy or grant or reimbursement, by whatever name called.
(e) Depreciation allowable.
(f) Written down value at the end of the year.

Note

- Show Adjustment Due to Additional Depreciation Disallowance separately
  - Under this clause we give reconciliation of block of assets from opening balance to closing balance.
  - In reduced rate of taxation under 115BA / 115BAA / 115BAB / 115BAC / 115BAD additional depreciation is not allowed only normal depreciation is allowed.

    Sec 115BAA / Sec 115BAB – From 1st April 20
    Sec 115BAB / Sec 115 BAC – From 1st April 21

  - When these sections get applicable first time, there can be situation where unabsorbed additional depreciation may be remaining outstanding, assessee will not be able to take its setoff in future, to give relief to assessee, such unabsorbed additional depreciation should be added to block of asset. So that deduction is received over period of time.
- Show adjustment due to disallowance of good will amortization separately
  - Good will amortization will not be allowed as deduction from 1st April 2021 so any unadjusted goodwill should be removed from block of asset.
  - And such removal should be shown as separate adjustment in this schedule.

Clause 19
(QNO-540.000)
(MCQ-Incs.50.3)

CLAUSE 19

List of sections starting 32/33/35 → If assessee has claimed deduction → Whether it is allowed / admissible ?

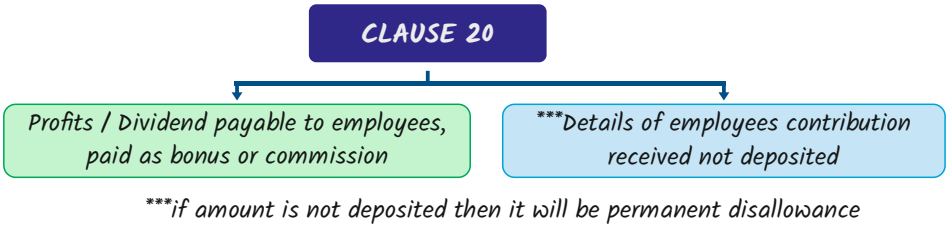
- Text –

  Amount admissible under sections – 32AC,32AD, 33AB, 33ABA, 35(1)(i), 35(1)(ii), 35(1) (iia), 35(1)(iii), 35(1)(iv), 35(2AA), 35(2AB), 35ABB, 35AC, 35AD, 35CCA, 35CCB, 35CCC, 35CCD, 35D,35DD, 35DDA, 35E.

- **Notes –**

Sec 32AD is recently included in above list. In this section a one-time benefit is available in the year of installation of the new asset by the eligible undertaking and is available over and above the claim of depreciation, as well as the additional depreciation of 35% available under section 32(1) (iia) for the same backward areas.

Clause 20



- **Text –**

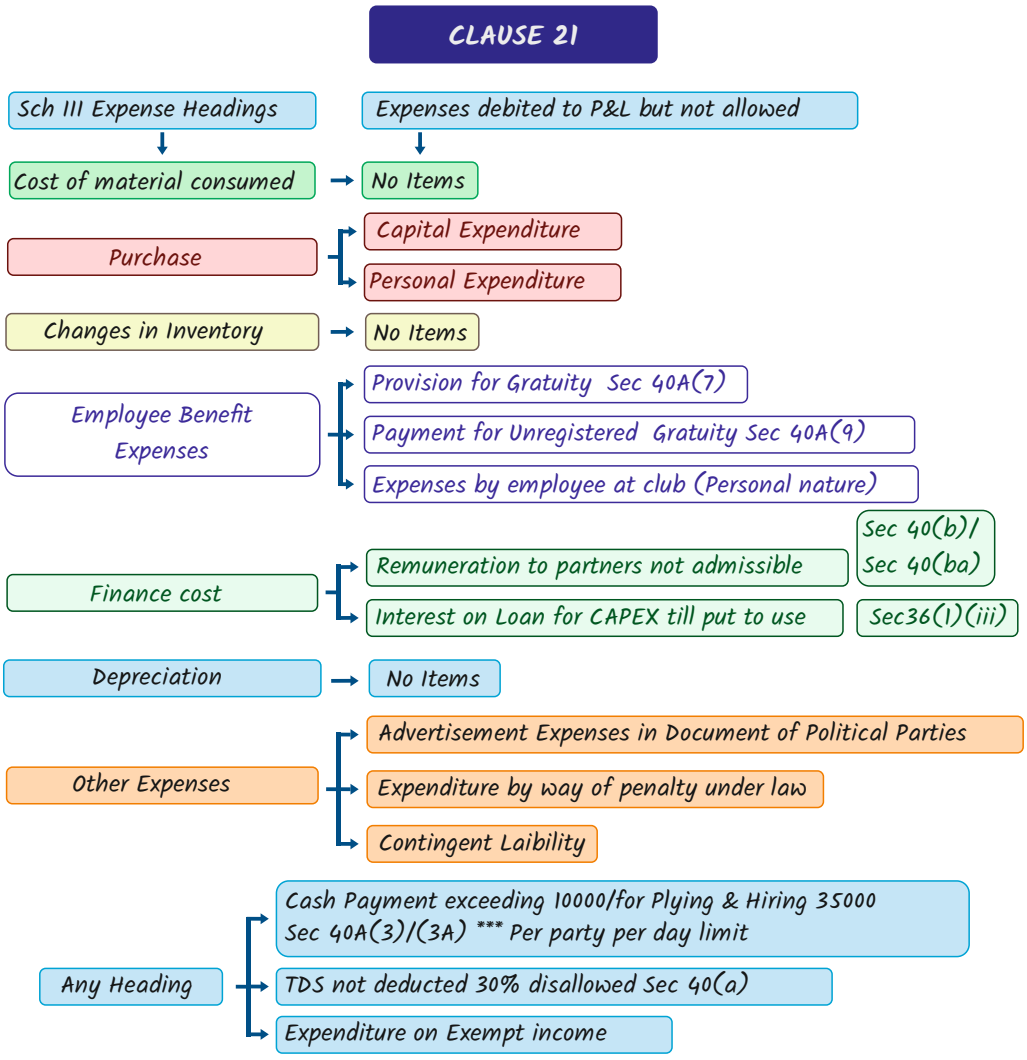
(a) Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(1)(ii)].

(b) Details of Contributions received from employees for various funds as referred to in section 36(1) (va)

- **Notes –**
  - *Careful analysis will be required to distinguish bonus &commission*
  - *If amount is not deposited it will be a permanent disallowance, in case of voluminous data test check is allowed.*

Clause 21

(QNO542.000/ 543.000/ 544.000/ 545.000) (MCQ – FL.11 / Incs.30.1 / Incs.30.4)



- **Text –**

(a) Please furnish details of amount debited to the profit and loss account, being in nature of capital, personal expenditure, advertisement expenditure in documents of political party etc.

(b) **Amounts inadmissible under section 40(a);** (TDS not deducted, 30% Disallowed)

(c) **Amounts debited to Profit and Loss Account being interest, salary, bonus, commission or remuneration inadmissible under section 40(b) / 40 (ba) and computation thereof.** (Limit on remuneration to partners)

(d) **Disallowance/deemed income under section 40A (3).** (Cash Payment Exceeding 10,000 / Plying & Hiring then 35,000)

(e) **Provision for payment of gratuity not allowable under sec.40A (7).** (Provision for gratuity not allowed)

(f) **any sum paid by the assessee as an employer not allowable under section 40A (9) ;**(Payment to unregistered gratuity / PF)

(g) **Particulars of any liability of a contingent nature.** (AS 29, CL should be in notes to account)

(h) **Amount of deduction inadmissible in terms of sec. 14A in respect of the expenditure incurred in relation to income which does not form part of the total income;** (Expenditure on exempted income)

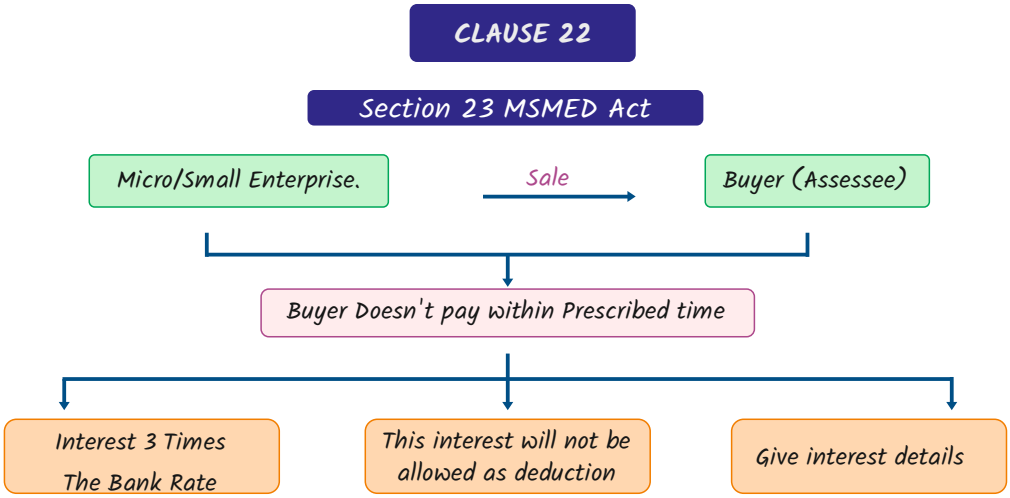
(i) **Amount inadmissible under the proviso to sec. 36(1)(iii)** (Interest on loan for CAPEX till it is put to use)

- **Notes –**
  - **Obtain List:** – For the purpose of furnishing the above particulars, the tax auditor should obtain a list of all cash payments in respect of expenditure exceeding Rs 10,000/- (Rs 35000/- in case of plying, hiring or leasing goods carriages) made by the assessee during the relevant year which should include the list of payments exempted in terms of Rule 6DD with reasons.
  - **Test Checks:** – In case of voluminous nature of the information, the tax auditor can apply materiality principles, tests check and compliance tests for verifying the information required to be provided under this clause
  - **Verify with Books:** – This list should be verified by the tax auditor with the books of account in
  - order to ascertain whether the conditions for specific exemption granted under clauses (a) to (l) of Rule 6DD are satisfied. Details of payments which do not satisfy the above conditions should be stated under this clause.
  - **Online Payments:** – The tax auditor has to take into account the technological advancements in the field of banking and information technology where payments have been taken other than through an account payee cheque or bank draft.

- **Shortcut to Remember in Sequence Sch III Expense Headings**
  - **Cost of Material Consumed**
  - **Purchases**
    - Capital Expenditure
    - Personal Expenditure
  - **Change in Inventory**
  - **Employee Benefit Costs**
    - Remuneration to Partners Not Admissible Under Sec 40(b) / 40(ba)
    - Provision for gratuity not allowed Sec 40A (7)
    - Payment to unregistered gratuity / PF 40A (9)
    - Expenditure by employees at club
  - **Finance Cost**
    - Interest on loan for CAPEX till it is put to use Sec 36(1)(iii)
  - **Depreciation**
  - **Other Expenses**
    - Advertisement Expenditure in documents of political party
    - Contingent Liability
    - Expenditure by way of penalty under any law

- **Any Heading**
  - Cash Payment Exceeding 10,000 / Plying & Hiring then 35,000 Sec 40A(3)
  - TDS not deducted, 30% Disallowed Sec 40(a)
  - Expenditure on Exempted Income

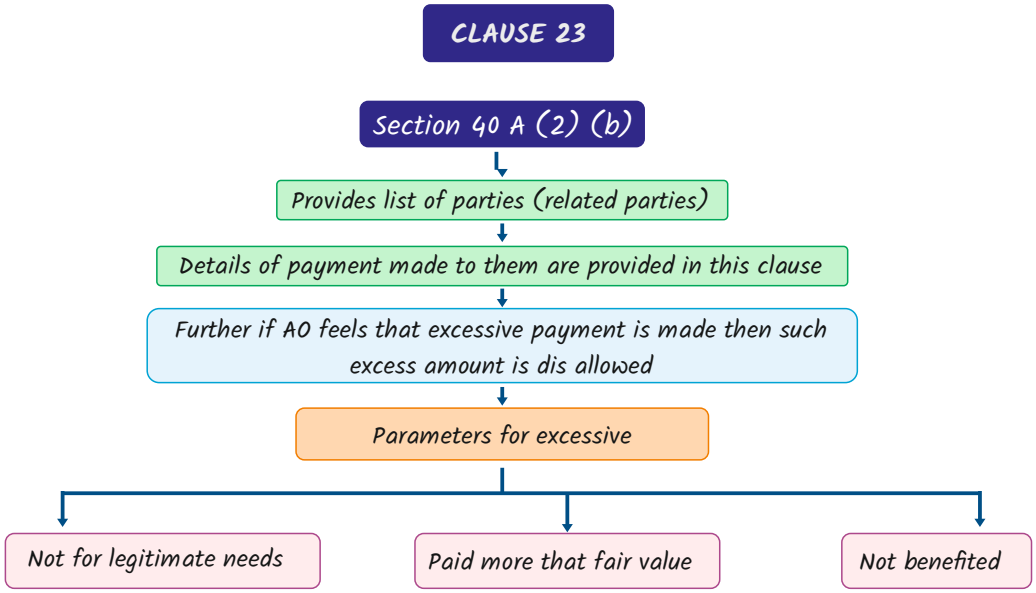
Clause 22



- **Text –**

Amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006 (3 times bank rate)

Clause 23
(QNO546.000)



- **Text –**

Particulars of payments made to persons specified under section 40A (2) (b). (All Payment to relatives, if they excessive they will be disallowed under 40A(2)(a))

- **Notes –**

CASE

An assesses has paid Rent to his brother Rs 2,50,000/- and paid interest to his sister Rs 4,00,000. State the reporting requirements in the Tax Audit Report.

Solution

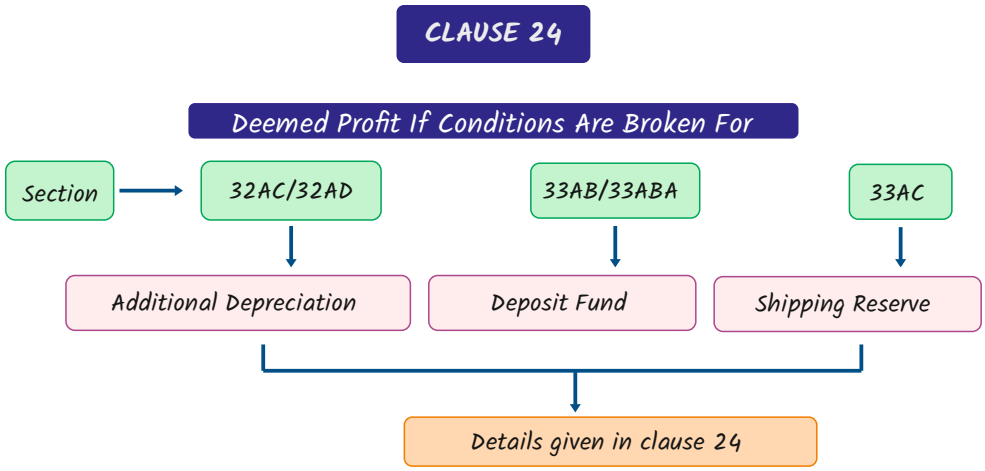
(1) Payment of Rent and Interest: A tax auditor has to report under Clause 23 of Form 3CD which deals with the particulars of payments made to persons specified under Section 40A(2)(b) of the Income Tax Act, 1961. Where the assessee is an individual, the specified persons include any relative of the assessee (i.e. Husband, Wife, Brother, Sister or any other Lineal Ascendant or Descendant)

(ii) In the present case, an assessee has paid rent to his brother Rs 2,50,000 and interest to his sister of Rs 4,00,000 which may be disallowed if, in the opinion of the Assessing Officer, such expenditure is excessive or unreasonable having regard to:

- the **fair market value** of the goods, services or facilities for which the payment is made; or
- for the **legitimate needs of business or profession** of the assessee; or
- the **benefit derived by or accruing** to the assessee from such expenditure.

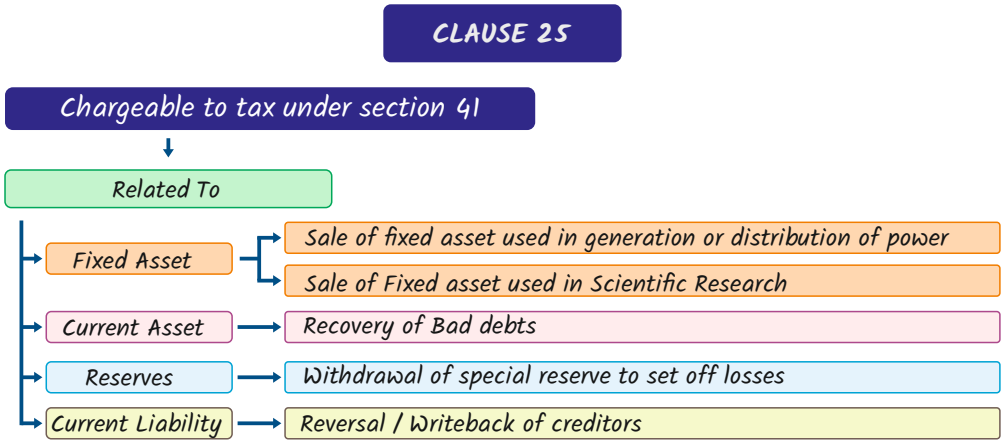
Hence this fact **needs to be reported** in the Tax Audit Report accordingly.

Clause 24
(FL.S)



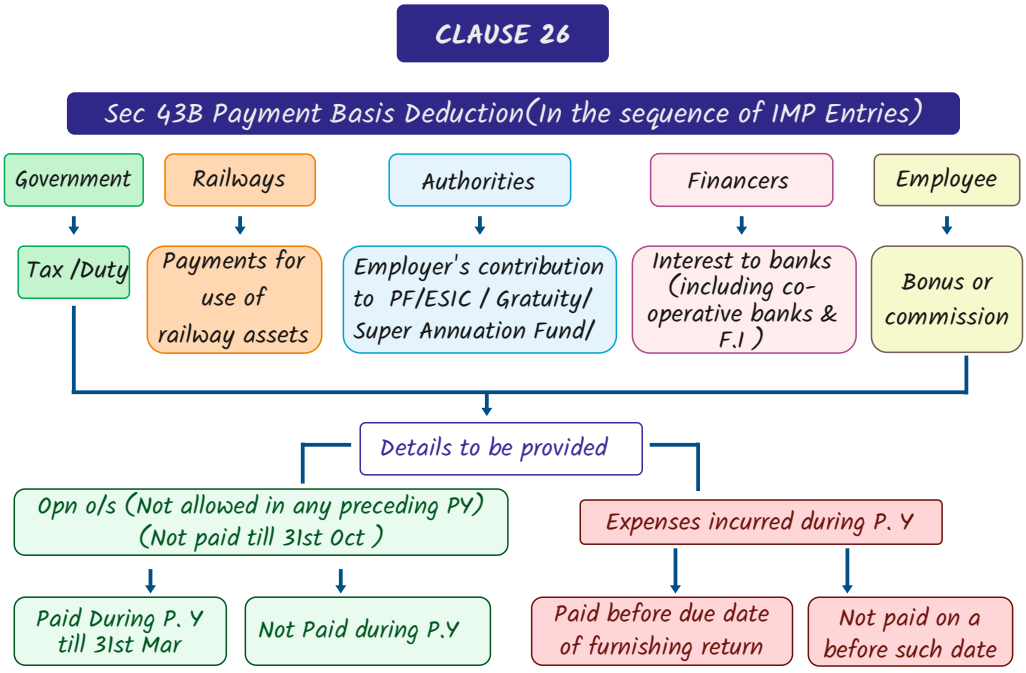
- **Text –**
  - **Amount deemed to be profits & gains under section 32AC / 32AD / 33AB /33ABA / 33AC.**
    (Withdrawal / Closure of deposit is taxed)

Clause 25
(QNO – S46.050)



- **Text –**
  Any amount of profit chargeable to tax under section 41 & computation thereof.
- **Notes –**
  - Sale of Assets of undertaking engaged in generation and distribution of power
  - Sale of assets used in scientific research
  - Recovery of Bad Debts allowed earlier
  - Withdrawal from Special Reserve to Set-off of loss
  - Reversal/writing back of trading liability.

Clause 26
(QNO-546.000 / 546.100) (MCQ – Incs.10.4)



***State whether indirect taxes are Routed through P & L

- **Text –**

In respect of any sum referred to in clause (a), (b), (c), (d), (e), (f) or (g) of section 43B, the liability for which:

A. Pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was – (Opening Balance &Its treatment)

(I) Paid during the previous year;

(ii) Not paid during previous year

B. Was incurred in the previous year &was – (Closing Balance &Its treatment)

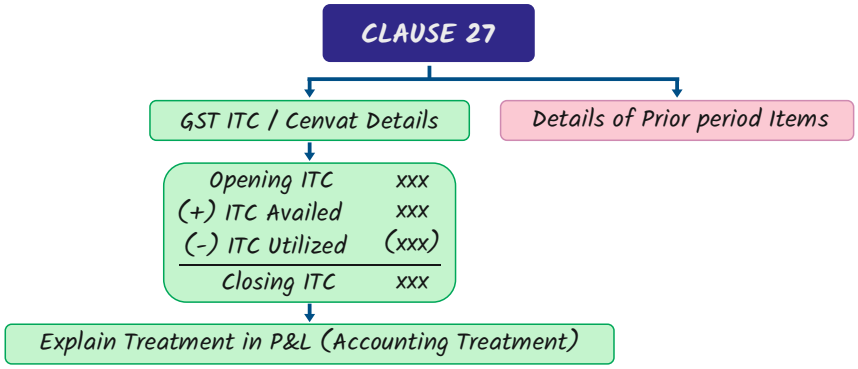
(I) paid on or before the due date for furnishing the returns of income of the previous year under section 139(1).

(ii) Not paid on or before the aforesaid date.

(State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess impost, etc., is passed through the profit and loss account)

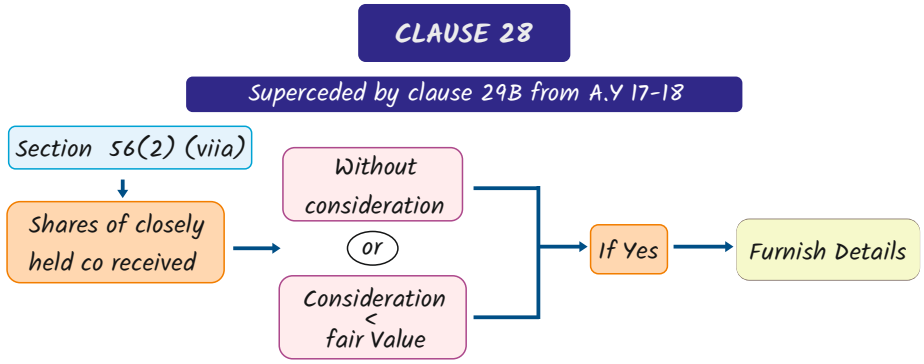
- **Notes – (In sequence of powerful entities)**
  - **(Govt)** Tax, duty
  - **(Railways)** Clause (g) was inserted by the Finance Act 2016 and applies from assessment year 2017-18. It refers to any sum payable by the assessee to the Indian Railways for the use of railway assets.
  - **(Authorities)** Employer contribution to PF / ESIC / Superannuation Fund/Gratuity Fund,
  - **(Financers)** Interest on Loan from Banks/Financial Institutions, Leave encashment, etc."Also, Interest payment to co-operative bank is allowed on payment basis, other than PACS, PCARDB
  - **(Employee)** Bonus or commission to employees,

Clause 27
(QNO-546.500)



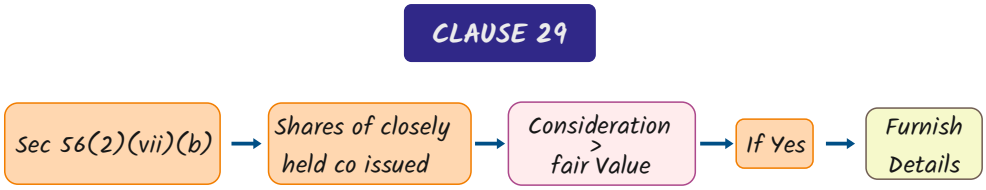
- **Text –**
  - **(a) Amount of Central Value Added Tax credits availed of or utilized during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.**
  - **(b) Particulars of income or expenditure of prior period credited or debited to the profit and loss account.**
- **Notes –**
  - It may be noted that information under this clause would be relevant only in those cases where the **assessee follows mercantile system of accounting.** Under cash system of accounting, expenses debited/ income credited to the profit and loss account would be **current year's expenses/income even though they may relate to earlier years.**

Clause 28



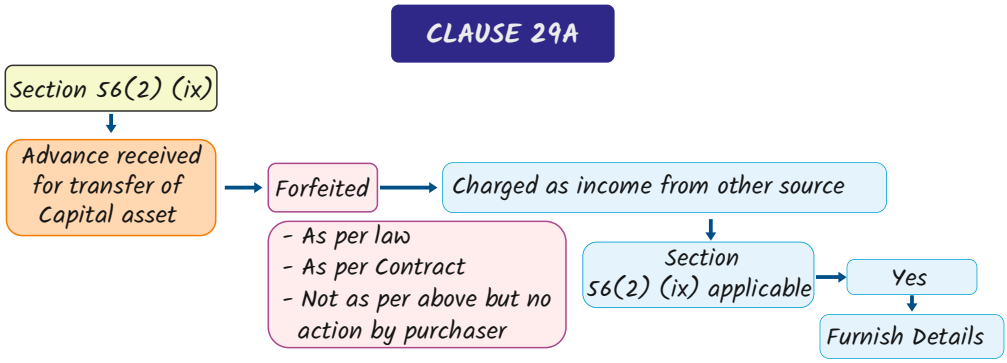
- **Text –**
  Whether during the previous year the assessee has received any property, being share of a company not being a company in which the public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2) (viia). If yes, please furnish the details for the same.
- **Notes –**
  - Sec 56(2) (viia) is applicable for transaction **after 1st June 2010 and before 1st April 2017,** now Sec 56(2)(x) is applicable which is much wider in scope which is covered in Clause 29B

Clause 29
(QNO-548.000)
(MCQ-Incs.10.1)



- **Text –**
  Whether during the previous year the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2) (viib). If yes, please furnish the details of the same.
- **Notes –** "Ready-made information to tax as gift"

Clause 29A
(QNO-546.600)

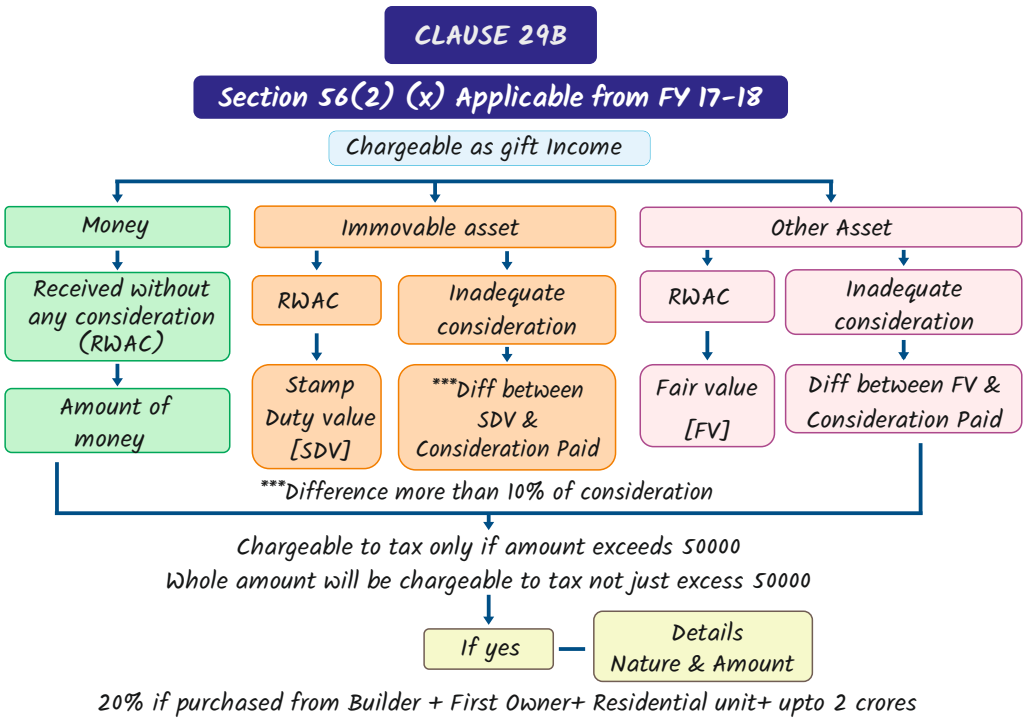


*** Not applicable to advance received for personal capital asset or stock in trade.

- **Text –**
  - **(a) Whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub-section (2) of section 56? (Yes/No)**
  - **(b) If yes, please furnish the following details:**
    - **(i) Nature of income:**
    - **(ii) Amount thereof:**

- **Notes –**
  - **Sec 56(2)(ix)**
    Section 56(2)(ix) was inserted by the Finance (No 2) Act 2014, with effect from assessment year 2015-16. It provides for taxability as Income from Other Sources of any sum of money received as an **advance or otherwise in the course of negotiations for transfer of a capital asset,** if such sum is forfeited and the negotiations do not result in transfer of such capital asset.
  - **Not Applicable to Personal Capital Asset**
    The auditor is not required to report any such forfeited amount if it is in respect of a personal capital asset, where neither the asset, the advance nor the forfeiture is recorded in the books of account relating to the business or profession.
  - **Not Applicable for Advance for Stock in Trade**
    Any advances received and forfeited towards sale of stock-in-trade would be taxable under section 28(i) and would not be required to be reported since the amount would be credited to profit & loss account.
  - **Advance Long Outstanding – No Reporting Required**
    The requirement of reporting arises only on forfeiture of such amount. If an advance has been received and has been outstanding for a considerable period of time, there is no requirement to report such amount unless and until it is forfeited by an act of the assessee. Only forfeiture of amounts received as advance towards transfer of a capital asset is required to be reported under this clause.
  - **Forfeiture Right**
    - Such forfeiture should be as per right in contract or as per sanction of law.
    - If there is no such right and amount is forfeited with no action by purchaser party, then it becomes income under Sec 56(2)(ix) and auditor has to report it.

Clause 29B
(QNO-547.000)



- **Text**

  (a) Whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (x) of sub-section (2) of section 56? (Yes/No)

  (b) If yes, please furnish the following details:

  - **Nature of income:**
  - **Amount (in Rs.) thereof:**

- **Notes –**

  Section 56(2)(x)

  Section 56(2)(x) was introduced by the Finance Act 2017, with effect from assessment year 2017-18. However, since it applies to amounts or assets received on or after 1st April 2017, it effectively applies with effect from assessment year 2018-19.

  Under this section, the following amounts/value of assets received by an assessee from any person or persons are chargeable to tax as Income from Other Sources:

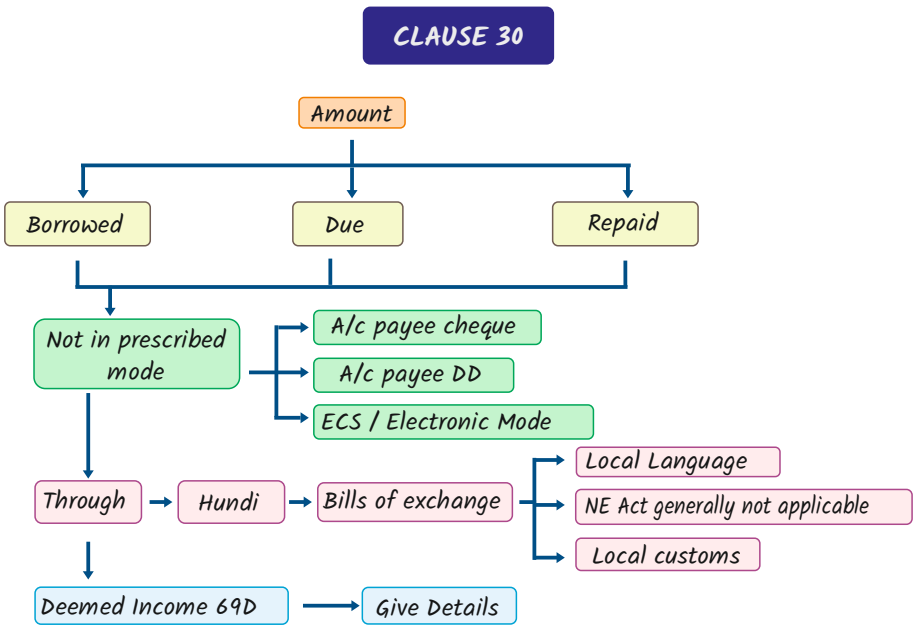
  - **Money**

    Any sum of money, received without consideration, if it exceeds Rs. 50,000

  - **Immovable Asset**
    - Stamp duty value of any immovable property received without consideration, stamp duty value of which exceeds Rs. 50,000.
    - Stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely: —
      - the amount of fifty thousand rupees; and
      - the amount equal to five per cent of the consideration:

  - **Other Asset**
    - Aggregate Fair market value of property, other than immovable property, without consideration, where the aggregate fair market value of such property exceeds Rs. 50,000.
    - Aggregate Fair market value of property, other than immovable property, in excess of the consideration, where the aggregate fair market value exceeds the consideration by more than Rs. 50,000.

Clause 30



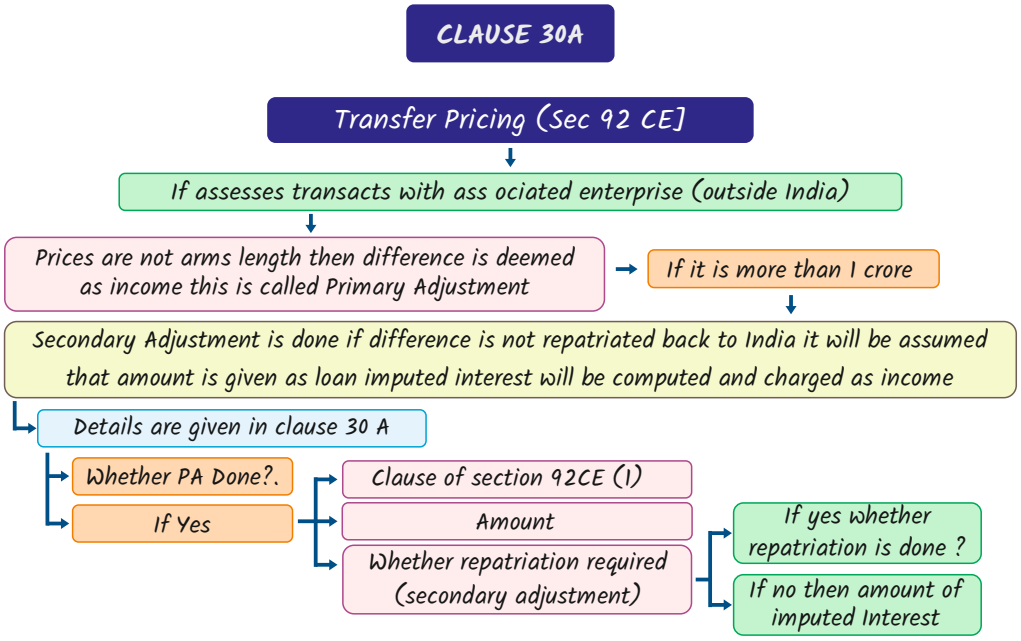
- **Text –**

  Details of any amount borrowed on hundi or any amount due thereof (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque [Section 69D].

- **Notes –**

  No threshold limits

Clause 30A



- **Text –**
  - **(a) Whether primary adjustment to transfer price, as referred to in sub-section (1) of section 92CE, has been made during the previous year? (Yes/No)**
  - **(b) If yes, please furnish the following details: -**
    - **Under which clause of sub-section (1) of section 92CE primary adjustment is made?**
    - **Amount (in Rs.) of primary adjustment:**
    - **Whether the excess money available with the associated enterprise is required to be repatriated to India as per the provisions of sub-section (2) of section 92CE? (Yes/No)**
    - **If yes, whether the excess money has been repatriated within the prescribed time (Yes/No)If no, the amount (in Rs.) of imputed interest income on such excess money which has not been repatriated within the prescribed time.**

- **Notes – Section 92CE**
  - **Primary Adjustment**

    Sub section (1) Where a primary adjustment to transfer price, —
    - **(i)** has been made Suo moto by the assesse in his return of income;
    - **(ii)** made by the Assessing Officer has been accepted by the assessee;
    - **(iii)** is determined by an advance pricing agreement entered into by the assessee under section 92CC;
    - **(iv)** is made as per the safe harbor rules framed under section 92CB; or
    - **(v)** is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or section 90A for avoidance of double taxation, the assessee shall make a secondary adjustment:

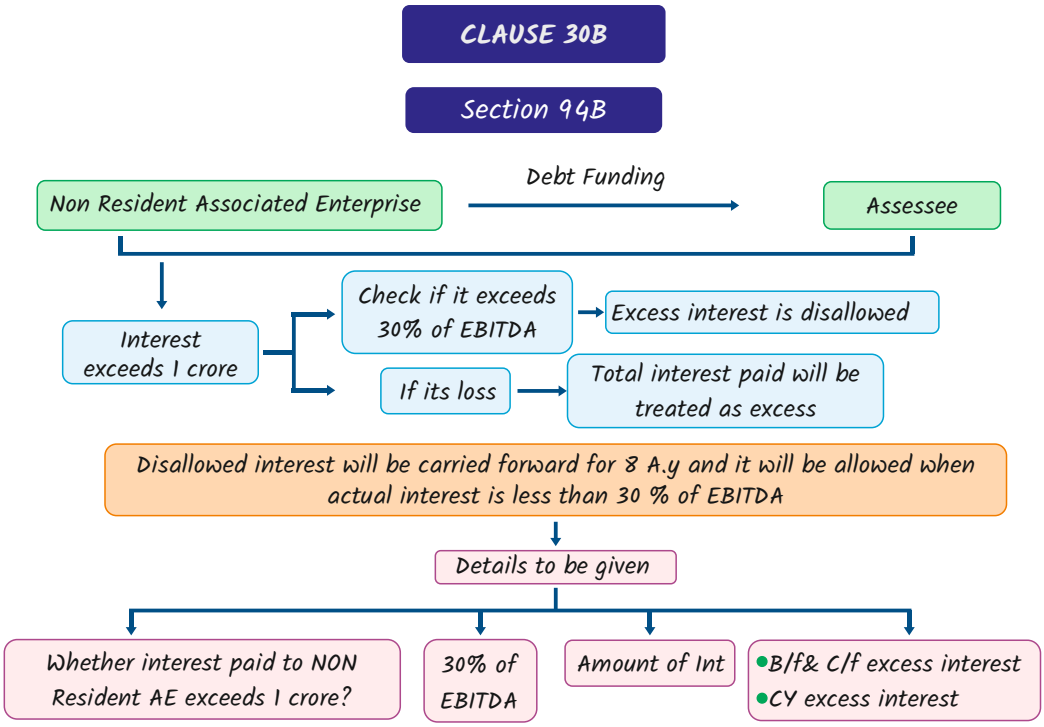
  - **Non-Applicability**

    No secondary adjustment is required if the primary adjustment relates to assessment year 2016-17, or an earlier assessment year. **No secondary adjustment is required if the amount of primary adjustment made in any previous year does not exceed Rs. 1 crore.**
  - **Secondary Adjustment**

    Sub section (2) Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee,

the excess money which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed.

Clause 30B



- ***Text –***

  (a) Whether the assessee has incurred expenditure during the previous year by way of interest or of similar nature exceeding one crore rupees as referred to in sub-section (1) of section 94B? (Yes/No)

  (b) If yes, please furnish the following details: -

  - ***Amount (in Rs.) of expenditure by way of interest or of similar nature incurred:***
  - ***Earnings before interest, tax, depreciation and amortization (EBITDA) during the previous year (in Rs.):***
  - ***Amount (in Rs.) of expenditure by way of interest or of similar nature as per (i) above which exceeds 30% of EBITDA as per (ii) above:***
  - ***Details of interest expenditure brought forward as per subsection (4) of section 94B:***

A.Y.	Amount (in Rs.)

  - ***Details of interest expenditure carried forward as per subsection (4) of section 94B:***

A.Y.	Amount (in Rs.)

- ***Notes –***

  - ***Limit excess Interest Expense***

    Section 94B was inserted by the Finance Act 2017, with effect from assessment year 2018-19. It provides that, where an Indian company or a permanent establishment of a foreign company in India, incurs any expenditure ***by way of interest or of similar nature exceeding Rs. 1 crore which is deductible in computation of income under the head "Profits & Gains of Business or Profession" in respect of a debt issued by a non-resident AE,*** *such interest, to the extent of* ***excess interest, shall not be deductible.*** *Further, if the debt is issued by a lender who is not associated, but an AE provides either an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt is also regarded as having been issued by an AE.*

- **Computation of Extra Interest**

  The excess interest is to be computed as the **lower of:**

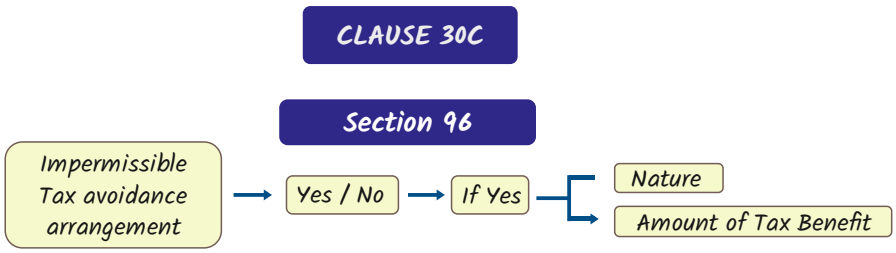
  (i) Total interest paid or payable in excess of 30% of earnings before interest, taxes, depreciation and amortization ("EBITDA") of the borrower in the previous year; or

  (ii) Interest paid or payable to AEs for that previous year.

- **Carry forward of Interest**

  The excess interest, which is disallowed, is allowed to be **carried forward for a period of 8 assessment years** following the year of disallowance, to be allowed as a deduction against profits and gains of any business in the subsequent years, to the extent of maximum allowable interest expenditure under this section.

Clause 30C



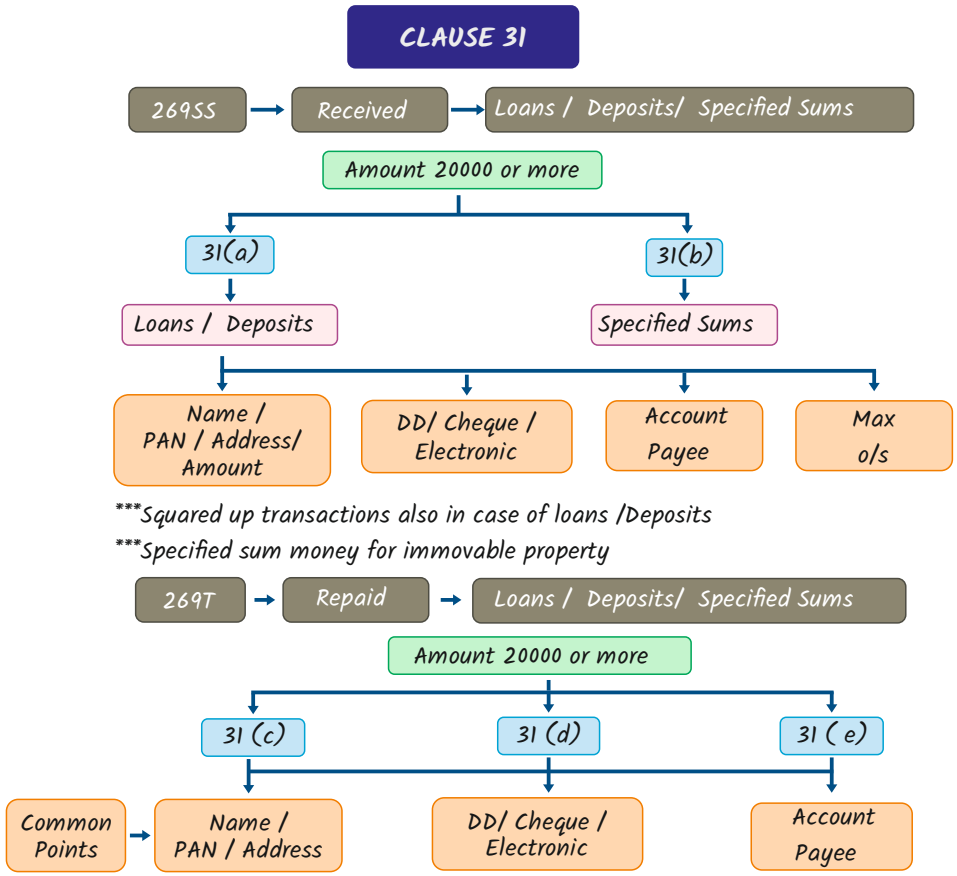
- **Text –**

  (a) Whether the assessee has entered into an impermissible avoidance arrangement, as referred to in section 96, during the previous year? (Yes/No.)

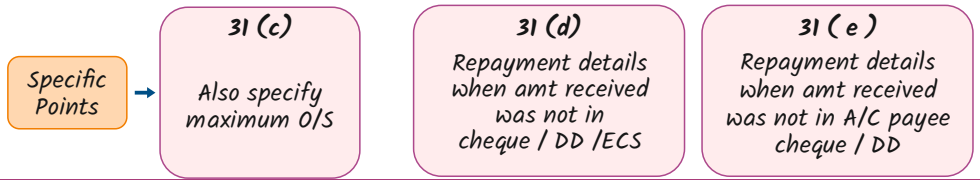
  (b) If yes, please specify: —

  - **Nature of impermissible avoidance arrangement:**
  - **Amount (in Rs.) of tax benefit in the previous year arising, in aggregate, to all the parties to the arrangement:**

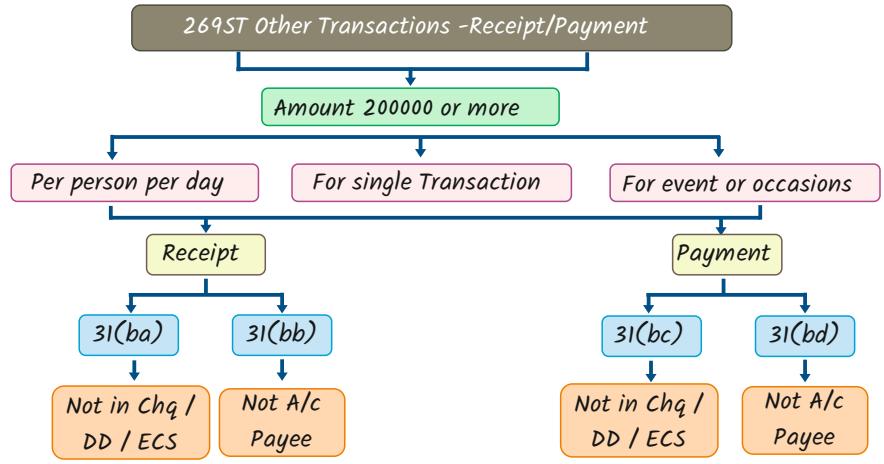
Clause 31
(QNO-549.000 / 549.500 / 549.600 / 549.700) (Incs.01.5)



Continue on next Page...



Clause 30B



	269SS/269T	269ST
Govt	E	E
Post office	E	E
Bank/CO -OP Bank	E	E
Corporation	E	X
Govt Co	E	X

*E-Exempt

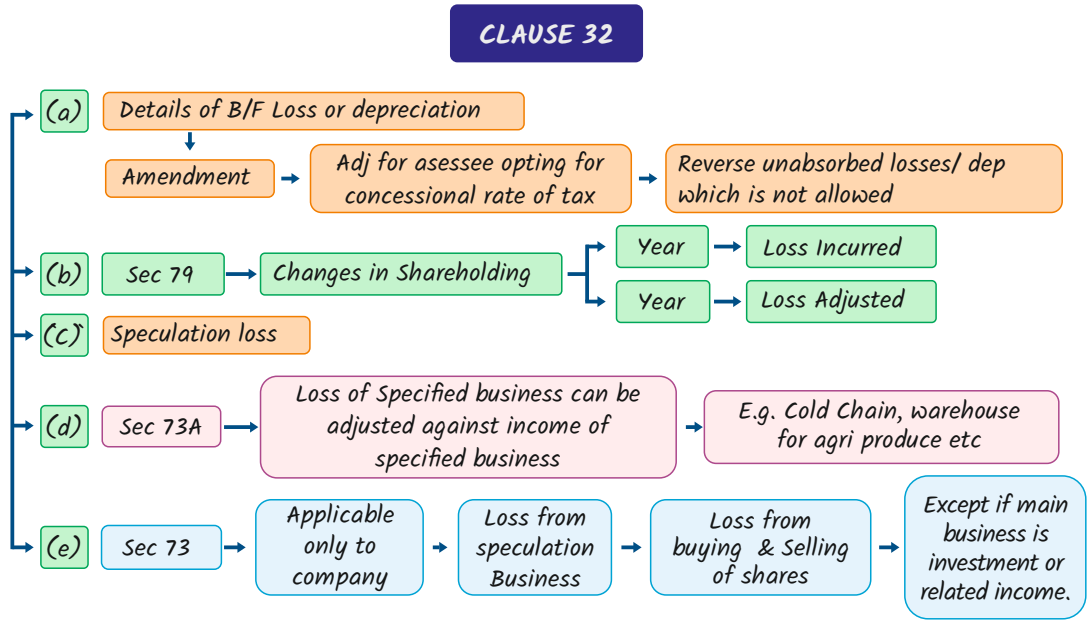
➤ **Text & Notes**

(a)*	***Particulars of each loan or deposit in an amount exceeding the limit specified in Section 269SS taken or accepted during the previous year: -***	--All loans or deposits taken or accepted in aggregate from single party exceed 20,000
	(I) name, address and permanent account number (if available with the assessee) of the lender or depositor;	
	(ii) amount of loan or deposit taken or accepted;	
	(iii) whether the loan or deposit was squared up during the previous year;	
	(iv) maximum amount outstanding in the account at any time during the previous year;	
	(v) whether the loan or deposit was taken or accepted by cheque or bank draft or use of electronic clearing system through a bank account	
	(vi) in case the loan or deposit was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or an	
(b)	***Particulars of each specified sum in an amount exceeding the limit specified in Section 269SS taken or accepted during the previous year: -***	--All sums taken or accepted with respect to immovable property in aggregate from single party exceed 20,000
	(I) name, address and Permanent Account Number (if available with the assessee) of the person from whom specified sum is received;	
	(ii) amount of specified sum taken or accepted;	
	(iii) whether the specified sum was taken or accepted by cheque or bank draft or use of electronic clearing system through a bank account;	

	(iv) maximum amount outstanding in the account at any time during the previous year; (v) in case the specified sum was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or an account payee bank draft (Particulars at (a) and (b) need not be given in the case of a Government company, a banking company or a corporation established by the Central, State or Provincial Act.)	
(ba)	**Particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, during the previous year, where such receipt is otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account:** (I) Name, address and Permanent Account Number (if available with the assessee) of the payer; (ii) Nature of transaction; (iii) Amount of receipt (in Rs.); (iv) Date of receipt;	--Receipt not in prescribed mode Rs. 2,00,000 or more a) in aggregate from a person in a day; or b) in respect of a single transaction; or c) in respect of transactions relating to one event or occasion from a person
(bb)	**Particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, received by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year: —** (I) Name, address and Permanent Account Number (if available with the assessee) of the payer; (ii) Amount of receipt (in Rs.);	--Receipt by cheque or DD which is not account payee Rs. 2,00,000 or more **a)** in aggregate from a person in a day; or **b)** in respect of a single transaction; or **c)** in respect of transactions relating to one event or occasion froma person
(bc)	**Particulars of each payment made in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion to a person, otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year.** (I) Name, address and Permanent Account Number (if available with the assessee) of the payee (ii) Nature of transaction; (iii) Amount of payment (in Rs.); (iv) Date of payment;	--Payment not in prescribed mode Rs. 2,00,000 or more **a)** in aggregate from a person in a day; or **b)** in respect of a single transaction; or **c)** in respect of transactions relating to one event or occasion froma person
(bd)	**Particulars of each payment in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion to a person, made by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year:**	--Payment by cheque or DD which is not account payee Rs. 2,00,000 or more **a)** in aggregate from a person in a day; or **b)** in respect of a single

	(I) Name, address and Permanent Account Number (if available with the assessee) of the payee	transaction; or **c)** in respect of transactions relating to one event or occasion froma person
	(ii) Amount of payment (in Rs.)	
	Particulars at (ba), (bb), (bc) and (bd) need not be given in the case of receipt by or payment to a Government company, a banking Company, a post office savings bank, a cooperative bank or in the case of transactions referred to in section 269SS or in the case of persons referred to abcaus.in in Notification No. S.O. 2065(E) dated 3rd July, 2017)";	
(c)	***Particulars of each repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T made during the previous year: —***	--All loans or deposits repaid in aggregate to single party exceed 20,000 --All sums repaid with respect to immovable property in aggregate from single party exceed 20,000
	(I) name, address and Permanent Account Number (if available with the assessee) of the payee;	
	(ii) amount of the repayment;	
	(iii) maximum amount outstanding in the account at any time during the previous year;	
	(iv) whether the repayment was made by cheque or bank draft or use of electronic clearing system through a bank account;	
	(v) Iin case the repayment was made by cheque or bank draft, whether the same was repaid by an account payee cheque or an account payee bank draft.	
(d)	***Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year: —***	Repayment details where 3 prescribed mediums were not used while receiving funds
	(I) name, address and Permanent Account Number (if available with the assessee) of the payer;	
	(ii) repayment of loan or deposit or any specified advance received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year.	
(e)	***Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received by a cheque or bank draft which is not an account payee cheque or account payee bank draft during the previous year: —***	Repayment details where while receiving funds cheques and DD were not account payee
	(I) name, address and Permanent Account Number (if available with the assessee) of the payer;	
	(ii) repayment of loan or deposit or any specified advance received by a cheque or a bank draft which is not an account payee cheque or account payee bank draft during the previous year.	
	▪ ***Aggregate Amount*** If the total of all loans/deposits from a person exceed Rs 20,000 but each individual item is less than Rs 20,000, the information will still be required to be given in respect of all such entries starting from the entry when the balance reaches Rs 20,000 or more and until the balance goes down below Rs 20,000. As such the tax auditor should verify all loans/deposits taken or accepted where balance has reached Rs 20,000 or more during the year for the purpose of reporting under this clause	

Clause 32
(QNO-550.000)



(a) Details of brought forward loss or depreciation allowance, in the following manner, to the extent available:

Serial Number	Assessment Year	Nature of loss/ allowance (in rupees)	Amount as returned (in rupees)	Amount as assessed (give reference to relevant order)	Remarks

(b) Whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79.

(c) Whether the assessee has incurred any speculation loss referred to in section 73 during the previous year, if yes, please furnish the details of the same.

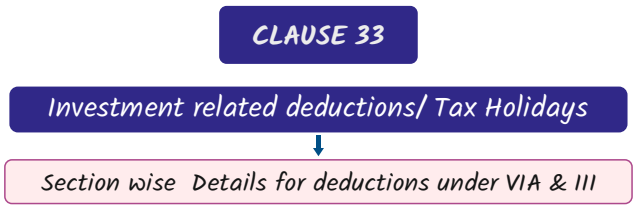
(d) Whether the assessee has incurred any loss referred to in section 73A in respect of any specified business during the previous year, if yes, please furnish details of the same.

(e) In case of a company, please state that whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73, if yes, please furnish the details of speculation loss if any incurred during the previous year.

Note :-

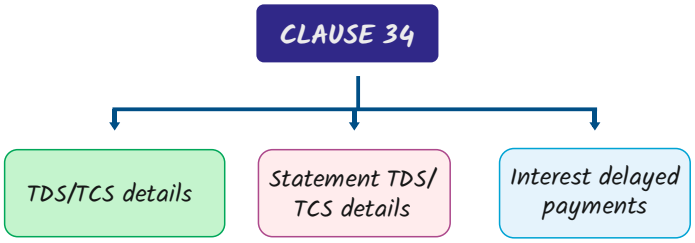
- In this clause sub clause (a) we give details related to losses and unabsorbed depreciation.
- As certain specified losses and unabsorbed additional depreciation is not allowed as deduction, such balances should be removed and such removal should be shown in separate column for that assessment year. As discussed in Clause 18

Clause 33



- **Text –**
  Section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10A & Section 10AA.
- **Notes –**
  Can Chapter VI A deduction be more than the Gross Total Income- Income tax computation is pending???-- No

Clause 34
(MCQ- FL.3)



(a) Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB. If Yes, please furnish

TAN	Sec	Nature of Payment	Total Amt of Payment or Receipt of the nature specified in Col. 3	Total Amt on which tax was required to be deducted or collected out of (4)	Total Amt on which tax was deducted or collected at specified rate out of (5)	Amt of tax Ded. Or coll. Out of (6)	Total Amt on which tax was deducted or collected at less than specified rate out of (7)	Amt of tax deducor collecion (8)	Amt of tax deducted or collected not deposited to the credit of the Central Govt out of (6) and (8).

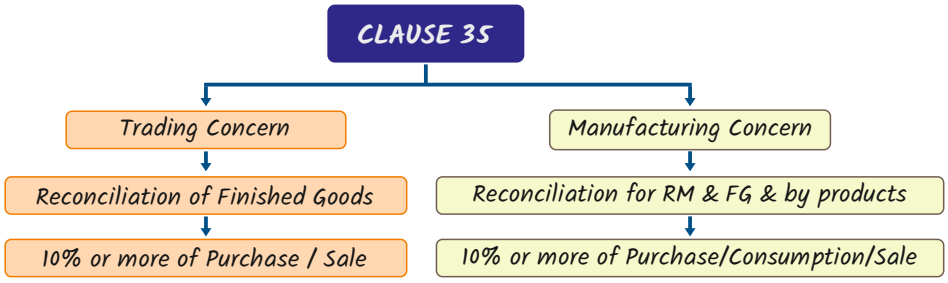
(b) whether the assessee is required to furnish the statement of tax deducted or tax collected. If yes, please furnish the details:

Tax deduction and collection Account Number (TAN)	Type of Form	Due date for furnishing	Date of furnishing,	Whether the statement of tax deducted or collected contains information about all details/transactions which are required to be reported. If not, please furnish list of details/ transactions which are not reported

(C) whether the assessee is liable to pay interest under section 201(IA) or section 206C (7). If Yes, please furnish.

Clause 35

(MCQ – Incs.18.2)



(a) In the case of a trading concern, give quantitative details of principal items of goods traded:

(i) Opening stock;
(ii) Purchases during the previous year;
(iii) Sales during the previous year;
(iv) Closing stock;
(v) Shortage/excess, if any.

(b) In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products.

a. **Raw Materials: -**

(i) Opening stock;
(ii) Purchases during the previous year;
(iii) Consumption during the previous year;

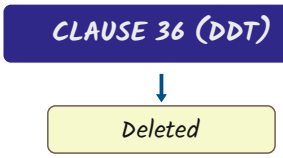
(iv) Sales during the previous year;
(v) Closing stock;
(vi) *Yield of finished products
(vii) *Percentage of yield;
(viii) *Shortage/excess, if any.

B. Finished Products/By-products:

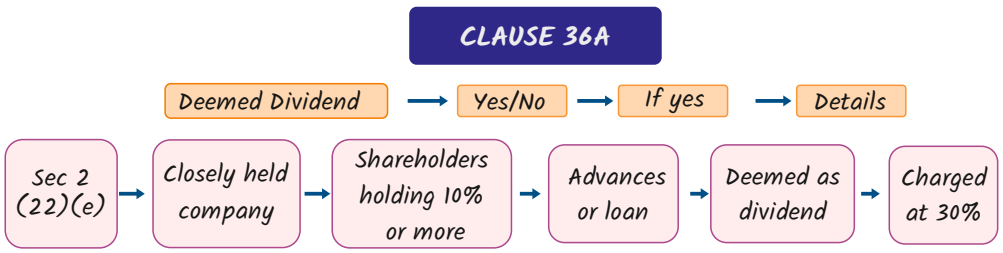
(i) Opening stock;
(ii) Purchases during the previous year;
(iii) Quantity manufactured during previous year;
(iv) sales during the previous year;
(v) Closing stock;
(vi) Shortage/excess, if any.

*Information may be given to the extent available.

Clause 36



Clause 36A

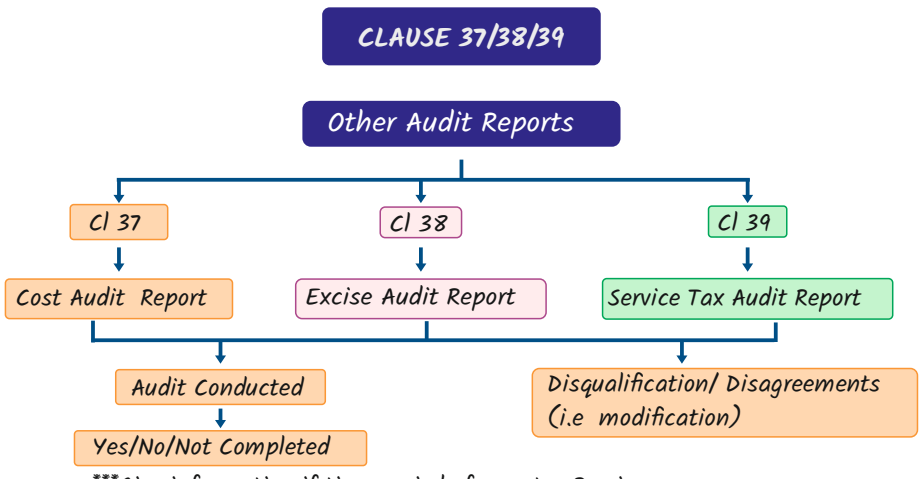


(a) Whether the assessee has received any amount in the nature of dividend as referred to in sub-clause (e) of clause (22) of section 2? (Yes/No)

(b) If yes, please furnish the following details: -

(i) Amount received (in Rs.):

(ii) Date of receipt:



***Give information if time period of report = Previous year

Clause 37 (QNO-553.000)

Whether any cost audit was carried out, if yes, give the details if any, of disqualification or disagreement on any matter/ item/ value/ quantities may be reported/identified by the cost auditor.

Clause 38

Whether any audit was conducted under the Central Excise Act, 1944, if yes, give the details if any, of disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/identified by the auditor.

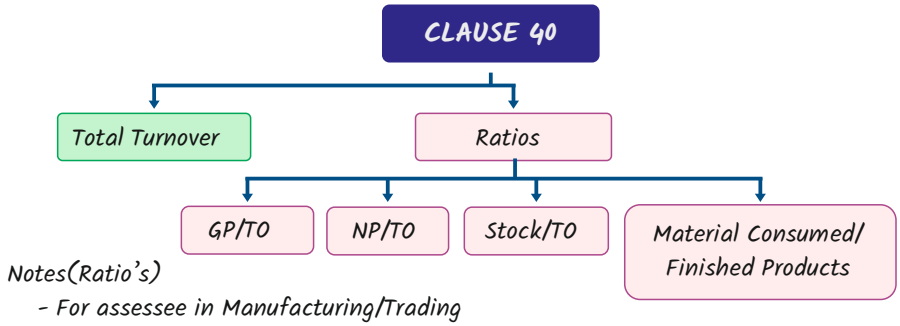
Clause 39

- **Text –**

  Whether any audit was conducted under section 72A of the Finance Act 1994 in relation to valuation of taxable services. If Yes, give the details, if any, of the disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/identified by the auditor.

- **Notes –**
  - The tax auditor need not express any opinion in a case where such audit has been ordered but the same has **not been carried out.**
  - In cases where audit which might have been ordered is **not completed by the time the tax auditor issues his report,** he has to report appropriately in this report stating that since audit is not completed and the report is not available with the Assessee.
  - The tax auditor should examine the time period for which the audit if any has been required to be carried out. Information is required to be given only in respect of such report the time period of which falls within the relevant previous year. In effect, the information is required to be given in respect of that report which is received up to the date of tax audit report.

Clause 40 (QNO-554.000)



Notes(Ratio's)
- For assessee in Manufacturing/Trading
- Consumption ratio not for Trading/Service Provider
- Business wise not product wise
- Profit - PBT
- Stock - Closing Stock

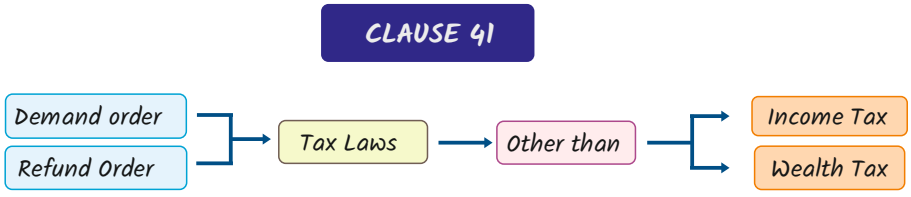
- **Text –**

  Details regarding turnover, gross profit, etc., for the previous year and preceding previous year:
  - **(a) Total Turnover**
  - **(b) Gross Profit/Turnover**
  - **(c) Net Profit/Turnover**
  - **(d) Stock in trade/Turnover**
  - **(e) Material Consumed/Finished Goods Produced**

- **Notes –**

  These ratios have to be calculated only for assesses who are engaged in manufacturing or trading activities Moreover, the ratios have to be given for the business as a whole and need not be given product wise. Further, the ratio mentioned in (5) need not be given for trading concern or service provider.

Clause 41 (QNO-555.000 / 555.500)



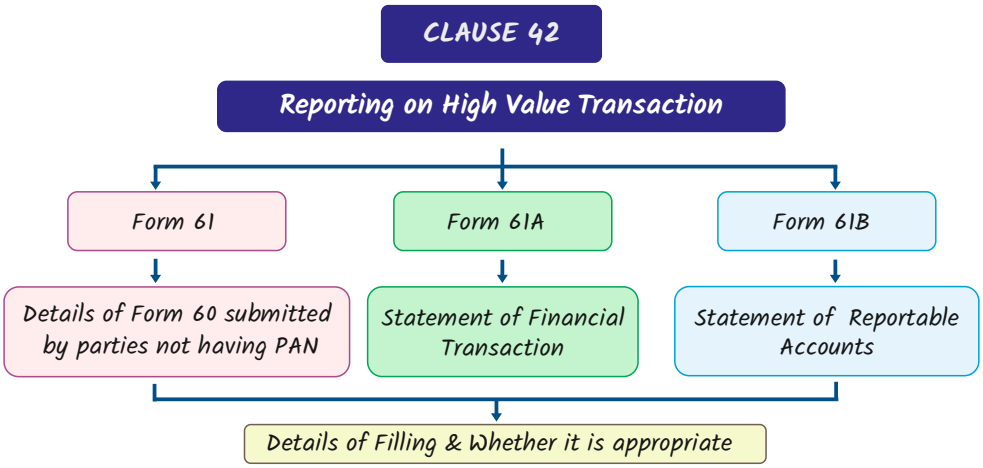
*** For any Previous Year
*** Irrespective of Audit Receipt/payment

- **Text –**

  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.

- **Notes –**
  - *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.*

Clause 42 (QNO - 555,600)

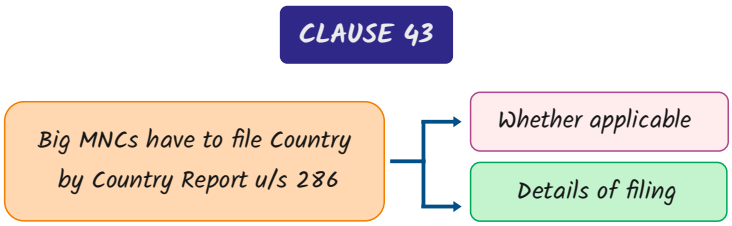


(a) Whether the assessee is required to furnish statement in Form No.61 or Form No. 61A or Form No. 61B? (Yes/No)

(b) If yes, please furnish:

Income-tax Department Reporting Entity Identification Number	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.

Clause 43



(a) Whether the assessee or its parent entity or alternate reporting entity is liable to furnish the report as referred to in subsection (2) of section 286 (Yes/No)

(b) if yes, please furnish the following details:

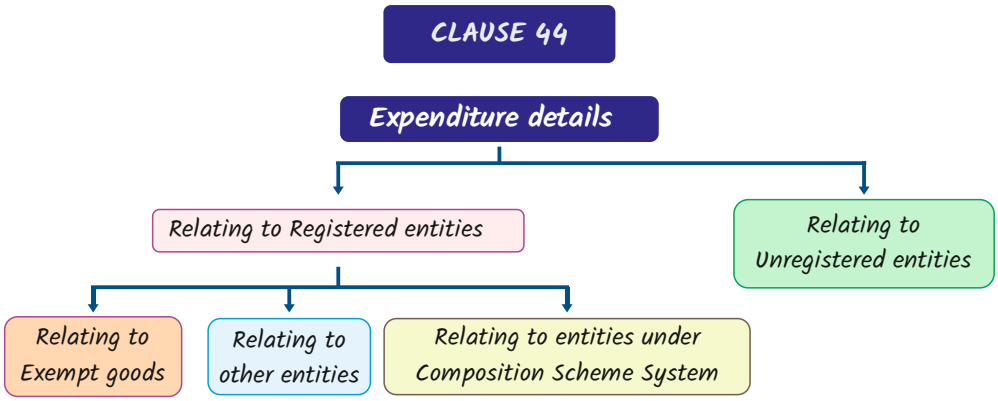
(i) Whether report has been furnished by the assessee or its parent entity or an alternate reporting entity

(ii) Name of parent entity

(iii) Name of alternate reporting entity (if applicable)

(iv) Date of furnishing of report

Clause 44



Note :- Not applicable till 31th March 2022

Break-up of total expenditure of entities registered or not registered under the GST:

Sl. No.	Total amount of Expenditure incurred during the year	Expenditure in respect of entities registered under GST				Expenditure relating to entities not registered under GST
		Relating to goods or services exempt from GST	Relating to entities falling under composition scheme	Relating to other registered entities	Total payment to register edentities	

Deferral

***Note: Reporting under Clause 44 has been kept in abeyance till 31 March 2022 (Circular No. 05/2021 of the Central Board of Direct Taxes dated 25 March 2021).**

(CNO—TAXAUD.258) Matters tax auditor should consider to while furnishing the particulars in Form No, 3CD

(QNO - 530,500)

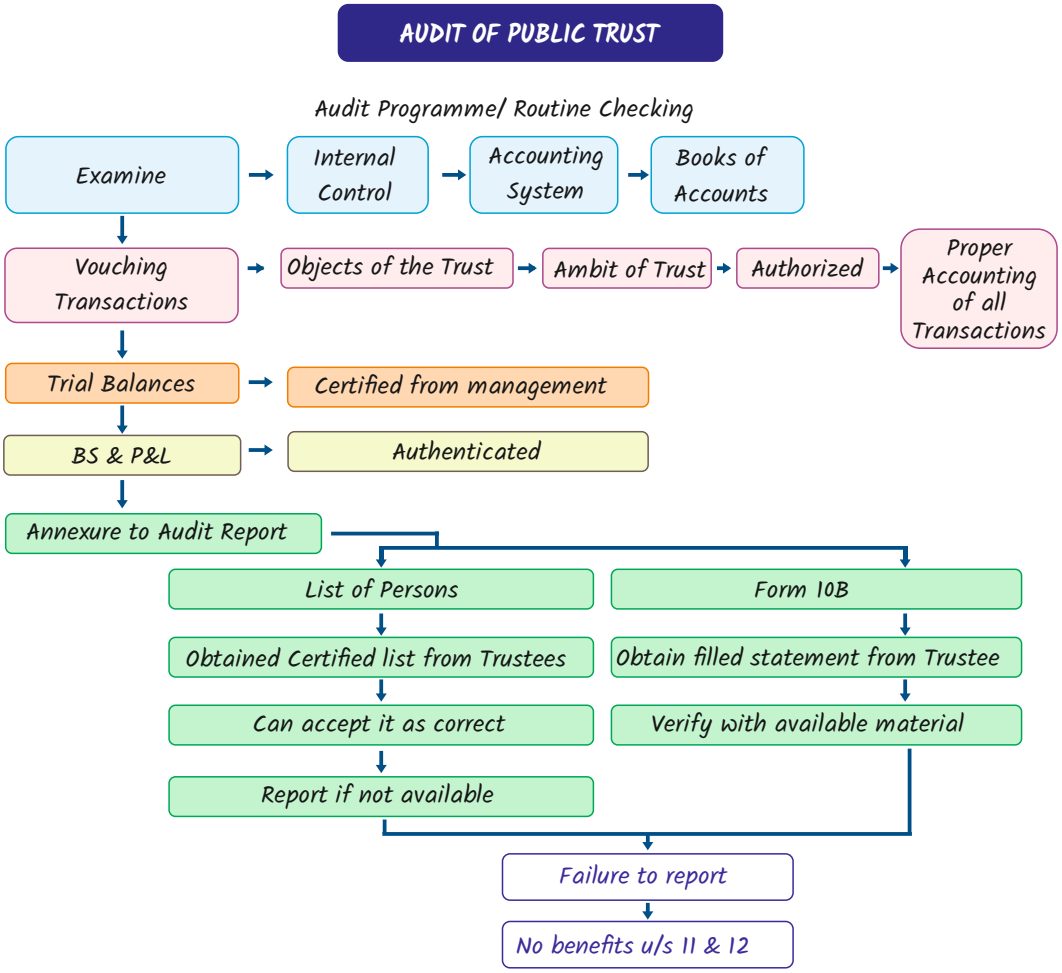
- The statement of particulars given in Form No. 3CD as annexure to the audit report contains 44 clauses (counting wise 50). The tax auditor has to report whether the particulars are true and correct. This Form is a statement of particulars required to be furnished under section 44AB. The same is to be annexed to the reports in Forms No. 3CA and 3CB in respect of a person who carries on business or profession and whose accounts have been audited under any other law and in respect of person who carries on business or profession but who is not required by or under any other law to get his accounts audited respectively.
- **While furnishing the particulars in Form No. 3CD it would be advisable for the tax auditor to consider the following:**
  - If a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, care should be taken to make a suitable cross reference to such items at the appropriate places.
  - If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD, the tax auditor should state both the view points and also the relevant information in order to enable the tax authority to take a decision in the matter.
  - If any particular clause in Form No. 3CD is not applicable, he should state that the same is not applicable.
  - In computing the allowance or disallowance, he should keep in view the law applicable in the relevant year, even though the form of audit report may not have been amended to bring it in conformity with the amended law.
  - In case the prescribed particulars are given in part or piecemeal to the tax auditor or relevant form is incomplete and the assessee does not give the information against all or any of the

clauses, the auditor should not withhold the entire audit report. In such a case, he can qualify his report on matters in respect of which information is not furnished to him. In the absence of relevant information, the tax auditor would have no option but to state in his report that the relevant information has not been furnished by the assessee.

- The information in Form No. 3CD should be based on the books of accounts, records, documents, information and explanations made available to the tax auditor for his examination.
- In case the auditor relies on a judicial pronouncement, he may mention the fact as his observations in clause (3) of Form No. 3CA or clause (5) provided in Form No. 3CB, as the case may be.

(CNO—TAXAUD.260) AUDIT OF PUBLIC TRUSTS (QNO 561.000) (MCQ – Incs.23.4)

Audit Programme / Routine Checking



An auditor should conduct routine checking during the course of audit of a public trust, in the following manner:

- ***Internal Control / System of Accounting / Books of Account***
  Check the books of account and other records having regard to the system of accounting and internal control.

- ***Vouching***
  Vouch the transactions of the trust to satisfy that;

  - ***Objects / Ambit / Authorization***
    - amounts shown as applied towards the ***object of the trust*** are covered by the objects of the trust as specified in the document governing the trust.
    - the transaction falls within the ***ambit of the trust;***
    - the transaction is properly ***authorized by the trustees or other delegated authority*** as

	may be permissible in law; ▪ ***Proper Accounting*** ▾ *all incomes due to the trust have been properly accounted for on the basis of the system of accounting followed by the trust;* ▾ *all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting followed by the trust; and* ➢ ***Trial Balance*** *Obtain a trial balance on the closing date* ***certified by the trustees.*** ➢ ***BS and P&L*** *Obtain the Balance Sheet and Profit & Loss Account of the trust* ***authenticated by the trustees and check the same with the trial balance*** *with which they should agree.*
Annexure to the Audit Report	➢ ***List of Persons*** ▪ *Obtain from the trustees, a* ***certified list of persons*** *covered by Section 13(3).* ▪ ***The Auditor can accept as correct the list of persons covered by Section 13(3) as given by the managing trustees.*** ▪ *Where a* ***list of persons specified in Section 13(3) is not available, indicate against Sections II and III of the items specified in the annexure the appropriate qualifying remarks.*** ➢ ***Form 10B*** ▪ *Obtain from the trustees,* ***a statement enlisting the various items specified in the Annexure to Form No. 10B*** *and giving the information against each item together with explanatory or supporting schedules.* ▪ ***Verify the information supplied*** *by the trustees in the statements specified above in the light of available material.* ➢ ***Audit Report & Effect if Not Available*** ▪ *The audit report is required to be furnished to the relevant year. Failure to furnish the report will disentitle the trust or institution to the benefit of Sections 11 and 12.*

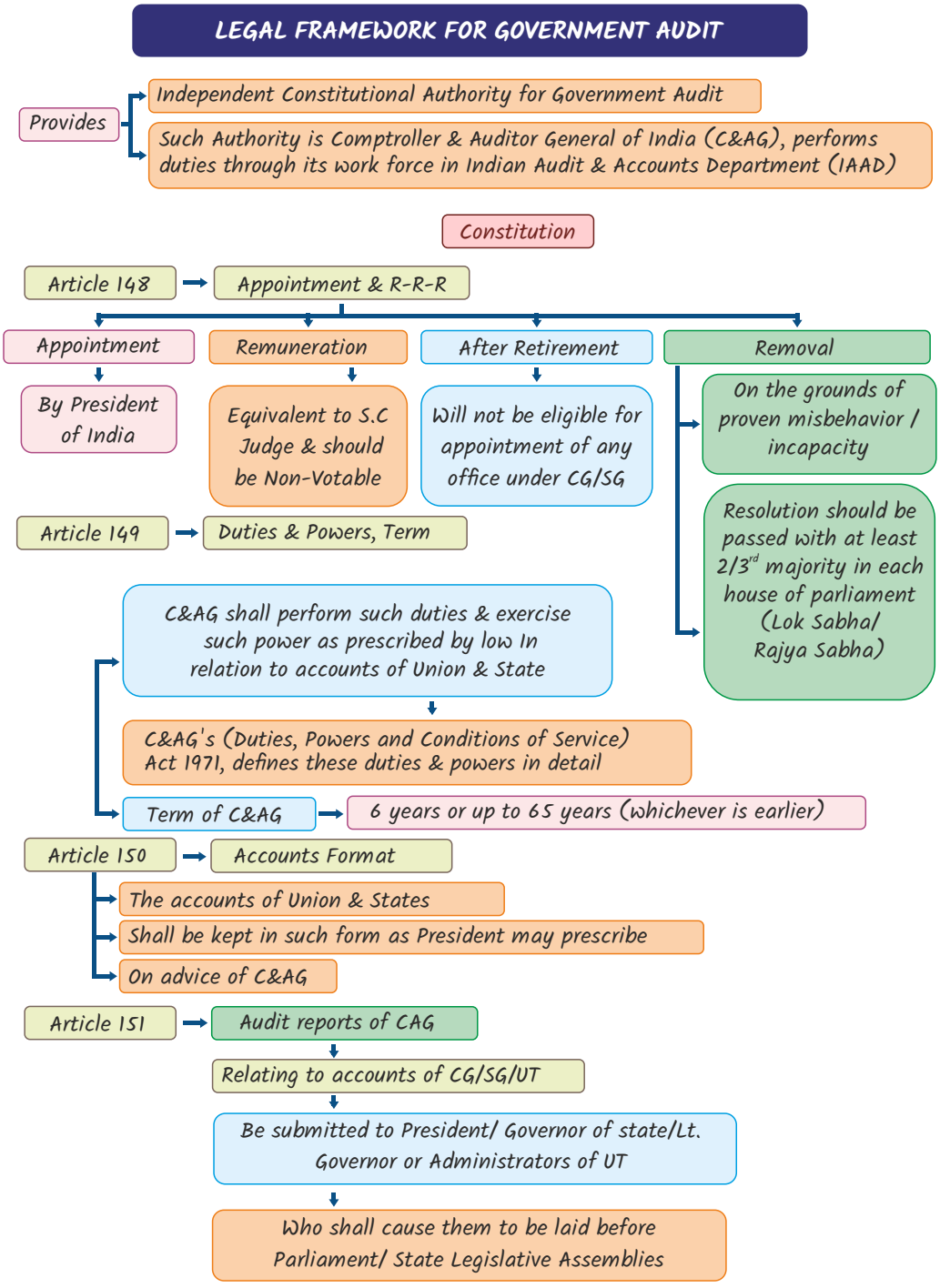
UNIQUE Question	
QNO 558.020	*Applicability of SAs & GNs in Tax Audit*
QNO 560.000	*Tax Audit of Co-Operative*

UNIQUE MCQS	
MCQ No.	*FL.4*
MCQ No.	*FL.6*
MCQ No.	*FL.7*
MCQ No.	*FL.9*
MCQ No.	*FL.10*

Students Notes

13 AUDIT OF PUBLIC SECTOR UNDERTAKING

(CNO—PSU.020) FRAMEWORK FOR GOVERNMENT AUDIT



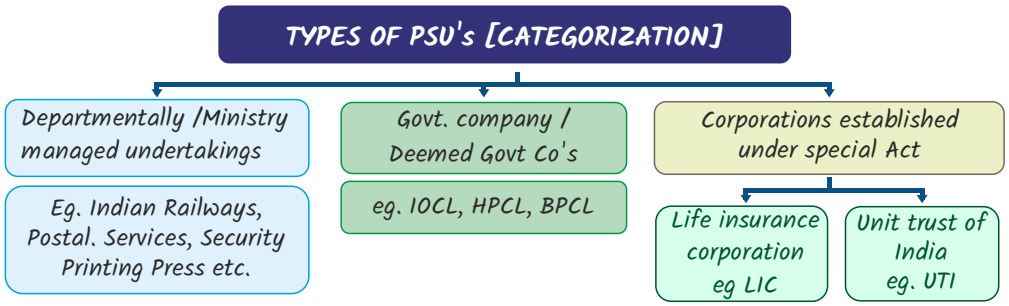
Legal Framework of CAG: - (Article 148 to 151)

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

- **Appointment:** - CAG shall be appointed by the President of India. (Article 148)
- **Term:** - CAG shall hold office for six years or up to 65 years, whichever is earlier.
- **Powers and duties (Articles 149):** - Prescribed under the C&AG (Duties, Powers and Conditions of Services) Act, 1971.

- **Maintenance of accounts (Articles 150):** –Accounts of Union and the States will be maintained as per the descriptions given by the President on advice of C&AG.
- **Submission of Accounts (Articles 151):** – The report of the CAG relating to the accounts of the union and State shall be submitted to the President/Governor who shall cause them to be laid before the Parliament/State Legislature.
- **Remuneration:** – CAG shall be paid as equivalent to that of SC Judge remuneration. And it should not be Votable
- The CAG shall not be eligible for further office under CG or SG after end of tenure.
- **Removal:** –He shall not be removed from office except on the grounds of proven Mis-behaviour or incapacity. He can be removed only when each House of Parliament decides to do so by a majority of not less than 2/3 of the members present and voting.

(CNO—PSU.030) TYPES OF PSU'S



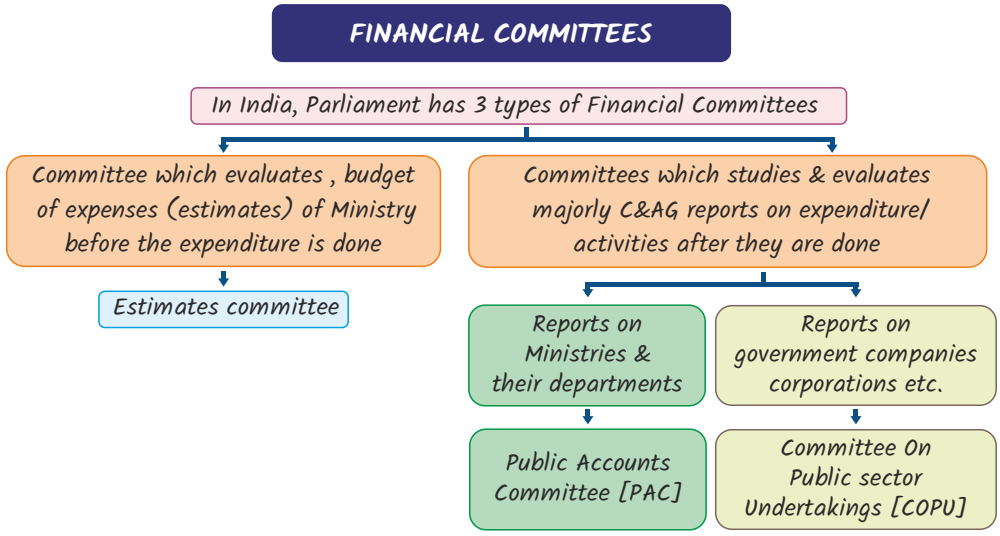
The number of organisations subject to the audit of the Comptroller and Auditor General of India is very large. This includes:

- All the Union and State Government departments and offices including the Indian Railways and Posts and Telecommunications.
- Public commercial enterprises controlled by the Union and State governments, i.e. government companies and corporations
- Non-commercial autonomous bodies and authorities owned or controlled by the Union or the States.
- Authorities and bodies substantially financed from Union or State revenues

(CNO—PSU.040) SCRUTINY/ACTION REPORT ON AUDIT

Annual Accounts and the Audit Reports will be referred to specialized Committees constituted by the Parliament and the State Legislatures i.e. Public Accounts Committee (PAC) and the Committee on Public Undertakings (COPU)

Financial committee



Chart

PUBLIC ACCOUNTS COMMITTEE [PAC]

- Examine **Reappropriation (Redesigning)** of expenditure by the ministries/ departments
- Whether expenditure was properly **authorized** by ministry officials
- Whether expenditure was properly accounted & whether **accounts** represent the expenditure done
- Examine statement of accounts of **autonomous & semi-autonomous bodies** covered under ministries/ departments

Public Accounts Committee (PAC)

PAC performs the following functions

- Examine that re-appropriation (re-design of expenditures) has been made in accordance with the provisions made (i.e. Distribution of fund). (In six cases, re-appropriation orders proved unnecessary because expenditure did not come even up to the level of budget provisions and in other seven cases reduction of provision also proved injudicious as there was excess expenditure under these cases. In many cases, anticipated savings of Rs 5846.86 crore were not surrendered leaving no scope for utilizing these funds for other developmental purposes.)

- Examined that expenditure was **authorized.** (The CAG has rapped the health department for an unauthorized expenditure of Rs 29.12 crore by the assistant engineer, engineering cell, Reproductive and Child Health Society. The assistant engineer was "authorized to sanction works and incur expenditure up to Rs 10,000 only.)

- Examines that the **moneys (shown in the accounts)** were disbursed for the purpose to which they were applied. (During 2014-15, 6951 crores under 79 Major Heads of Account (representing functions of the Government) was classified under the Minor Head "800-Other Expenditure.)

- Examines that statements of accounts of **autonomous and semi-autonomous bodies,** the audit of which is conducted by CAG either under direction of President or Statute of Parliament. (Sports Authority of India Report: - Depreciation of Rs. 17.98 crore was charged on Fixed Assets during 2008-09. The same was reduced from Fixed Assets and the corresponding amount of depreciation was reduced from the Liabilities under Capital Grant directly instead of routing through the Income & Expenditure account. This resulted in understatement of Expenditure and understatement of excess of expenditure over income by Rs. 17.98 crore.)

Chart

COMMITTEE ON PUBLIC SECTOR UNDERTAKING [COPU]

- Examine reports given by CAG on PSU's
- To examine annual financial statements & Audit Reports given by management & auditors on PSU
- Evaluate performance of the PSU's (output)
- Examine efficiency of PSU's & how it can be improved (utilisation of resources)
- Such other functions as may be allotted by Speaker

Committee on Public Undertakings (COPU) (MCQ – PSU.S)

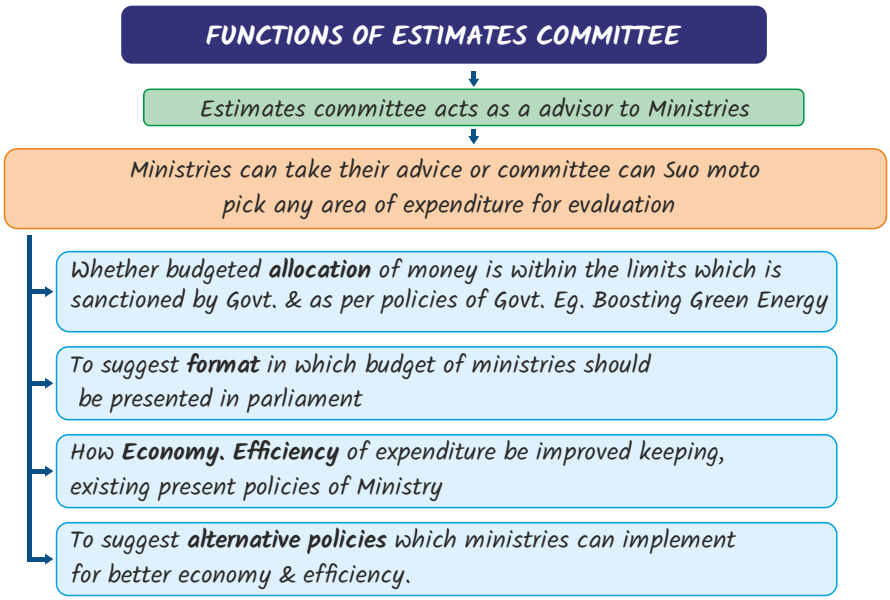
COPU performs the following functions: -

- To examine the **reports of the CAG** on public Undertakings. (Some paragraphs of audit report of CAG on performance audit of Power Grid Corporation were taken in FY 14-15)
- To examine the **report and accounts** of Public Undertakings. (Examination of accounts and reports of Coal India Limited a listed company was done in FY 14-15)

- To examine the **efficiency of the Public Undertakings** and to see whether they are being managed in accordance of sound business principles and prudent commercial practices
(BEL: - Exemption of Custom Duty, Excise Duty and Sales Tax in Global Bidding)
- To exercise **such other functions** as may be allotted by the speaker from time to time. (E.g. Revival of Air India.)

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

Chart



Estimate Committee

The Estimate Committee performs followings functions: -

- To examine whether the money is well laid out **within the limit;** and (As the budget of the Ministry of New & Renewable Energy is quite inadequate being only 0.024% of the Union Budget Estimates for 2010-11, even though the future of power sectors depends heavily on renewable energy)
- To suggest the form in which the estimates shall be **presented to Parliament.** (Main budget & railway budget was merged as in today's time we need integrated development of all means of transport, further it should be presented at 11 am and not 5 pm)
- To report what **economies, improvements in organization, efficiency or administrative reforms,** consistent with the policy underlying the estimates may be affected; (Dismayed to note that only 23% of the total hydropower potential of the country (which is pegged at 1,48,701 MW) has been developed so far, the Committee have recommended that the Government should immediately take proactive measures to develop hydroelectricity in the country.)
- To suggest **alternative policies;** in order to bring bout efficiency and economy in administration. (Don't ban but give tax incentives & finance pollution equipment's to small Scale units (SSIs) to become Zero Liquid Discharge (ZLD) units.)

(CNO—PSU.060) AUDIT CONDUCTED BY CAG

Chart

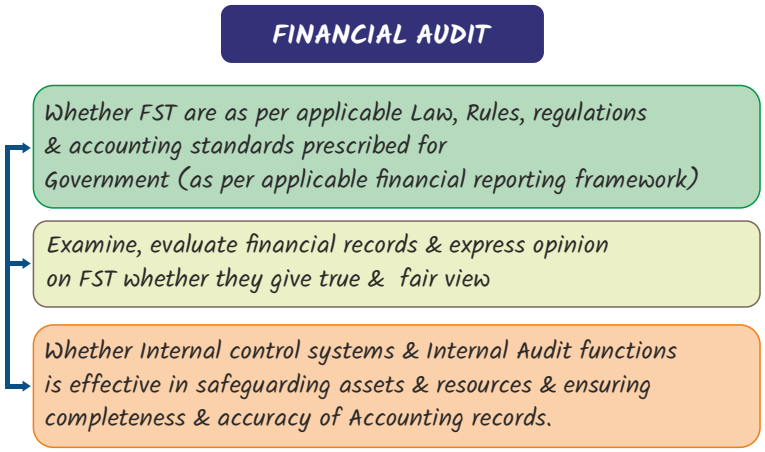


Followings are the various Types of Audit conducted by CAG

- ***Financial Audit:*** *– Financial audit is primarily conducted to express an audit opinion on a set of financial statements.*
- ***Compliance Audit:*** *– Compliance audit is an independent verification process of evaluating audit evidence to determine whether specified compliance requirements are met.*
- ***Comprehensive Audit:*** *– Comprehensive audit involves assessing overall efficiency and effectiveness of public Enterprises. This is done by reference to certain pre-determined standards, objectives and criteria.*
- ***Propriety Audit:*** *– Propriety audit is performed for Verification of transactions on the test of Public Interest, Commonly Accepted Customs and Standards of Conduct.*
- ***Performance Audit:*** *– A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.*

(CNO—PSU.080) FINANCIAL AUDIT

Chart

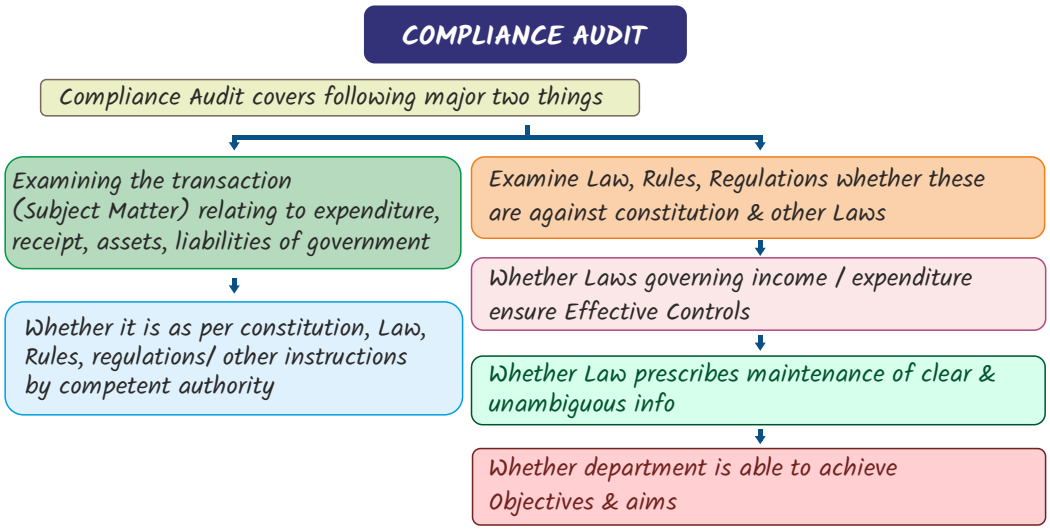


- ***Meaning:*** *– Financial audit is primarily conducted to express an audit opinion on a set of financial statements.*
- ***Coverage:*** *–*
  - *examination and evaluation of financial records and expression of opinion on Financial Statements; (Punjab:*

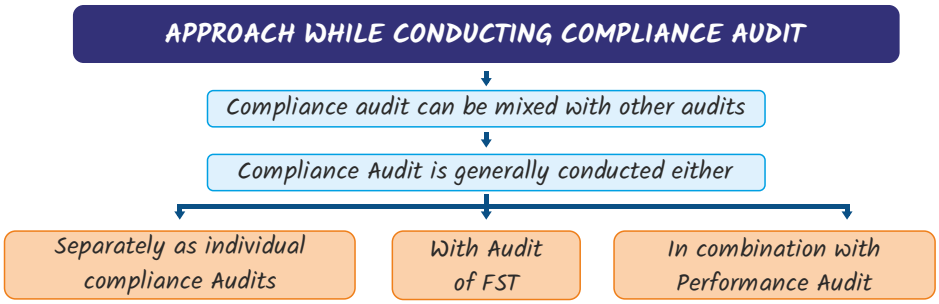
    GoI directly transferred Rs. 1751.30 crore to State implementing agencies during the current year. Since these funds do not pass through the State Budget, the Annual Finance Accounts of the State do not present a complete picture of fund flow of Central Government resources into the State
  - ***Audit of financial systems and transactions*** *including an evaluation of* ***compliance with applicable statutes and regulations which affect the accuracy and completeness of accounting records;*** *and (Fiscal liabilities of the State increased from Rs 1,24,081 crore in April 2014 to Rs 1,41,947 crore at the end of March 2015. This liability as a percentage of GSDP was 31.4 per cent which is higher than the target (29.8 per cent) fixed in the Kerala Fiscal Responsibility (Amendment) Act, 2011.)*
  - *Audits of internal control and internal audit functions that assist in* ***safeguarding assets and resources*** *and assure the accuracy and completeness of accounting records. (****Bihar****: - Utilization certificates (UCs) of Rs 31510.73 crore against the Grant-in-aid (GIA) bills drawn by different departments were outstanding as of 31 March 2015.)*

(CNO—PSU.100) COMPLIANCE AUDIT (MCQ - PSU.6)

Chart



Chart



Meaning: *– Independent verification process of evaluating audit evidence to determine whether specified compliance requirements are met.*

- ***Coverage:*** **–**
  - *It* ***examines the transactions*** *relating to expenditure, receipts, assets and liabilities of Government for compliance with:*
    - *the provisions of the* ***Constitution of India and the applicable laws;*** *and*
    - *the* ***rules, regulations, orders and instructions*** *issued by the competent authority either in pursuance of the provisions of the Constitution of India and the laws or by virtue of the powers formally delegated to it by a superior authority.*
      (Failure of Executive Engineers, Assistant Engineers and Junior Engineers to adhere to the provision of Standard Bidding Document in granting equipment advances to the contractors had resulted in unauthorized payment of Rs 4.14 crore to the contractors under Road Construction Department.)
  - ***Examination of the rules, regulations, orders and instructions*** *so as to determine whether these are:*
    - ***intra vires*** *of the provisions of the Constitution of India and the laws (Legality);*

      (E.g. Is Demonetization Constitutional? Net Neutrality Constitutional?)

    - *sufficiently comprehensive and* ***ensure effective control*** *over Government receipts, expenditure, assets and liabilities with sufficient safeguards against loss due to wastage, misuse, mismanagement, errors, frauds and other irregularities (Adequacy);*

      (E.g. Coal allocation should be through bidding process)

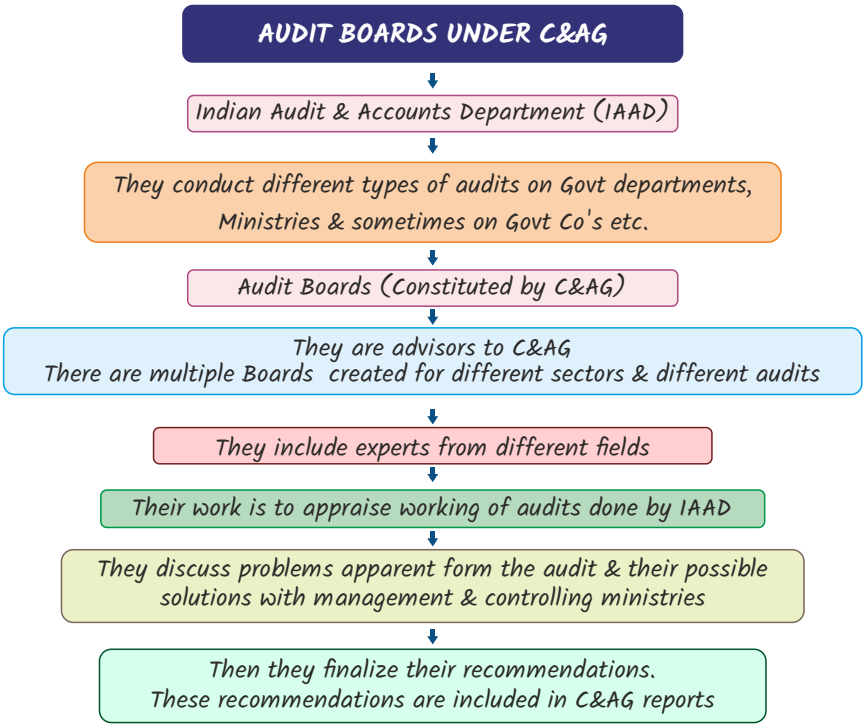
- ***clear and free from ambiguity and promote observance of probity*** *in decision making (Transparency);*

  (E.g. Tenders should be allotted as per pre-decided well-defined policies my ministries, preferably live e-auction prompting transparency)

- ***effective and achieve the intended objectives and aims*** *(Effectiveness). (Can government achieve proper disinvestment through existing laws)*

(CNO—PSU.110) AUDIT BOARDS UNDER C&AG

Chart



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

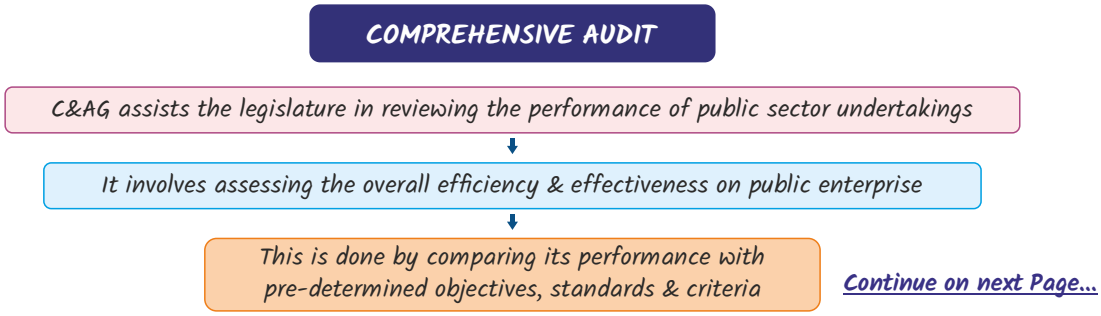
These Audit Boards associate with them experts in disciplines relevant to the appraisals. They discuss their findings and conclusions with the managements of the enterprises and their controlling ministries and departments of government to ascertain their view points before finalisation.

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

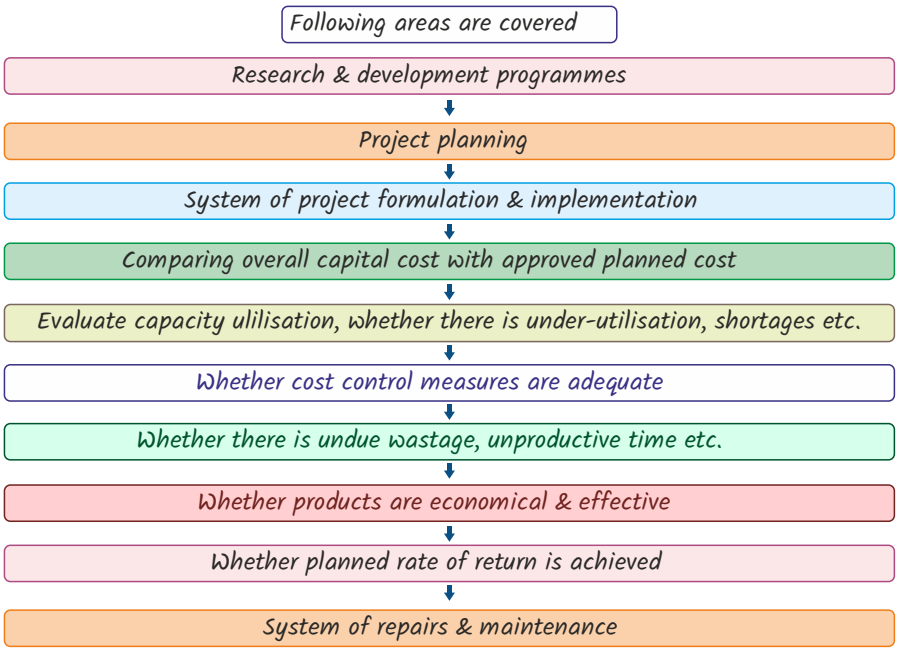
These Audit Boards have no separate legal entity and work under the supervision and control of the Comptroller and Auditor General.

(CNO—PSU.120) COMPREHENSIVE AUDIT OF PUBLIC ENTERPRISES (QNO-599.000)

Chart



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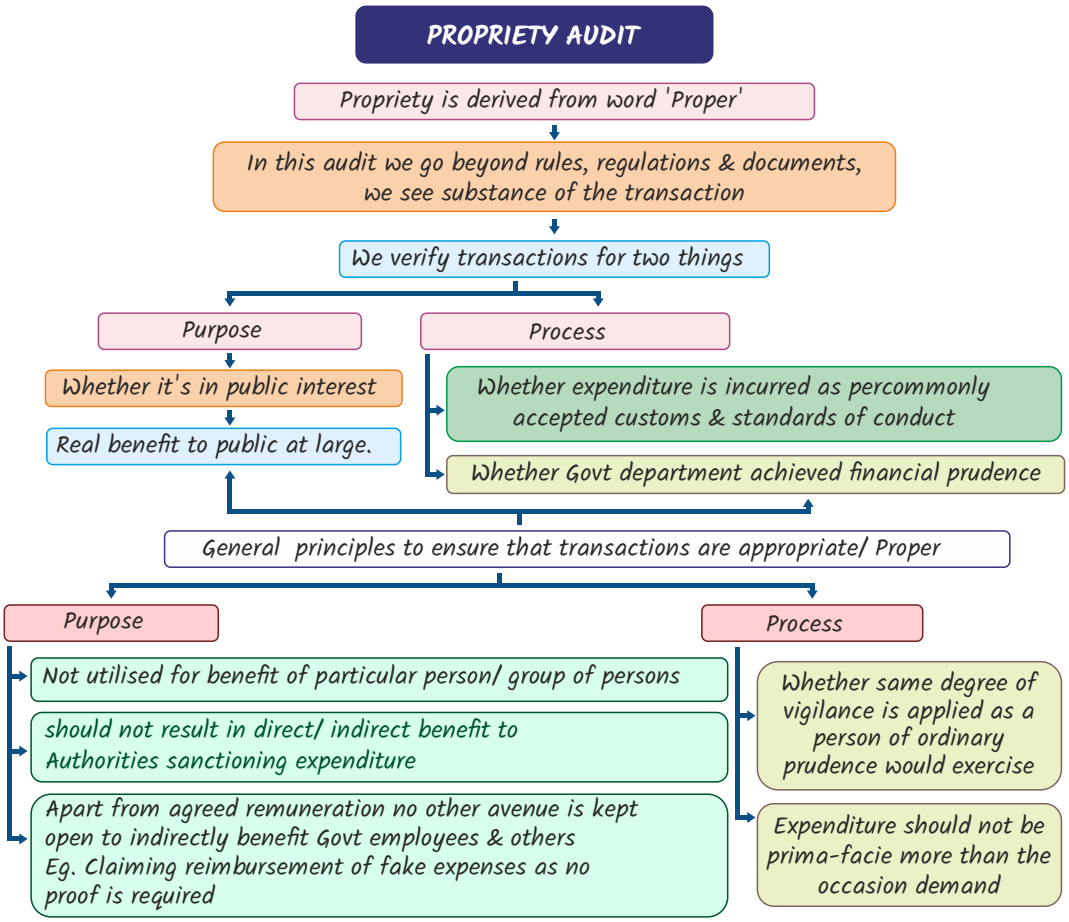
- ***Concept of Comprehensive Audit: –***
  - *Comprehensive audit involves assessing* ***overall efficiency and effectiveness of Public Enterprises.*** *This is done by reference to certain pre-determined standards, objectives and criteria.*
  - *The starting point of a comprehensive appraisal of a public enterprise, which covers aspects of economy, efficiency and effectiveness, is the preparation of an* ***audit programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organization, financial and operational details available in the annual reports and accounts, capital and operational budgets, deliberations of the board of directors, material in the earlier audit inspection reports on the enterprise and other relevant available papers.***
  - *These audit programmes (or guidelines) identify the areas/aspects which require further detailed audit analysis*

- ***Areas to be covered: –***

  The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the issues examined in comprehensive audit are:
  - *Comparison of the overall capital cost of the project with the approved planned costs. 4*
  - *Accepted production or operational outputs been achieved? Has there been underutilization of installed capacity or shortfall in performance? 5*
  - *Planned rate of return. 9*
  - *Systems of project formulation and implementation. 3*
  - *Cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc. 6*
  - *Research and development programmes. 1*
  - *System of repairs and maintenance. 10*
  - *Effective and economical. 8*
  - *Project planning. 2*
  - *Undue waste, unproductive time for men and machines, wasteful utilization or even non-utilization of resources. 7*

7(CNO—PSU.140) PROPRIETY AUDIT (QNO-601.000/602.000) (MCQ- PSU.2/ PSU.7)

Discussion



- ***Meaning:-***

  Propriety Audit stands for verification of transactions on the tests of –

  - *Public Interest (**Purpose** – Real Benefit to public at large)*
  - *Commonly accepted customs and Standards of Conduct (**Process** – Financial Prudence)*

- ***Emphasis/Scope:***

  *Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the **substance of transactions** and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure.*

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

- ***Principles:-***

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

  Process

  - *that the expenditure is not prima facie more than the occasion demands 2*

    (E.g.Car of 1 crore for Mps) and

  - *that every official exercise the same degree of vigilance in respect of expenditure as a*

person of ordinary prudence would exercise in respect of his own money; 1
(E.g. 50 cars were ordered without quotations)

- **Purpose**
  that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage; 2

  (E.g. Cars were used by government employees or given for rent)

- that funds are not utilized for the benefit of a particular person or group of persons and 1

  (E.g. Benefit was given only to ruling parties)

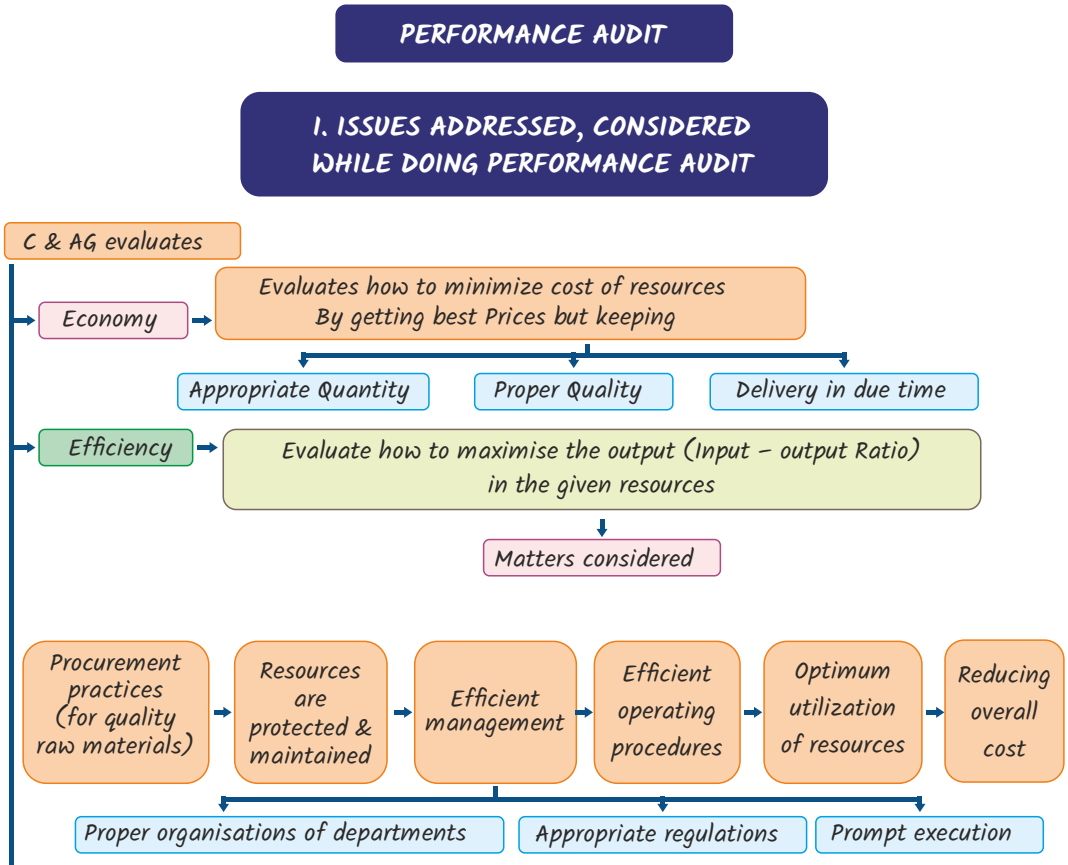
- that, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others. 3

  (E.g. Bribes were paid to government employees)

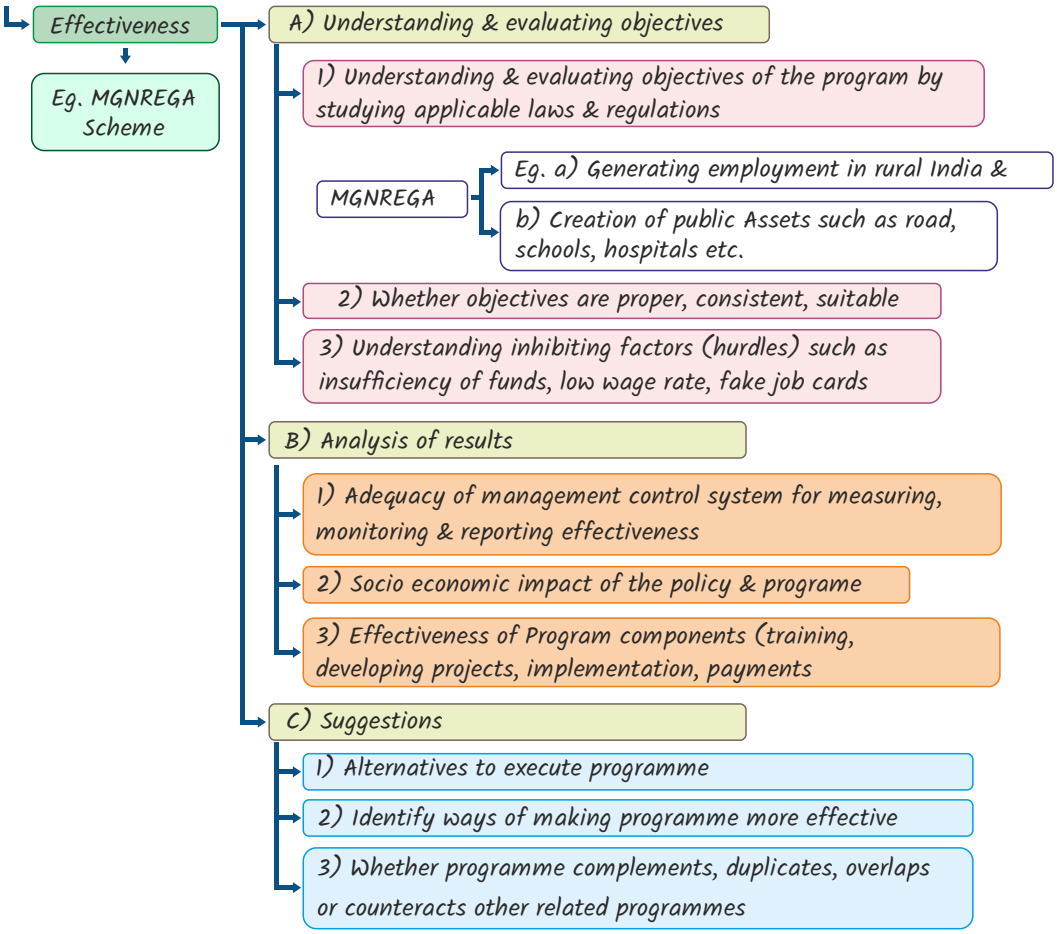
PLANNING FOR PERFORMANCE AUDIT

(CNO—PSU.160) ISSUES ADDRESSED, CONSIDERED WHILE DOING PERFORMANCE AUDIT (QNO-600.000/600.010) (MCQ-PSU.4)

Chart



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

- ***Economy-***
  It is **minimising the cost of resources** used for an activity, having regard to appropriate quantity, quality and at the best price.
  Judging economy implies forming an opinion on the resources (e.g. human, financial and material) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

- ***Efficiency-***
  It is the **input-output ratio.** In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

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

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

In auditing effectiveness, performance audit may, for instance:

Law

- *assess **compliance with laws and regulations** applicable to the program; and*

Object & System

- *assess whether the **objectives of and the means** provided (legal, financial etc.) for a new or ongoing public sector programme are **proper, consistent, suitable or relevant to the policy;***
- ***identify factors inhibiting satisfactory performance or goal-fulfilment;***
- *assess the adequacy of the **management control system** for measuring, monitoring and reporting a programme's effectiveness;*

Results

- *determine the extent to which a program achieves a **desired level of program results;***
- *assess and establish with evidence whether the observed direct or indirect **social and economic impacts** of a policy are due to the policy or to other causes;*
- *assess the effectiveness of the program and/or of individual program **components;***

Suggestions

- *determine whether management has considered **alternatives** for carrying out the program that might yield desired results more effectively or at a lower cost;*
- *identify **ways of making programmes work more effectively.***
- *assess whether the programme complements, duplicates, overlaps or counteracts **other related programmes;***

(CNO—PSU.180) FACTORS TO BE CONSIDERED WHILE PLANNING PERFORMANCE AUDIT (QNO-599.200)

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

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

(A) Understanding the Entity/Programme - It is the starting point for planning individual performance audit.
The auditor may use the following sources for understanding the entity:

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

(ii) Legislative documents: Legislation, parliamentary questions and debates, reports of the Public Accounts Committee, the Committee on Public Undertakings, the Estimates Committee, and letters from Members of Parliament.

(iii) Policy documents: Documents of Planning Commission, Ministry of Finance etc.

(iv) Academic or special research: Independent evaluations on the entity, academic research and similar work done by other governments and other SAIs.

(v) Past audits: Past financial and performance audits of the entity provide a major source of information and understanding.

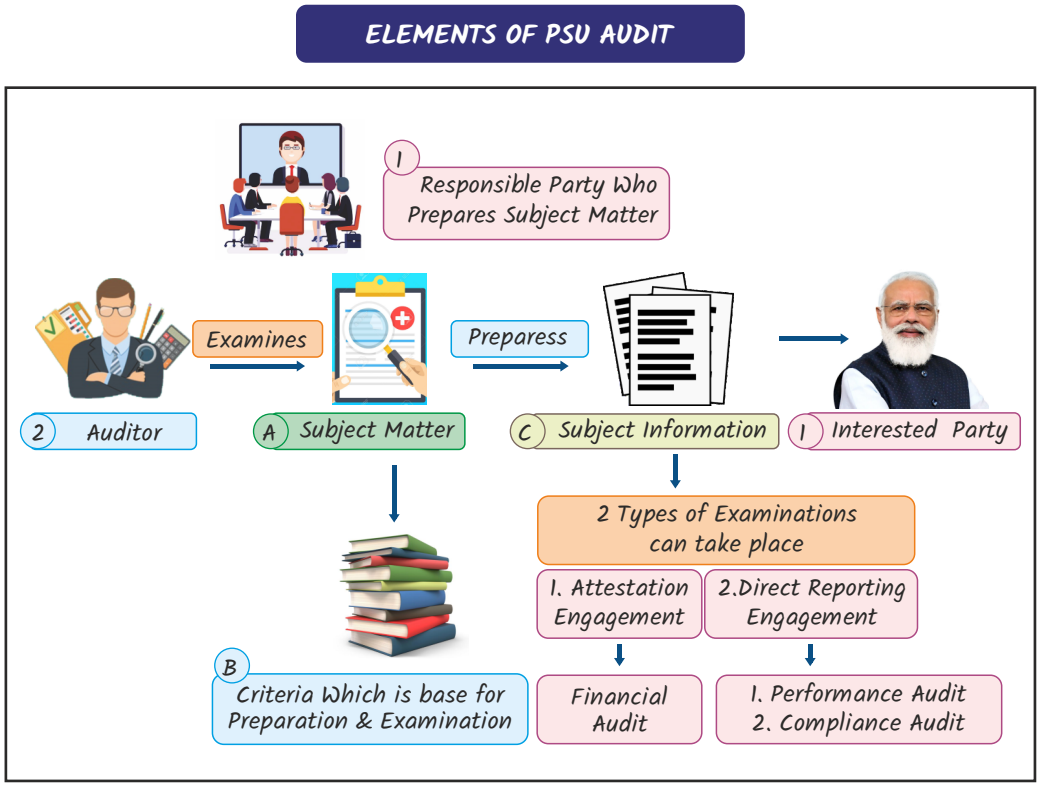
(vi) Media coverage: Print and electronic media - their systematic documentation on regular basis in a transparent manner.

(vii) Special focus groups: Audit Advisory Committee concerns, annual and special reports of World Bank, Reserve Bank of India, reports by special interest groups, NGOs, etc.

AUDIT OF PSU ADDITION

(CNO—PSU.200) ELEMENTS OF PSU AUDIT (MCQ – PSU.1)

Chart



Parties Involved

- **The responsible party:** In public sector auditing, the relevant responsibilities are determined by constitutional or legislative arrangement. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations and may be individuals or organizations. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties.
- **The auditor:** In public sector auditing the role of auditor is fulfilled by Supreme Audit Institution, India and by its personnel delegated with the task of conducting audits.
- **Intended users:** The intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report. The intended users may be legislative or oversight bodies, TCWG or the general public. The intended user is primarily the Parliament or the Legislature which represents the citizens by determining the priorities of public finance, purpose and content of public spending and income.

Important Documents Involved

- Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria.
- The criteria are the benchmarks used to evaluate the subject matter. Each audit shall have criteria suitable to the circumstances of that audit. In determining the suitability of criteria, the auditor considers their relevance and understandability for the intended users, as well as their completeness, reliability and objectivity (neutrality, general acceptance and comparability with criteria used in similar audits).
- Subject matter information refers to the outcome of evaluating or measuring the subject matter against the criteria.

Types of Engagement

There are two types of engagement: Attestation Engagements and Direct Reporting Engagements.

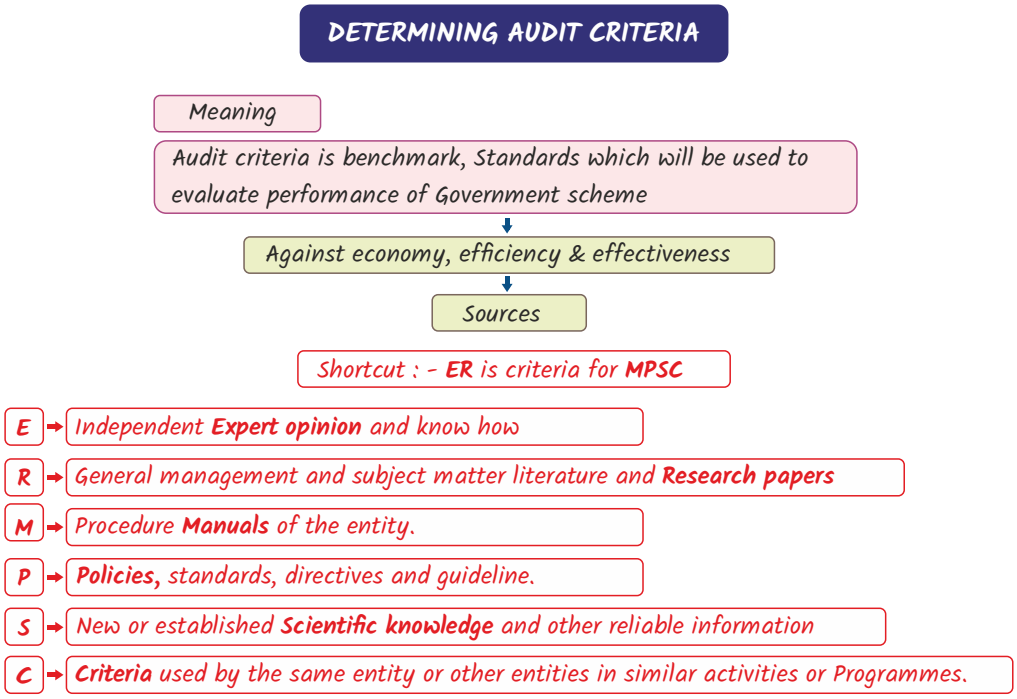
- In attestation engagements, the responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.
- In direct reporting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

against the criteria.

- Financial audits are always attestation engagements, as they are based on financial information presented by the responsible party. Performance audits and compliance audits are generally direct reporting engagements.

(CNO—PSU.220) Draft Audit Criteria (QNO-605.000)

Chart

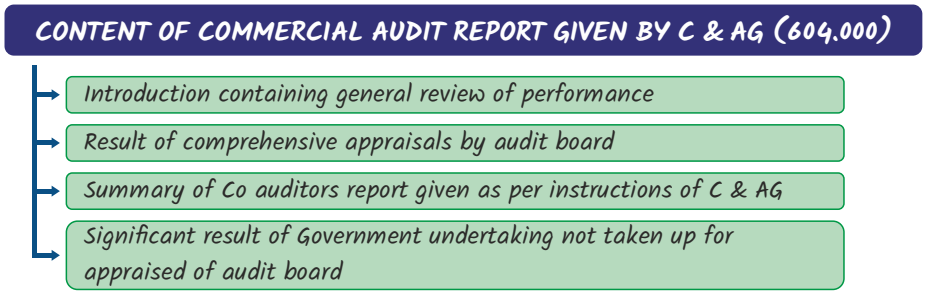


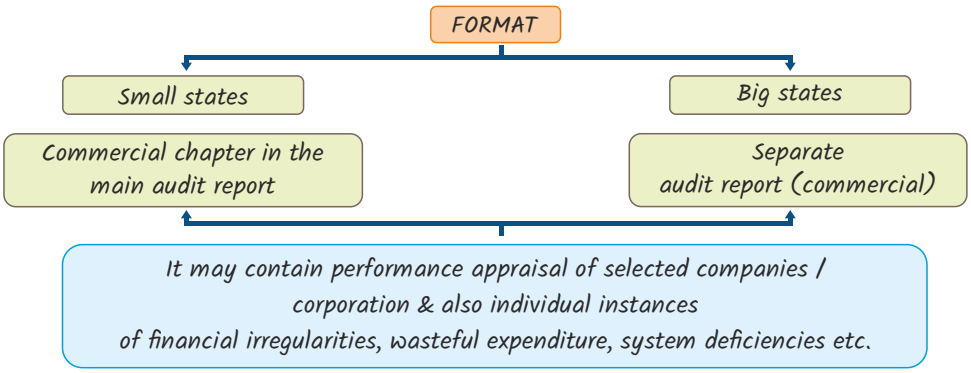
Determining Audit Criteria

- Audit criteria are the standards used to determine whether a program meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit criteria are reasonable and attainable standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed.
- The audit criteria may be sought to be obtained from the following sources:
  - procedure manuals of the entity.
  - policies, standards, directives and guidelines.
  - criteria used by the same entity or other entities in similar activities or programmes.
  - independent expert opinion and know how.
  - new or established scientific knowledge and other reliable information.
  - general management and subject matter literature and research papers

(CNO—PSU.240) CONTENT OF AUDIT REPORT BY C&AG (QNO - 604.000)

Chart





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

(a) Introduction containing a general review of the working results of Government companies, deemed Government companies and corporations;

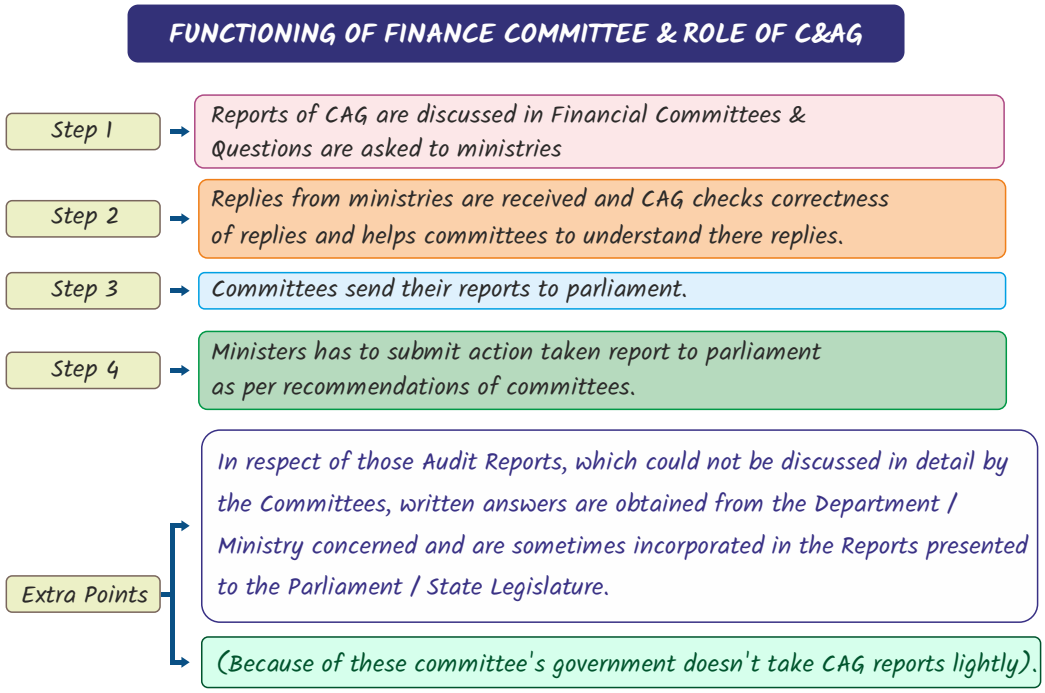
(b) Results of comprehensive appraisals of selected undertakings conducted by the Audit Board;

(c) Resume of the company auditors' reports submitted by them under the directions issued by the C&AG and that of comments on the accounts of the Government companies; and

(d) Significant results of audit of the undertakings not taken up for appraisal by the Audit Board. For certain specified states, the C&AG submits a separate audit report (commercial) to the legislature, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory audito rs, and a general review of the working results of Government companies and corporations.

(CNO—PSU.260) FUNCTIONING OF FINANCE COMMITTEE & ROLE OF C&AG

Chart



ILLUSTRATION

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

(i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;

(ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;

(iii) metering, billing and collection was managed efficiently and effectively;
(iv) monitoring and internal controls were efficient.
What kind of audit is this? Prepare two sample observations which could be part of the audit report.
This is a performance audit. Sample observations could be:

(i) Non replacement of defective/ burnt meters: Large number of meters, much in excess of the permitted limit of 1% of the total meters were defective and their replacement was not completed within the stipulated time of 1 month. This resulted in billing on average basis for a continuous period of several months. This could result in losses as well as administrative hassles and disputes with consumers.
(ii) Under charging of meter rent: As per Schedule of Charges, the Company is required to charge meter rent of `30 per month for a single phase meter and `40 per month for three phase meter. It was observed that the Company had short charged meter rent of `60 lakh from 3 lakh consumers in 5 lakh bills during the period.

UNIQUE QNO	
QNO-597.000	Powers of C&AG / Supplementary Audit (Reply)
QNO-600.005	Performance Audit - Audit Report Rejected
QNO-603.000	Propriety Audit (Company Act)
QNO-604.000	C&AG (Audit Report)
QNO-604.010	Functioning of Finance Committee & Role of C&AG
QNO-605.500	Government Company" definition

14 LIABILITIES OF AUDITOR

(CNO—LOA.020) CIVIL LIABILITIES UNDER THE COMPANIES ACT (MCQ-LA.1/LA.2/LA.3/LA.4) (QNO 374.000)

Sec 35 of Companies Act 2013 (Damages due to misleading content in Prospectus)

Civil liability for misstatement in prospectus under Section 35 of the Companies Act, 2013, are:

(MCQ – Incs.41.2)

In this chapter we will discuss Liabilities under various sections of Companies Act, Income Tax Act & CA act & related rules which chartered Accountant may have to face in Capacity of Auditor or any other capacity

CIVIL LIABILITY for Misstatement in prospectus

SECTION 35 (1)

I — Situation which will lead to Liability

- Person Subscribes for Securities of Co.
- On the basis of Statements or any other information which is mis-leading
- He incurs loss/ damage because of this

II — Liability

- Liability to pay Compensation to every person who sustained such loss/damage
- Additionally they may be also responsible u/s 36 [Fraudulently inducing person to invest]

III — Who is liable?

Company & following persons will be liable

(In the sequence of Importance)

- Promoter
- Director at the time of issue of prospectus
- To be director : Person who has authorised himself to be named as person who has agreed to be a director
- Authorizers to prospectus (Generally includes directors, selling share holders etc.)
- Experts whose reports, valuations or part thereof are included in prospectus & he has given consent that they should be included as given in Sec 26(5)

SECTION 35(2) Exceptions to liability given under 35(1)

For to be director

- Withdrawal of Consent to become director before issue of prospectus, further prospectus was issued with misstated information without his authority consent

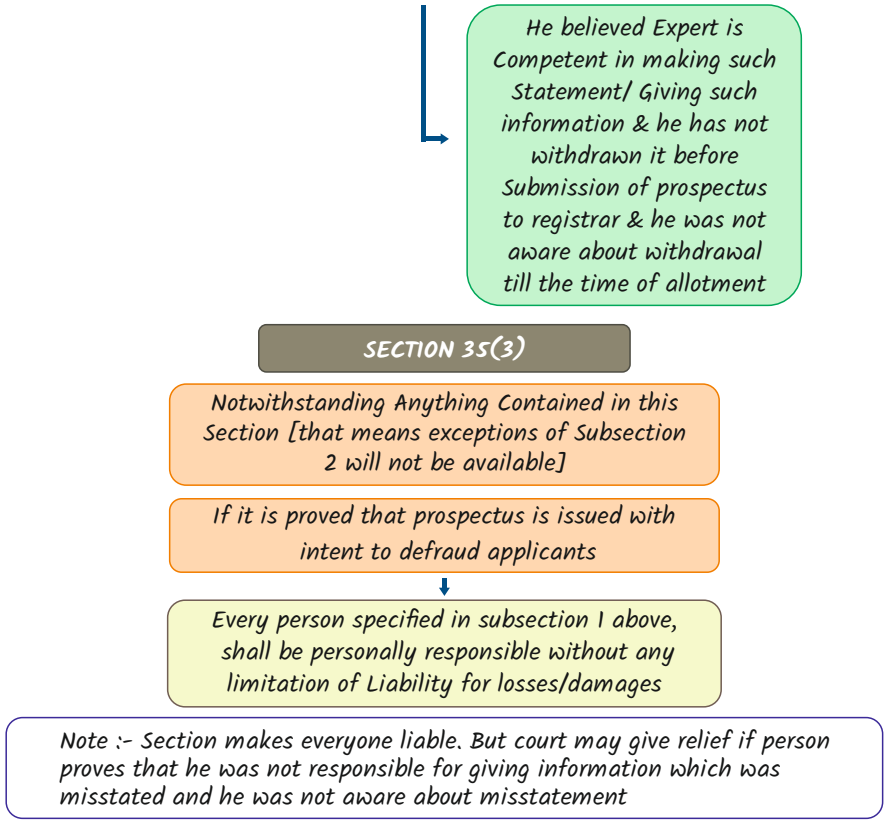
For inclusion of name

- Prospectus was issued / without his knowledge / consent
- On becoming aware of its issue→ Gave Reasonable public Notice & informed people that it was issued without his knowledge/consent

For relying on expert

- If the person proves that he relied on statement made by expert in prospectus or copy / extract from report/ valuation of Expert which is Mis-leading
- Person had reasonable ground to believe that information is proper till the time of issue of prospectus

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Condition for Civil Liability Sec 135(1)

- Where a person has subscribed for securities of a company acting on 1-any statement included, or the 2-inclusion or 3-omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

  1. Company has 50 acres of land near Delhi.
  2. Graph showing false growth of sales in past 12 months.
  3. Schedule of cases against company was missing.

- Apart from company who will be responsible?

  - ***Promoter***

    is a promoter of the company;

  - ***Director***

    is a director of the company at the time of the issue of the prospectus;

  - ***To be director***

    has authorized himself to be named and is named in the prospectus as a director of the company or has agreed to become such director either immediately or after an interval of time;

  - ***Authorizer***

    has authorized the issue of the prospectus; and

  - ***Expert***

    is an expert referred to in sub-section (5) of section 26 (Who is engaged & given consent to issue prospectus), **shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.**

Punishment sec 135(3)

Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

Relief from punishment sec 135(2)

No person shall be liable under sub-section (1), if he proves—

- ***Withdrawal of consent and issue without consent***

  that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent or

- ***Issue without consent and reasonable public notice given about the same***

  that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

- ***If any of above people prove that misleading statement / report / extract of report is made by expert and he has reason to believe that such expert was competent and given consent to prospectus and has not withdrawn it or informed to such defendant, then he will not be responsible and punishable.***

  No person shall be liable under sub-section (1), if he proves (Promoter / Director / To be Director / Authorizer / Other Expert)

  That, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or to the defendant's knowledge, before allotment thereunder.

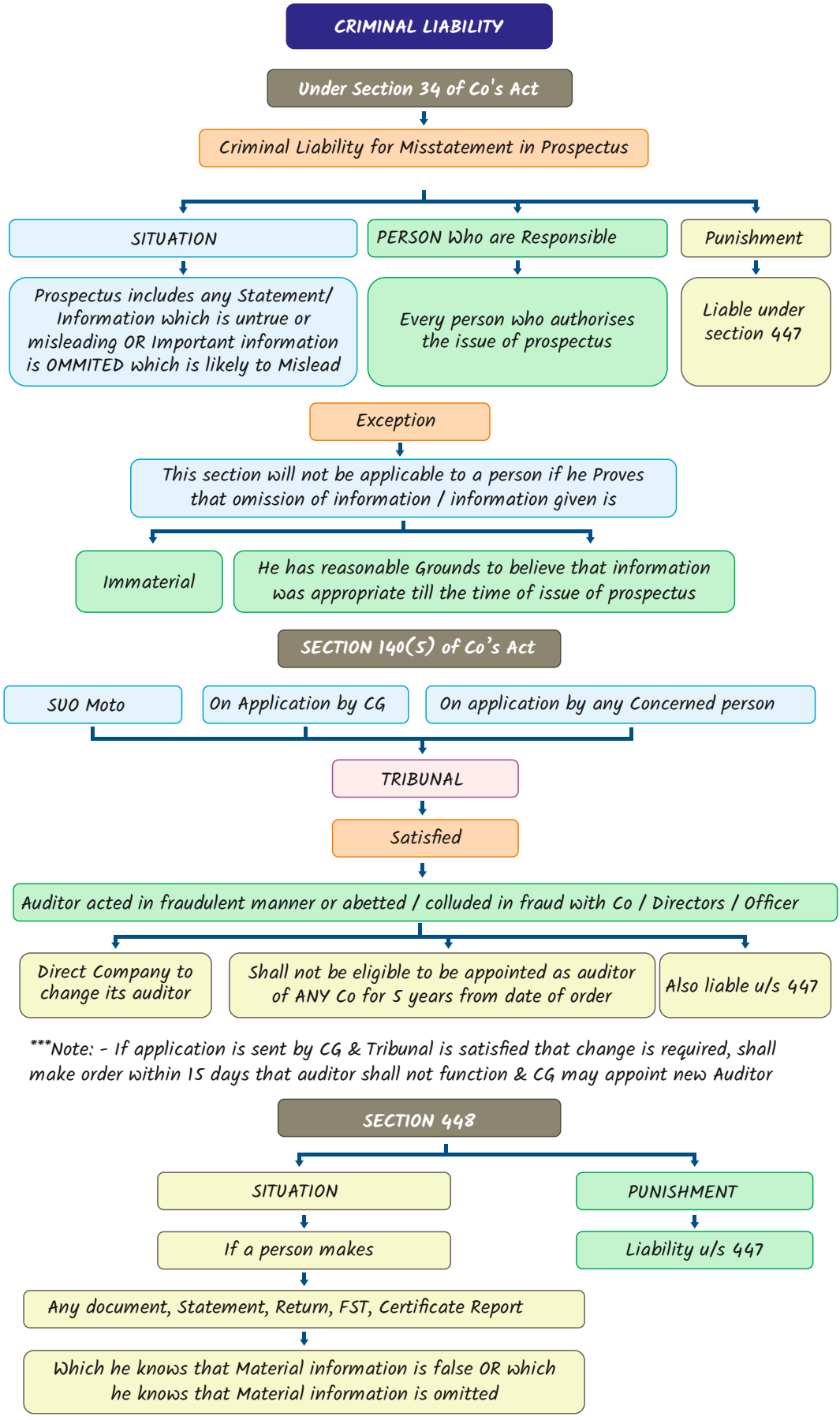
Expert

It may be noted that the term "expert" as defined in Section 2(38) of the Companies Act, 2013 includes an ***engineer, a valuer, a chartered accountant, a company secretary, a cost accountant*** and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force. Also, that under Section 26 of the Act a statement may be considered to be untrue, not only because it is so but also if it is misleading in the form and context in which it is included. (5 years old profits figures were highlighted as annual profits at many places)

The liability would arise if the written consent of the auditor to the issue of the prospectus, including the report purporting to have been made by him as an "expert" has been obtained.

(CNO—LOA.060) CRIMINAL LIABILITY UNDER THE COMPANIES ACT (QNO 370.000)

The circumstances in which an auditor can be prosecuted under the Companies Act and the penalties to which he may be subjected are briefly stated below:



Section 34

Criminal liability for Misstatement in Prospectus- As per Section 34 of the Companies Act, 2013, where a prospectus, issued, circulated or distributed includes ***any statement which is untrue or misleading in form or context*** *in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.*

- ***Relief***

  This section shall not apply to a person if he proves that such statement or omission was

1 immaterial or that he had 2 reasonable grounds to believe and did up to the time of issue of the prospectus believe, that the statement was true, or the inclusion or omission was necessary.

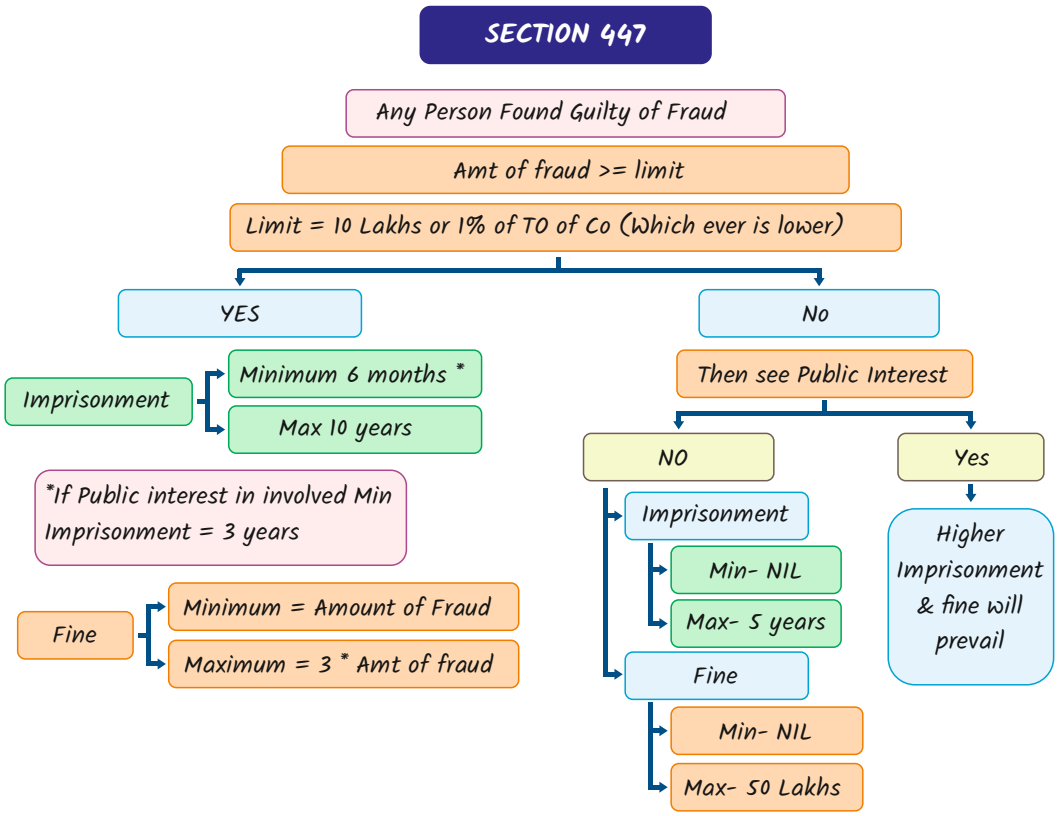
- **Example of 1** -Last name of auditor was misspelled, it was not resembling to anyone else / Last digit of firm registration number, was accidentally omitted while finalising.
- **Example of 2**- Auditor believed that employees working with company were on full time basis and not part time on contract basis

Section 448 (QNO-370.020)

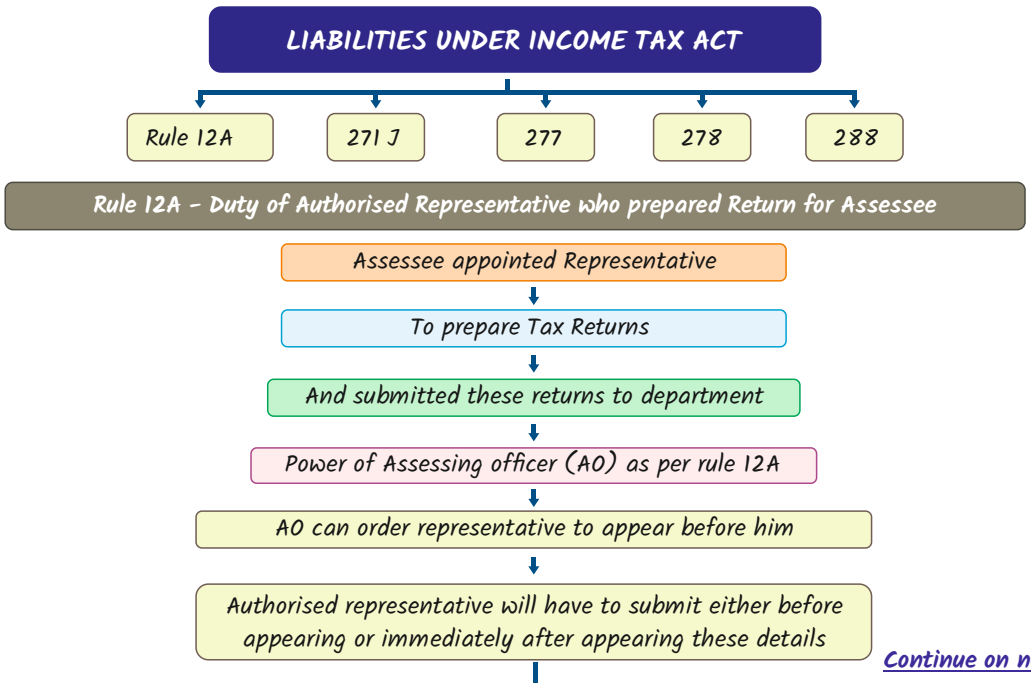
Punishment for false statement - According to Section 448 of the Companies Act, 2013 if in any return, report, certificate, financial statement, prospectus, statement or other document required by or for the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement —

- which is false in any material particulars, knowing it to be false; or
- which omits any material fact, knowing it to be material, he shall be liable under section 447.

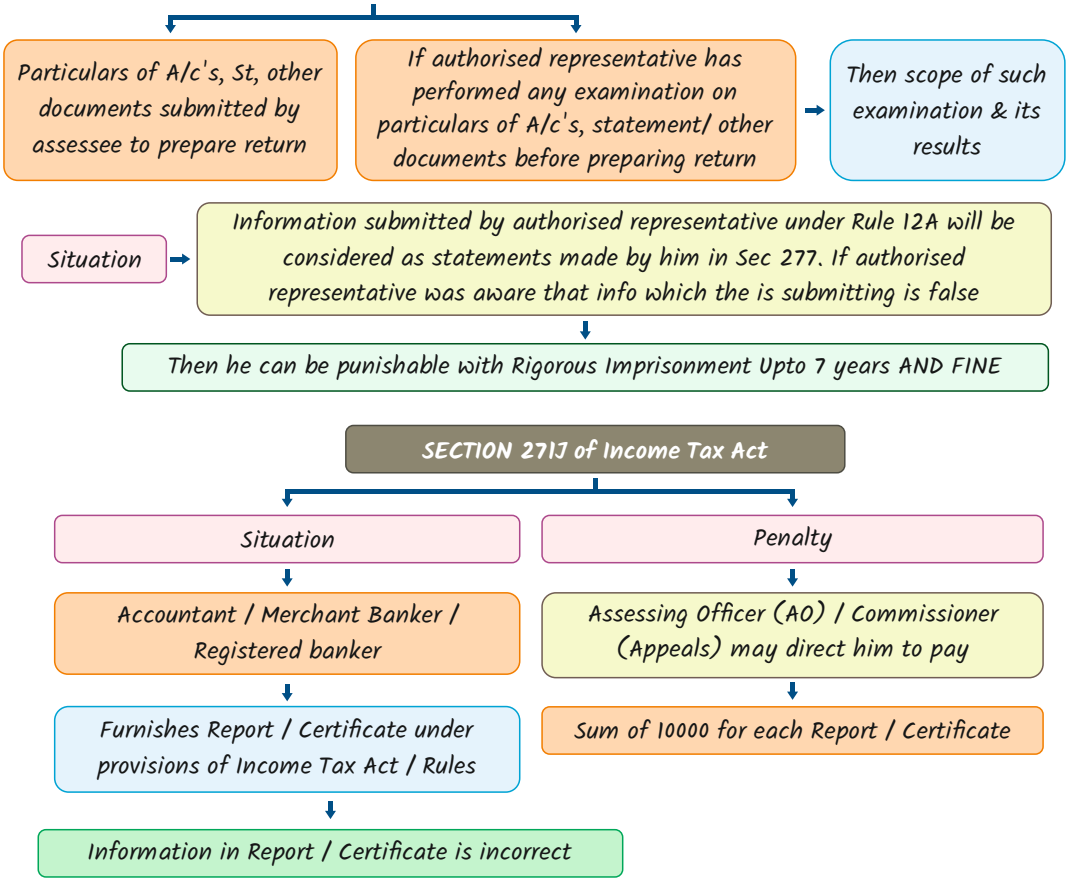
Section 447 (QNO-370.020)



(CNO—LOA.080) LIABILITIES UNDER INCOME TAX ACT 1961 (QNO-378.100)



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***NOTE -(1) Incorrect information may be provided intentionally / unintentionally
(2) Penalty under other Sections will also apply if its intentional like Sec 277 & Sec 278.

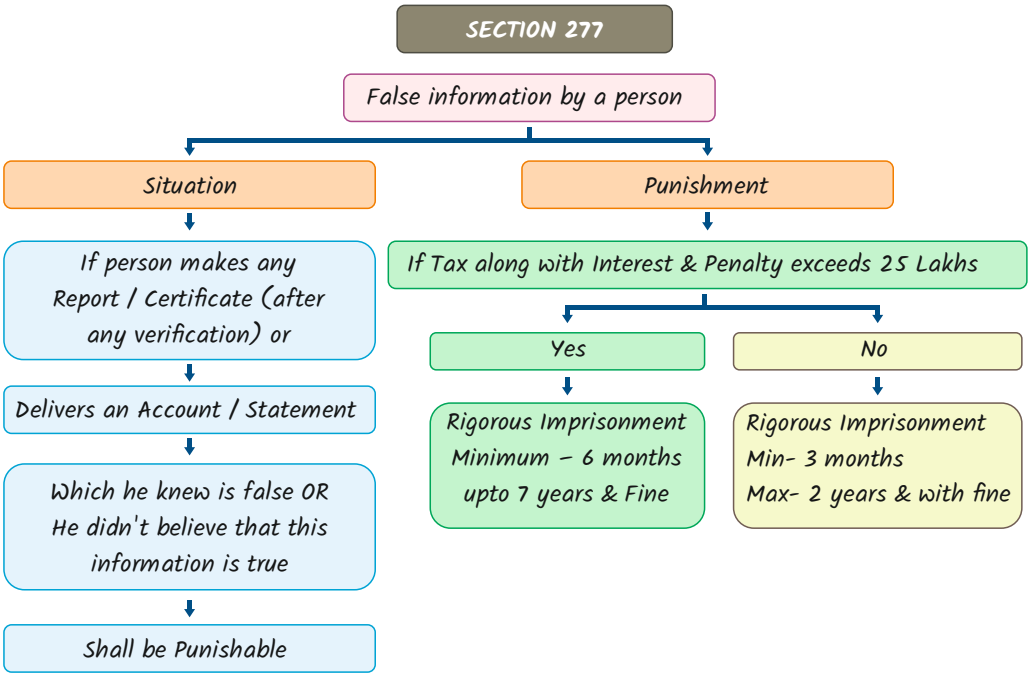
Rule 12A

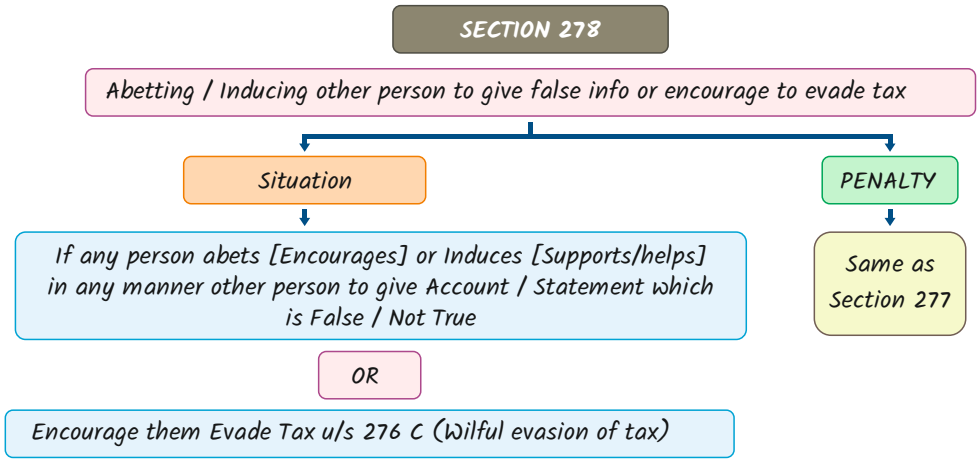
- **Under Rule 12A of the Income Tax Rules:** Under this rule a Chartered Accountant who as an authorized representative has prepared the return filed by the assessee, has to furnish to the Assessing Officer, the particulars of accounts, statements and other documents supplied to him by the assessee for the preparation of the return.

  Where the Chartered Accountant has conducted an examination of such records, he has also to submit a report on the scope and results of such examination. The report to be submitted will be a statement within the meaning of Section 277 of the Income Tax Act. Thus, if this report contains any information which is false and which the Chartered Accountant either **knows or believes to be false or untrue,** he would be liable to rigorous imprisonment which may extend to seven years and to a fine.

Section 271J

- **Under Section 271J of the Income Tax Act:** As per new section inserted by the Finance Act, 2017 if an accountant or a merchant banker or a registered valuer, **furnishes incorrect** information in a report or certificate under any provisions of the Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of **ten thousand rupees for each such report or certificate by way of penalty.** [section 271J]

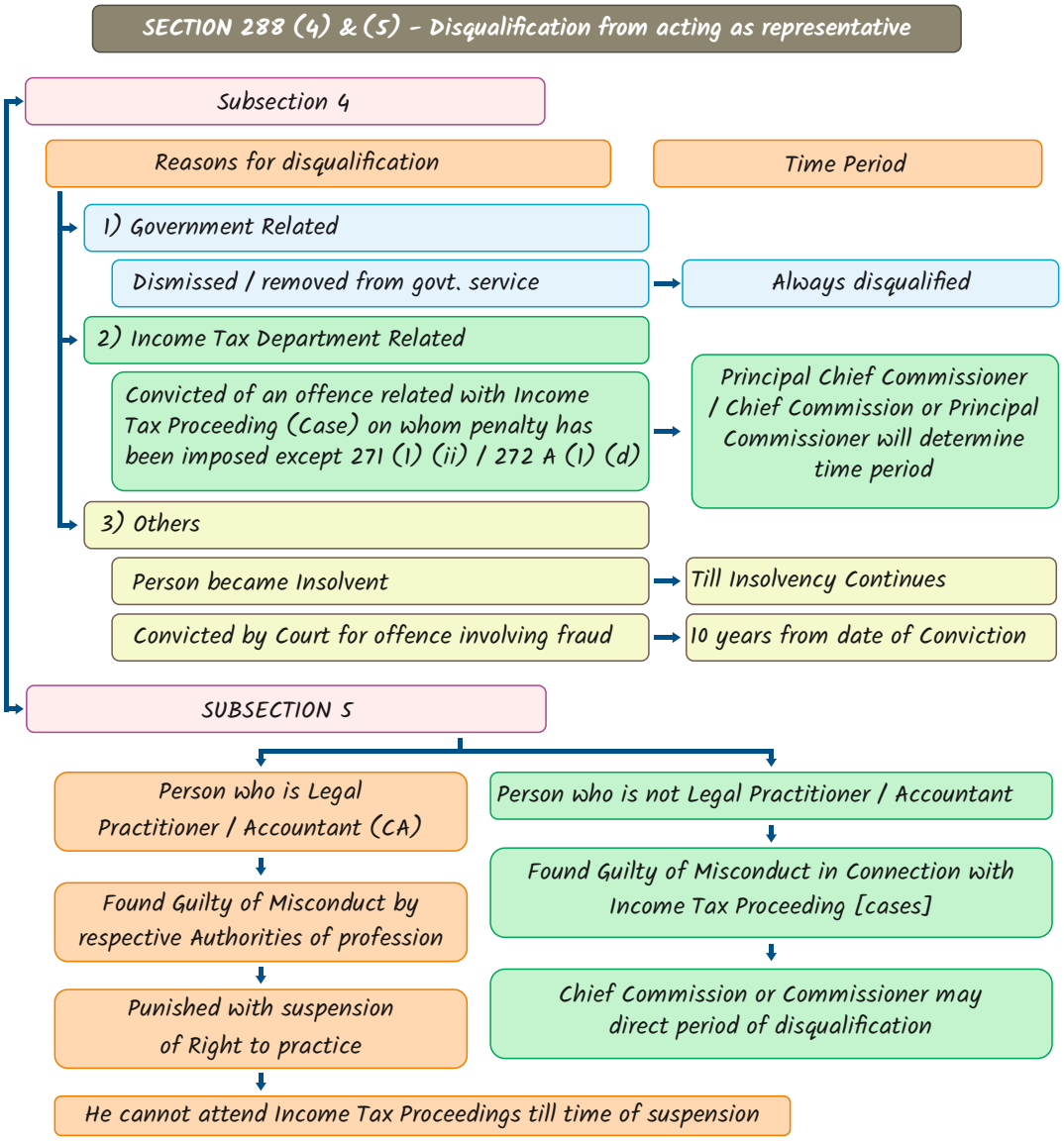




Section 277 & Section 278 (QNO 378,200)

- ***Under Section 277 and Section 278*** *any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true. he shall be punishable: -*
  - *in a case where the amount of tax, penalty or interest which would have been evaded, if the declaration, account or statement had been accepted as true, or which is willfully attempted to be evaded,* ***exceeds Rs 25,00,000, with rigorous imprisonment for a term which shall not be less than 6 months, but which may extend to 7 years and with fine;***
  - ***in any other case,*** *with rigorous imprisonment for a term which shall* ***not be less than 3 months, but which may extend to 2 years and with fine.***

(CNO—LOA.100) DISQUALIFICATIONS REGARDING AUTHORIZED TAX REPRESENTATIVES.



Section 288

In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorized representative of his clients and attends before an Income Tax Authority or the appellate tribunal. **His Disqualifications under the Income Tax Act of 1961 are as below:**

Section 288 (4) & (5) of the Income Tax Act, 1961

- **Sub section 4 of Section 288 of the Income Tax Act:**
  No person-
  (a) who has been **dismissed or removed from Government service** after the 1st day of April, 1938;or
  (b) Who has been **convicted of any offence connected with any Income Tax proceeding or on whom a penalty has been imposed under the said Act** (except under clause (ii) of sub section (1) of Section 271) (Nominal Penalty of 10,000 when failed to comply with some notices) [or clause (d) of sub-section (1) of section 272A];(Inquiry before assessment / Attendance during assessment / Special Audit) or
  (c) who has become an **insolvent; or**
  (d) who has been convicted by a **court** for an offence involving fraud,
  shall be qualified to represent an assessee under sub-section (1),

- **Time Limits**
  - for **all times** in the case of a person referred to in clause(a),
  - for such time as the **Principal Chief Commissioner** or Chief Commission or Principal

Commissioner or Commissioner may, by order determine in the case of a person referred to in clause (b),

- *for the period during which the* ***insolvency continues*** *in the case of a person referred to in clause (c),*
- *and for a period of* ***ten years from the date of conviction*** *in the case of a person referred to in clause (d).*

- ***Sub section 5 of Section 288 of the Income Tax Act:***

  If any person-

  - *who is a* ***legal practitioner, or an accountant is found guilty of misconduct in his professional capacity*** *by any authority entitled to* ***institute disciplinary proceedings against him,*** *an order passed by that authority shall have effect in relation to his* ***right to attend before an income-tax authority as it has in relation to his right to practice as a legal practitioner or account, as the case may be;***

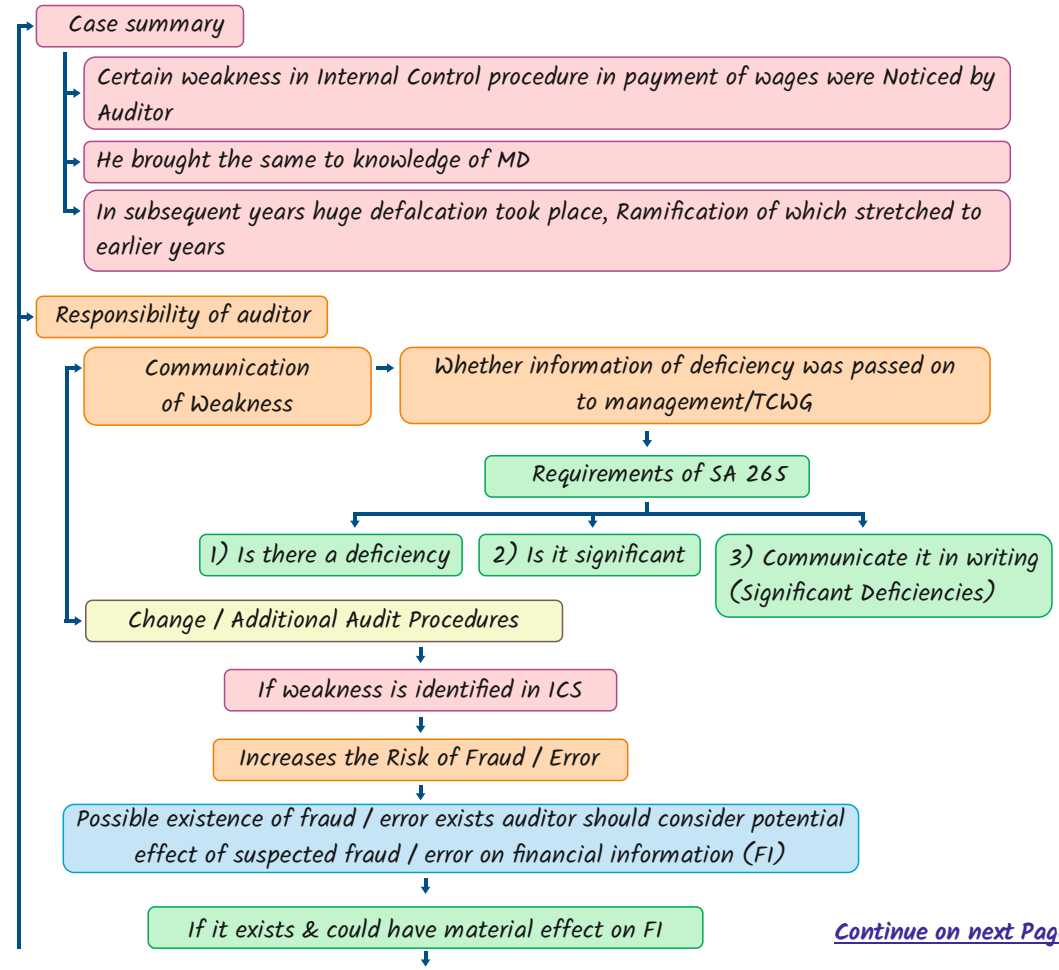
  - *Who is* ***not a legal practitioner or an accountant, is found guilty of misconduct in connection with any income-tax proceedings by the prescribed authority, the prescribed authority (Chief Commissioner or Commissioner having requisite jurisdiction)*** *may direct that he shall thenceforth be disqualified to represent an assessee under sub section (1).*

(CNO—LOA.120) PROFESSIONAL NEGLIGENCE & INTERNAL CONTROL SYSTEM (QNO 378.000, 377.000)

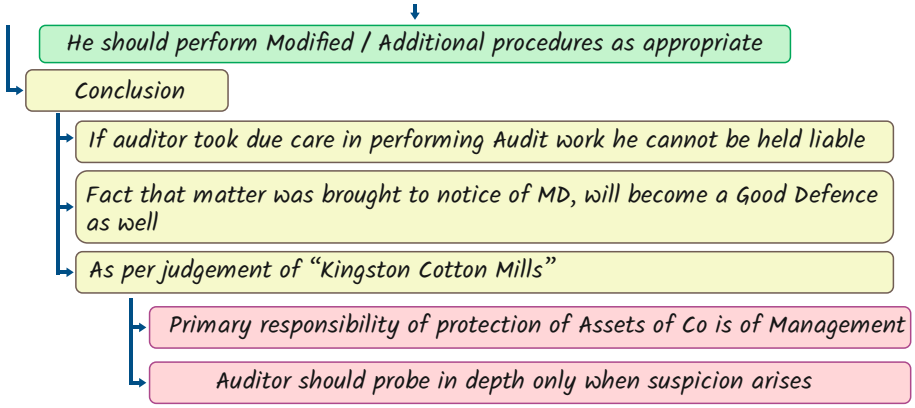
Q

Certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor who in turn brought the same to the knowledge of the Managing Director of the company. In the subsequent year huge defalcation came to the notice of the management. The origin of the same was traced to the earlier year. The management wants to sue the auditor for negligence and also plans to file a complaint with the Institute.

WEAKNESS IN ICS LEADING TO FRAUD & AUDITOR'S RESPONSIBILITY



Continue on next Page...



Internal Control Deficiency Identified by Auditor

Answer

In the given case, certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor and brought the same to the knowledge of the Managing Director of the company. In the subsequent year, a huge defalcation took place, the ramification of which stretched to the earlier year. The management of the company desires to sue the statutory auditor for negligence.

Is Auditor Responsible?

The precise nature of auditor's liability in the case can be ascertained on the basis of the under noted considerations:

- **Communication of Weakness2**
  Whether the defalcation emanated from the weaknesses noticed by the statutory auditor, the information regarding which was passed on to the management; and
- **Change in Audit Procedures1**
  Whether the statutory auditor properly and adequately extended the audit programme of the previous year having regard to the weaknesses noticed.

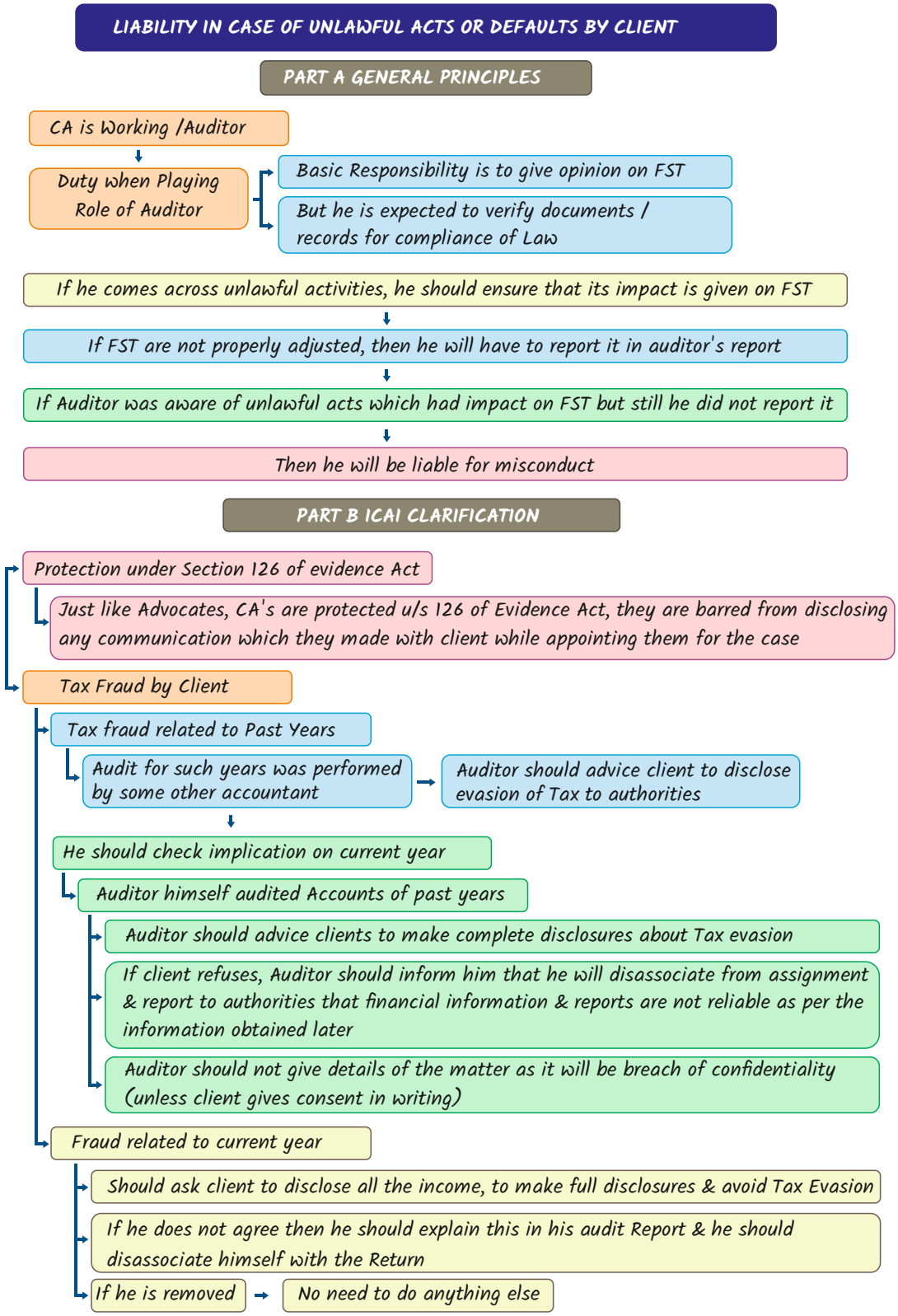
Requirements of SA 265

- **Communication of Weakness**
  SA 265 on "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" clearly mentions that,
  - **Auditor should determine is there a deficiency?**
    "The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.
  - **Is it significant deficiency?**
    If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.
  - **Communicate in Writing**
    The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis".
- **Change/Additional Audit Procedures?**
  The fact, however, remains that, weaknesses in the design of the internal control system and non-compliance with identified control procedures increase the risk of fraud or error. If circumstances indicate the possible existence of fraud or error, the auditor should consider the potential effect of the suspected fraud or error on the financial information. If the auditor believes the suspected fraud or error could have a material effect on the financial information, he should perform such modified or additional procedures as he determines to be appropriate.

Conclusion

Thus, normally speaking, as long as the auditor took due care in performing the audit work, he cannot be held liable. The fact that the matter was brought to the notice of the managing director may be a good defence for the auditor as well. According to the judgement of the classic case in re Kingston Cotton Mills Ltd., (1896) it is the duty of the auditor to probe into the depth only when his suspicion is aroused. The statutory auditor, by bringing the weakness to the notice of the managing director had alerted the management which is judicially held to be primarily responsible for protection of the assets of the company and can put forth this as defence against any claim arising subsequent to passing of the information to the management. In a similar case S.P. Catterson & Sons Ltd. (81 Acct. L. R.68), the auditor was acquitted of the charge.

Q **Write a short note on – Auditor's liability in case of unlawful acts or defaults by clients (QNO 377.000)**



Basic Responsibility is to give Opinion	**Answer** The auditor's basic responsibility is to report whether in his opinion the accounts show a true and fair view and in discharging his responsibility he has to see as to how the particular situations affected his position.
No Legal Obligation to Report	The general thinking with regard to unlawful acts or defaults by clients appears to be that the auditor should not 'aid or abet' but he is apparently not under any legal obligation to disclose the offence.
Auditor cannot Help	A professional accountant would himself be guilty of a criminal offence if he advises his client to commit any criminal offence or helps or encourages in planning or execution of the same or conceals or destroys evidence to obstruct the course of public justice or positively assists his client in evading prosecution.
Duty of Auditor	A professional accountant in his capacity as auditor, accountant, or tax representative has access to a variety of information concerning his clients. On some occasions, he may acquire knowledge that his client has been guilty of some unlawful act, default, fraud, or other criminal offence. The duty of the professional accountant in such a case would depend upon the actual circumstances of the situation. Due consideration should be given to the exact nature of services that a professional accountant is rendering to his client, i.e. is he representing the client in income-tax proceedings or is he acting in the capacity of an auditor or an accountant or a consultant.
ICAI Clarification for past tax frauds of clients	The Institute of Chartered Accountants of India has considered the role of chartered accountants in relation to taxation frauds by an assessee and has made the following major recommendations: › **Sec 126** A professional accountant should keep in mind the provisions of Section 126 of the Evidence Act whereby a barrister, an attorney, a pleader or a Vakil is barred from disclosing any communication made to him in the course of and for the purpose of his employment. › **Different Situations of Fraud** ▪ **Past Fraud, someone else did Audit** If the fraud relates to past years when the accountant did not represent the client, the client should be advised to make a disclosure. The accountant should also be careful that the past fraud does not in any way affect the current tax matters. ▪ **Past Fraud, Auditor himself did audit** In case of fraud relating to accounts examined and reported upon by the professional accountant himself, he should advise the client to make a complete disclosure. In case the client refuses to do so, the accountant should inform him that he is entitled to dissociate himself from the case and that he would make a report to the authorities that the accounts prepared or examined by him are unreliable on account of certain information obtained later. In making such a report, the contents of the information as such should not be communicated unless the client consents in writing. ▪ **Fraud in current year** In case of suppression in current accounts, the client should be asked to make a full disclosure. If he refuses to do so, the accountant should make a complete reservation in his report and should not associate himself with the return. However, it can be argued that the auditor has a professional obligation to ensure that the client is fully aware of the seriousness of the offence and to seriously consider full disclosure of the matter. It has been clearly established in various case laws that the auditor is expected to know the contents of documents and records and ascertain whether the affairs of the client are being conducted in an unlawful manner. It is in the course of the work, he comes across any unlawful acts, it is his duty to bring it to the notice of the client as also to make a disclosure in his report in appropriate cases. In this regard, one has to bear in mind the consequence of the act in relation to the professional code to which an auditor is

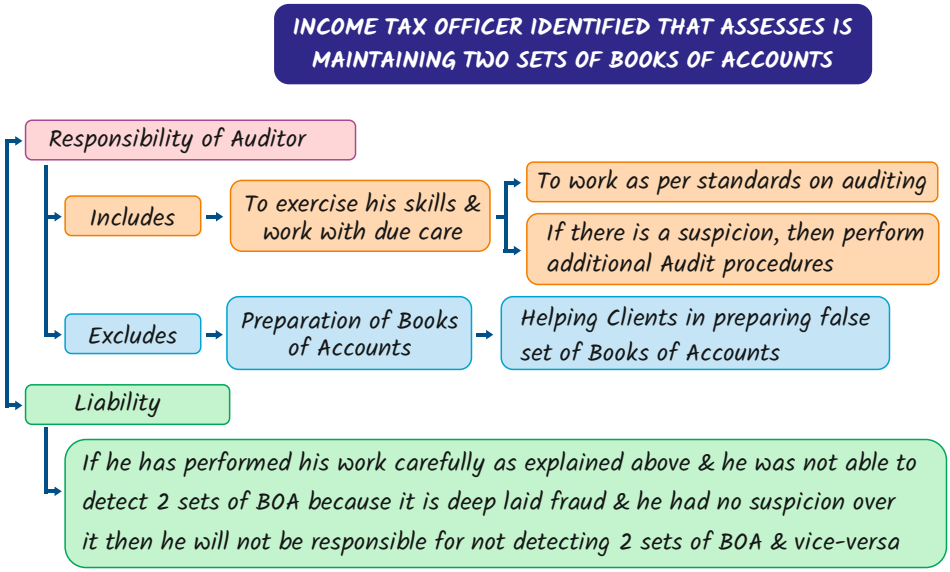
subjected. Under the code, an auditor cannot disclose confidential information unless permitted by the client or unlessrequired by law. Each case has to be judged on its circumstances. However, in every case he has to assess the implications of the unlawful act or default on the true and fair character of the accounting statements.

Conclusion

The question of liability of an auditor for unlawful acts or defaults by clients should be considered in the light of the broad parameters given above. However, it appears that if an auditor was aware of any unlawful act having been committed by client in respect of accounts audited by him and the unlawfulness was not rectified by proper disclosure or any other appropriate means, the auditor owes a duty to make a suitable report. If he does not, he may be held liable, if the true and fair character of the accounts has been vitiated.

(CNO—LOA.140) 2 SETS OF BOOKS BY CLIENT / RESPONSIBILITY OF TAX AUDITOR (QNO 376.000)

Q **In assessment procedure of M/s Cloud Ltd., Income Tax Officer observed some irregularities. Therefore, he started investigation of Books of Accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through books he found that M/s Cloud Ltd. used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the Institute of Chartered Accountants of India saying Mr. Old had negligently performed his duties. Comment.**



Responsibility of Auditor

Answer

"It is the auditor's responsibility to audit the statement of accounts and prepare tax returns on the basis of books of accounts produced before him. Also, if he is satisfied with the books and documents produced to him, he can give his opinion on the basis of those documents only by exercising requisite skill and care and observing the laid down audit procedure.

Case Discussion

In the instant case, Income tax Officer observed some irregularities during the assessment proceeding of M/s Cloud Ltd. Therefore, he started investigation of books of accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through the books, he found that M/s Cloud Ltd. Used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the ICAI saying Mr. Old had negligently performed his duties.

Conclusion

Mr. Old, the auditor was not under a duty to prepare books of accounts of assessee and he should, of course, neither suggest nor assist in the preparations of false accounts. He is responsible for the books produced before him for audit. He completed his audit work with official set of books only. In this situation, as Mr. Old, performed the auditing with due skill and diligence; and, therefore, no question of negligence arises. It is the duty of the Department to himself investigate the truth and correctness of the accounts of the assessee.

Unique Mcq's

MCQ No LA.5

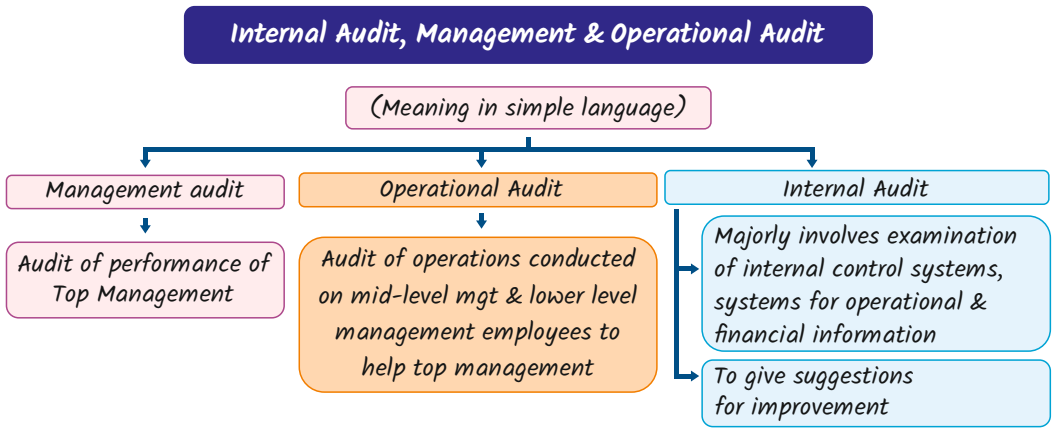
Students Notes

15 INTERNAL AUDIT, MANAGEMENT AND OPERATIONAL AUDIT

PART – I INTERNAL AUDIT

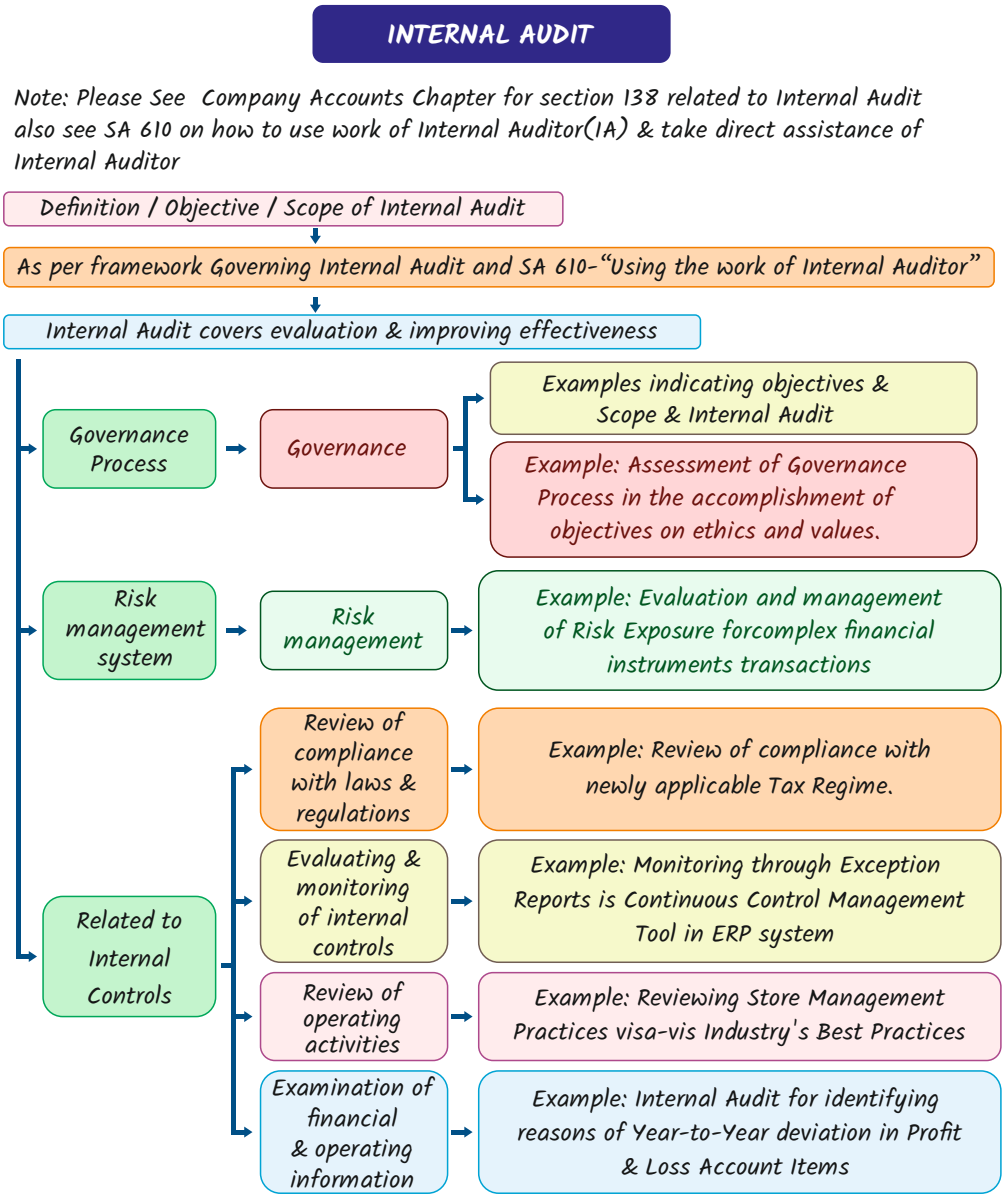
(CNO—IA.010) INTERNAL AUDIT VS MANAGEMENT AUDIT VS OPERATIONAL AUDIT

Chart



(CNO—IA.020) INTERNAL AUDIT DEFINITION SCOPE AS PER SA 610

Chart



(CNO—IA.030) SCOPE OF INTERNAL AUDITING INCLUDES REVIEW OF MANAGEMENT FUNCTION (QNO-614.010)

SCOPE OF INTERNAL AUDITING INCLUDES REVIEW OF MANAGEMENT FUNCTION

Following management Audit functions are covered

Shortcut – I²nternal auditor ne **GRASP** karni chahiye ye chije

- I → Review of **Internal control** system & procedures
- I → Relevance & Reliability of **Information**
- G → Accomplishment of **Goals** & objectives
- R → Utilization of **Resources**
- A → Custodianship & Safeguarding of **Assets**
- S → Organizational **structure**
- P → Review of Compliance with **Polices**, Plans, Procedures & Regulations

I → Review of Internal control system & procedures

- Assessing the **design** & operational efficiency & effectiveness
- Whether they are **operating** throughout the period
- Minimize **overall internal audit risk**
  - Inherent Risk
  - Control Risk
  - Detection Risk
- Whether internal controls are **cost effective**
- Reviewing **limitations of Internal controls**

I → Relevance & Reliability of Information

Evaluate reliability & integrity of financial & operating information given to management & external agencies

For this
- Examine reliability of financial & operational **records**
- Check whether there is **Exception Reporting**
- **Usefulness** of reports
- **Costing** requirements

G → Accomplishment of Goals & objectives

- Whether they are **clearly stated & attainable**
- Precise **quantifiable terms** (both monetary & Non monetary) → To achieve them proper **planning** including budgeting should be done
- There should be sufficient **flexibility**

R → Utilization of Resources

- For this compare Actual performance with **operating standards & norms [OSN]** for resources → Identify facilities/ Resources which are under-Utilized.
- Evaluate whether proper OSN have been established

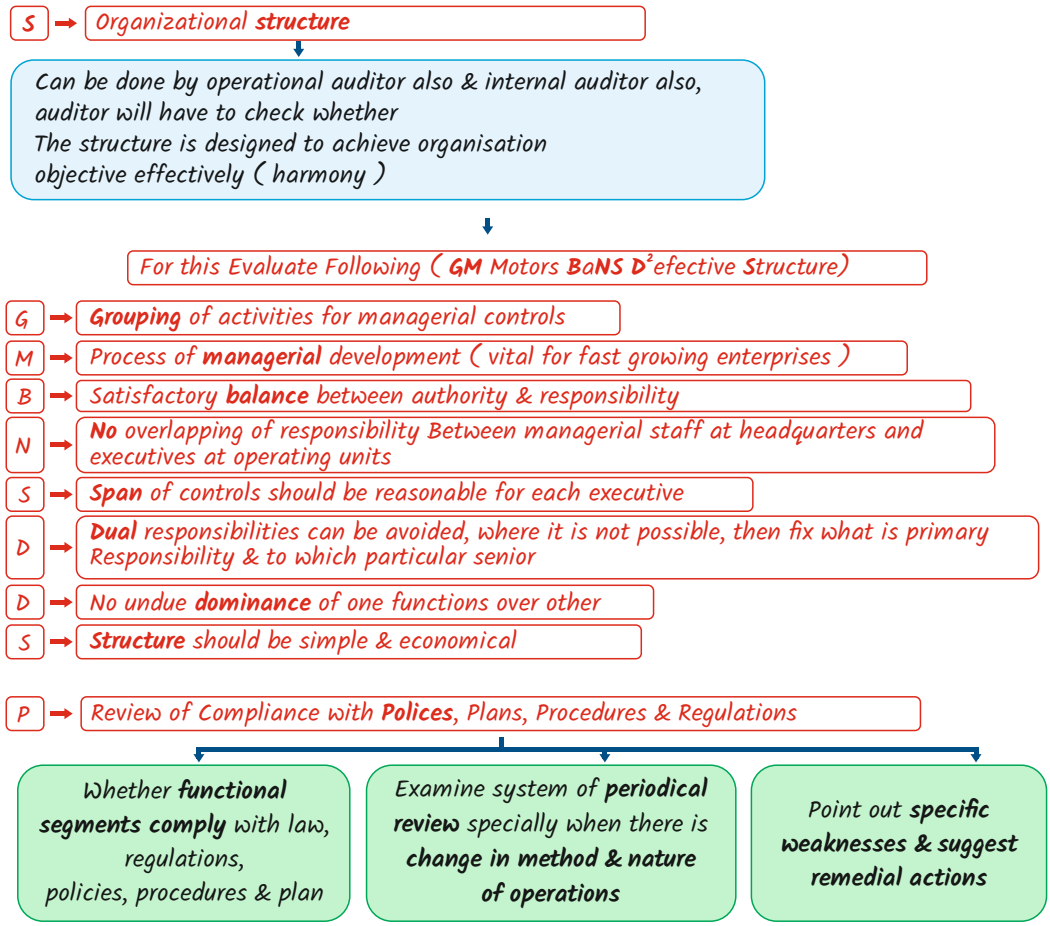
For this
- Review **methods** of establishing OSN
- Examine **assumptions** made while setting OSN
- Whether OSN are **detailed** enough for each resource / facility so that it can be used by operating person for monitoring & evaluating performance

A → Custodianship & Safeguarding of Assets

Asset Related
- Verify **existence** of Assets
- Safeguarding assets against loss
- whether all assets are accounted for fully

System related
- Review **segregation of duties**
- Review **Internal controls for Intangible assets**
- In case of electronic data processing review **physical & system controls on processing facilities**

Continue on next Page...



(i) Review of Internal Control System and Procedures -

(a) The review of internal control system and procedures involves assessing the design and operational efficiency and effectiveness of the internal control system to strengthen the overall internal control environment of the entity. The objective to review is to minimise the overall internal audit risk, i.e., the inherent risk, control risk and detection risk.

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

As far as possible, controls should be in-built in the operating functions, if they are to be cost-effective

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

(ii)Review of Custodianship and Safeguarding of Assets -

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

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

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

(iv) Review of Relevance and Reliability of Information - The internal auditor should review the information systems to evaluate the reliability and integrity of financial and operating information given to management and to external agencies such as governmental bodies, investors, trade organisations, labour unions, etc. He should examine the accuracy and reliability of financial and operational records. The usefulness of the reports as well as of the records should be evaluated with reference to their costs. The internal auditor should examine whether the reporting is by exception i.e. the reports highlight the significant and distinctive features.

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

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

(vi) Review of Utilisation of Resources –

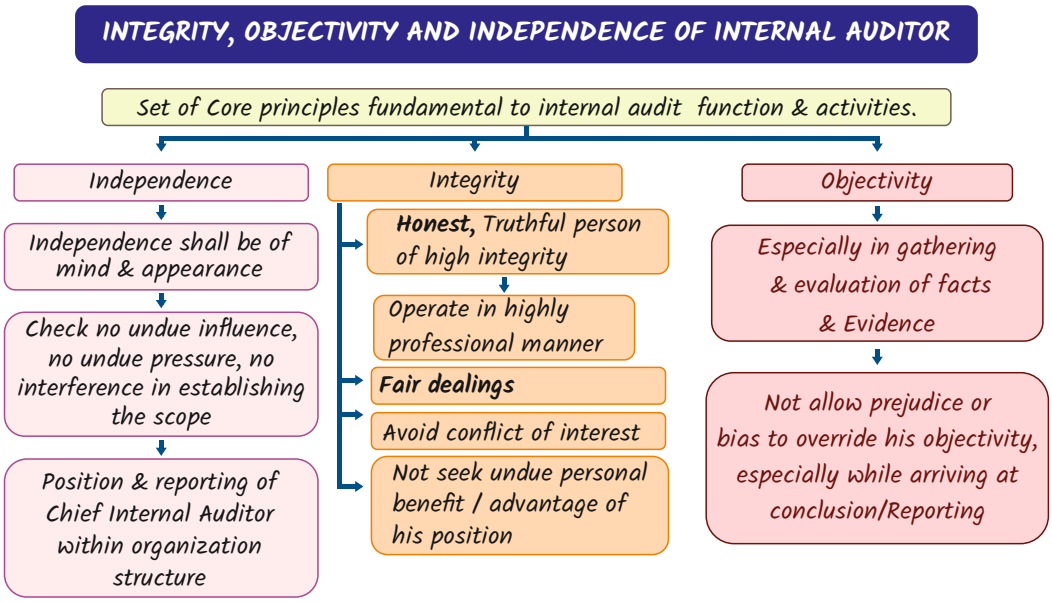
- The internal auditor should check whether proper operating standards and norms have been established for measuring the economical and efficient use of resources.
- They should be detailed enough to be identifiable with specific operating responsibilities and should be capable of being used by operating personnel for monitoring and evaluating their performance.
- The internal auditor should review the methods of establishing operating standards and norms. He should carefully examine the assumptions made while setting the standards to ensure that they are appropriate and necessary.
- Where there is a wide divergence between actual performance and the corresponding standards, reasons may be considered. As a part of evaluating resources utilisation, identifying the facilities which are under-utilized is an important function of the internal auditor.

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

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

(CNO—IA.060) CORE PRINCIPLES FUNDAMENTAL TO INTERNAL AUDIT FUNCTION -- INTEGRITY, OBJECTIVITY, AND INDEPENDENCE OF INTERNAL AUDITOR

Chart



Basic Principles / Core Principles

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

Independence

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

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

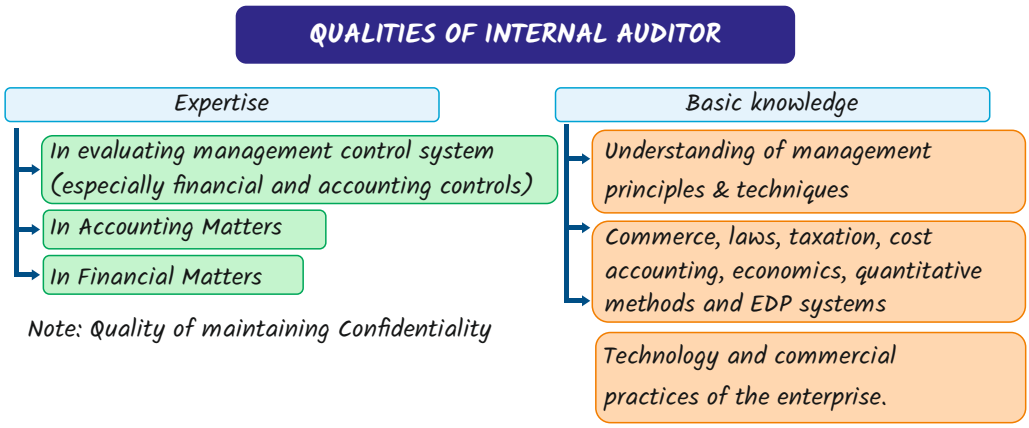
Integrity

2. The Internal Auditor shall be honest, truthful and be a person of high integrity. He shall operate in a highly professional manner and seen to be fair in all his dealings. He shall avoid all conflicts of interest and not seek to derive any undue personal benefit or advantage from his position.

Objectivity

3. The Internal Auditor shall conduct his work in a highly objective manner, especially in gathering and evaluation of facts and evidence. He shall not allow prejudice or bias to override his objectivity, especially in arriving at conclusions or reporting his opinion.

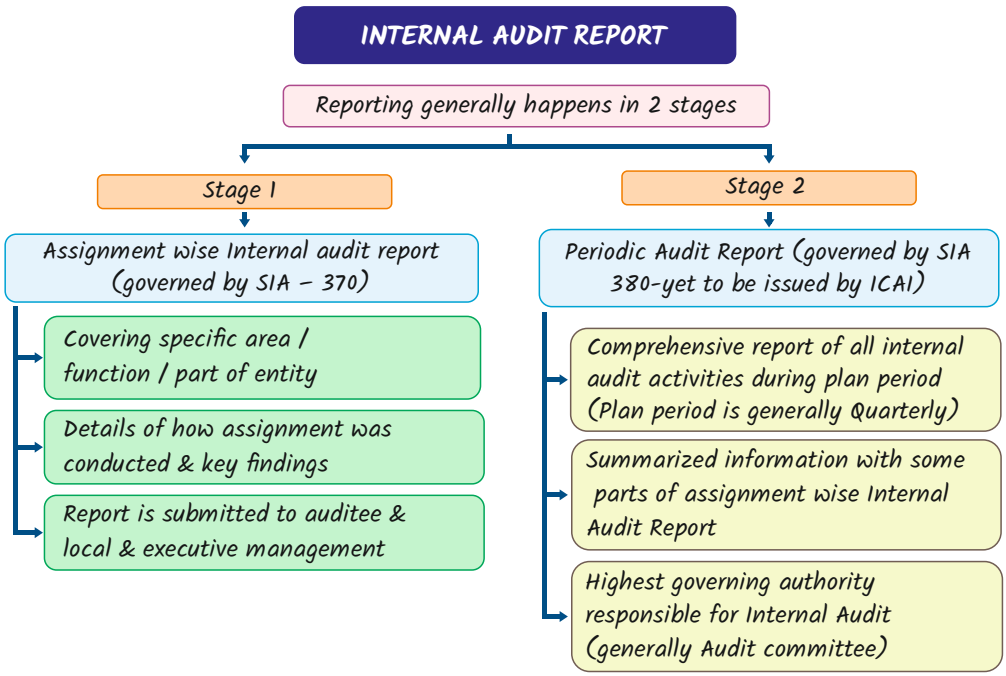
(CNO—IA.070) QUALITIES OF INTERNAL AUDITOR



Discussion

1. The internal auditor should have the special expertise necessary for evaluating management control systems, especially financial and accounting controls.
2. Accounting and finance functions provide basic data for management control of an enterprise. Therefore, the internal auditor must have accounting and financial expertise to be able to discharge his duties.
3. The internal auditor is also expected to evaluate operational performance and non-monetary, operational controls. This requires a basic knowledge of the technology and commercial practices of the enterprise.
4. He should also have a basic knowledge of commerce, laws, taxation, cost accounting, economics, quantitative methods and EDP systems.
5. An understanding of management principles and techniques is another essential qualification of an internal auditor as also the ability to deal with people.
6. By his conduct the internal auditor should provide an assurance to the management that the confidentiality of such information would be maintained.

(CNO—IA.080) INTERNAL AUDIT REPORT



Review & Assess Conclusions / Report Findings / Suggest Remedial Action	The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action. However, in case the internal auditor comes across any actual or suspected fraud or any other misappropriation of assets, it would be more appropriate for him to bring the same immediately to the attention of the management.
Stages of Reporting In Internal Audit	As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

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

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

Scope of SIA 370	This Standard on Internal Audit (SIA) deals with the internal auditor's responsibility to issue only the first type of reports, the Internal Audit Report pertaining to specific audit assignments and not to the periodic (e.g., Quarterly) reporting for the whole entity as per the Annual/Quarterly audit plan.

(CNO—IA.100) KEY ELEMENTS OF INTERNAL AUDIT REPORT (MCQ – IA.36)

KEY ELEMENTS OF INTERNAL AUDIT REPORT

- Overview of objective, scope & approach
- Internal audit was conducted as per standards of Internal Audit
- Executive summary of key observations covering all important aspects
- Summary of corrective actions for each observation
- Nature of assurance if any derived from observations

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

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

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

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

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

(e) Nature of assurance, if any, which can be derived form the observation

Consultation with Auditee & Reporting within Reasonable Time

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

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

(CNO—IA.120) FURTHER EXPLANATION ON PREPARING INTERNAL AUDIT REPORT

Important Concepts Related to Internal Audit Report

Draft Report	No Internal Audit Report shall be issued in final form unless a written draft of report has been previously shared with the auditee
Content & form	Content & form will be as per his professional judgement & in consultation with auditee & inputs from other key stakeholders
Time frame	Report should be issued within reasonable time frame from completion of Internal audit work

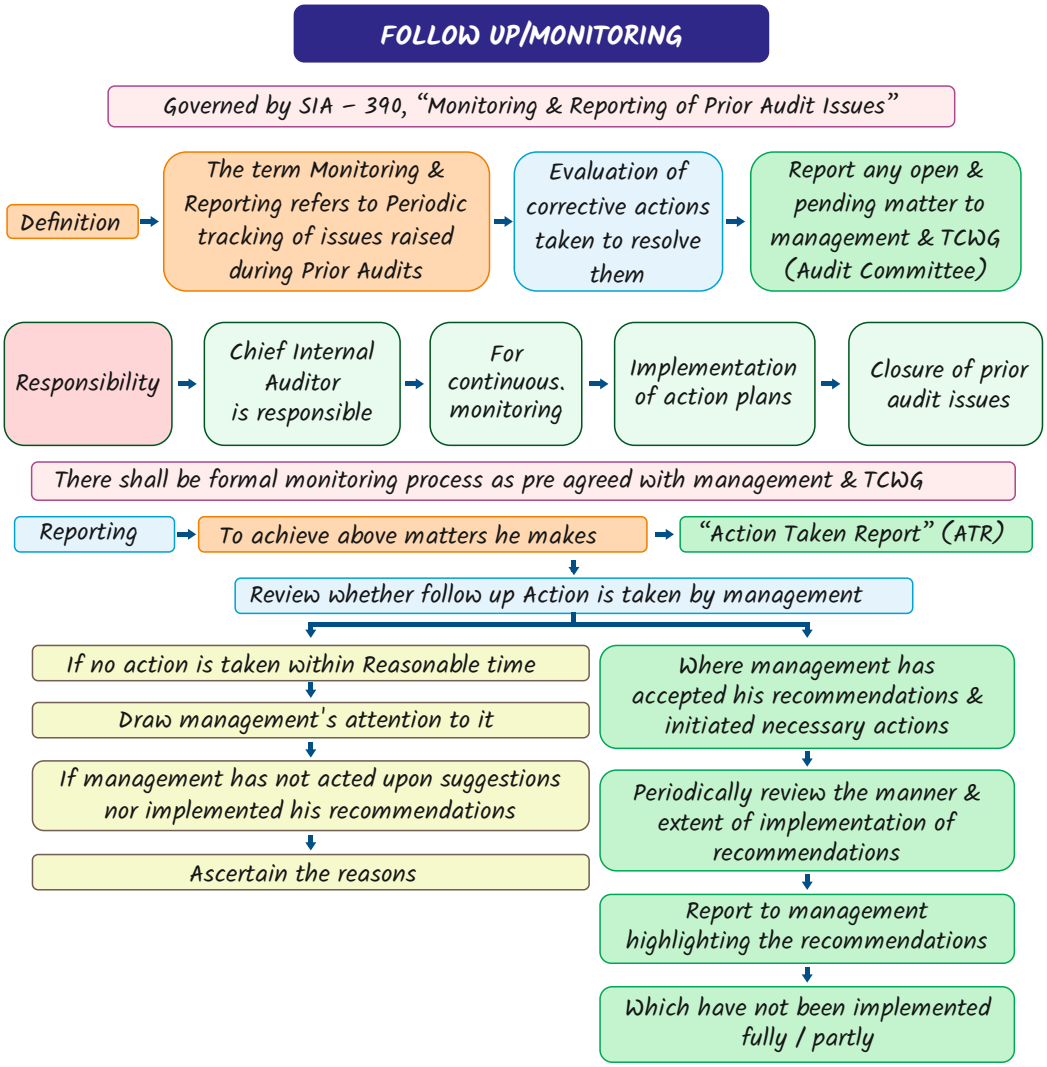
- **Basis of Internal Audit Report:** Each internal audit report is prepared on the basis of the audit procedures conducted and the analysis of the audit evidence gathered. Conclusions reached shall be based on all the findings rather than on a few deviations or issues noted. Controls operating effectively have their own importance and should be acknowledged, while the risk and significance of observations noted have a role to play in prioritising the matters to be reported.
- **Conducted in Accordance with SIAs:** Where the internal audit is conducted in compliance with the Standards of Internal Audit, (within the Framework governing Internal Audits), and the internal auditor can substantiate the same with supporting evidence and documentation, the internal audit report shall include a statement confirming that "the internal audit was conducted in accordance with the Standards of Internal Audit issued by the Institute of Chartered Accountants of India".
- **Content and Format of Internal Audit Report:** The manner in which the internal audit report is drafted and presented is a matter of professional judgment and choice and could be influenced by the preferences of the recipients. The SIA does not mandate any particular format or list of contents since the Internal Auditor is expected to exercise his best professional judgement on matters regarding how and what to report. Where some level of assurance is being provided, the form and content of the report shall be as per SIA 380, "Issuing Assurance Reports".
- **Documentation:** To confirm compliance of audit procedures with this SIA, the list of documents required is as follows:

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

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

(CNO—IA.140) FOLLOW-UP BY INTERNAL AUDITOR

Chart



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

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

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

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

Where the management has accepted his recommendations and initiated the necessary action, the

	internal auditor should periodically review the manner and the extent of implementation of the recommendations and report to the management highlighting the recommendations which have not been implemented fully or partly.

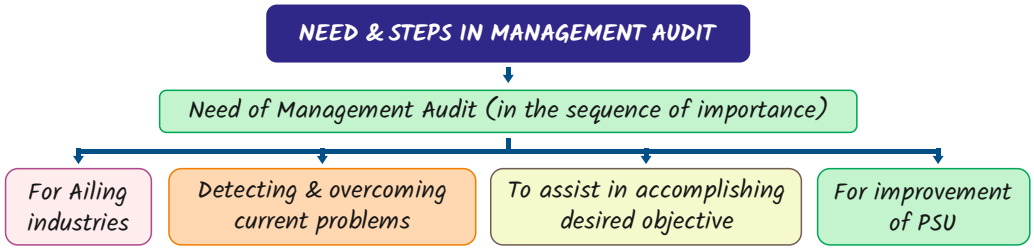
UNIQUE QNO	
QNO 621.005	Responsibility of Internal Auditor

UNIQUE MCQS (Related to Internal Audit)	
MCQ No.	IA.1/ IA.2/ IA.3/ IA.4/ IA.5/ IA.6/ IA.7/ IA.8/ IA.9/ IA.10/ IA.11/ IA.12/ IA.13/ IA.14/ IA.16/ IA.17/ IA.19/ IA.20/ IA.21/ IA.22/ IA.23/ IA.24/ IA.25/ IA.26/ IA.27/ IA.28/ IA.29/ IA.30/ IA.32/ IA.34/ IA.35/ IA.37/ Incs.14.5 / Incs.17.4 / Incs.20.1 / Incs.20.2 / Incs.20.3 / Incs.20.4

PART – 2 MANAGEMENT & OPERATIONAL AUDIT

(CNO—MA.020) NEED & STEPS IN MANAGEMENT AUDIT

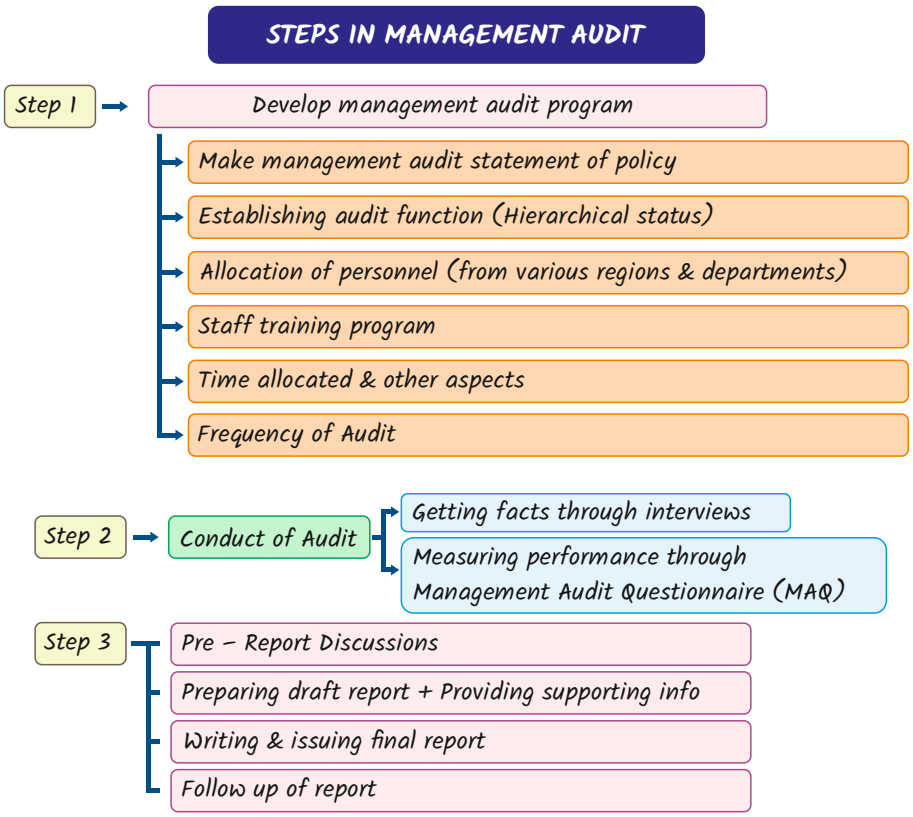
Chart



Need of Management Audit

- For detecting and overcoming current problems. (falling sales of Bajaj) 2
- Helpful for ailing industries. (Corus) 1
- To assist the organization in accomplishing desired objectives. (Bajaj wants to be number one 2-wheeler co.) 3
- For improved management in Public sector undertakings. 4

Chart



Steps in Management Audit

- **Steps-1 Develop Management Audit Programme;**
  - **Devising a statement policy:** – In consultation with the top management. The policy should ideally cover the scope, objective, the authority of the management audit function. (Causes of falling sales & how to increase them)
  - **Location of audit function within the organization:** – The hierarchical status of management auditor and his team should be clearly defined. (Below directors)
  - **Allocation of personnel:** – The management audit team should comprise of personnel who have adequate experience on various aspects of the organization. (from various regions & departments)
  - **Staff training programme:** – In order to maintain qualitative standard, adequate and continuous training should be offered to the management audit team. (5 days training)
  - **Time and other aspects:** – Adequate consideration should be given to time & cost involved in conducting the audit. (total duration 3 months)
  - **Frequency of audit:** – Should be determined on the basis of changes in industry and in

consultation with the top management. (Once in 2-3 years)

- **Steps 2: - Conduct of Audit: -**
  - Getting the facts through interviews. (MD / Sales Head / Branding Team / Product Team / Dealers / Customers)
  - Measuring performance through **Management Audit Questionnaire.**
- **Seps-3 Conclusion and Reporting: -**
  - Pre-Report Discussions. (Commuter Segment / Connect with Dealers / Pricing / Branding)
  - Preparing draft report.
  - Supporting information.
  - Writing & issuing the final report.
  - Follow up of the report.

(CNO—MA.030) Management Audit Reports

Purpose

The written report is the medium by which the comments, criticisms and recommendations of a management audit department are conveyed to the Board, to functional directors and to management in general. Management audit reports will inevitably cover a wide variety of subjects, reflecting the many and ever-increasing ramifications of management audit departments.

Categories (Depending on when they are prepared)

- Broadly, however, reports may be divided into four main categories:
  - Reports prepared by the management audit staff after their visits to a unit.
  - Periodical reports prepared by senior members of the management audit department which summaries the main audit findings and recommendations for the period under consideration and which afford a concise review of the department's activities for that period.
  - Reports on the results of special investigations and inquiries.
  - An annual audit report.

Types of Reports (QNO - 610.000)

The reporting of results covers a wide spectrum of types. We can describe the more important ones as follows:

- **Oral reports** – In many situations, the reporting of results will be on an oral basis. To some extent, this is inevitable since a part of the actual audit effort is carried on in conjunction with company personnel. In other cases, it is a result of emergency action needs. It may also be a prelude to more formal written reports. To some extent, there will always be oral reporting as a means of later supplementing written reports, especially when individuals being served have special needs.

  Oral reporting, therefore, serves a useful and legitimate purpose, especially the matters covered by emergency oral reporting, should be followed up immediately by a written report giving reference to oral reporting.

  Example: - A management auditor, if he has come across any embezzlement, should immediately inform the concerned management orally, so that steps may be immediately taken to prevent further embezzlement.
- **Interim written reports** – In situations where it is deemed advisable to inform management of significant developments during the course of the audit, or at least preceding the release of the regular report, there may be some kind of interim written report.

  This report may pertain to especially significant problems where there is a need for early consideration or the report may be of a progress nature. All in all, interim reports represent a type of reporting which, when used with judgement can be a good device to improve the total reporting process.
- **Regular written reports** – In the typical situation, the particular audit assignment will include the preparation of a formal written report. The form and content of such written reports will vary widely for different audit assignments and companies in terms of their length and depth, quantification and

overall presentation.

- ***Summary written reports*** – These summary reports are also referred to as 'flash' reports'. In a number of companies, the practice has developed of issuing an annual (or sometimes more frequent) report summarizing the various individual reports issued and describing the range of their content. These summary reports in some cases are primarily for audit committees of Boards of Directors, but in other cases for higher level management. They are especially useful to top level managers who do not actively review the individual reports. They are also useful to the general auditor in seeing his total reporting effort with more perspective and on an integrated basis.

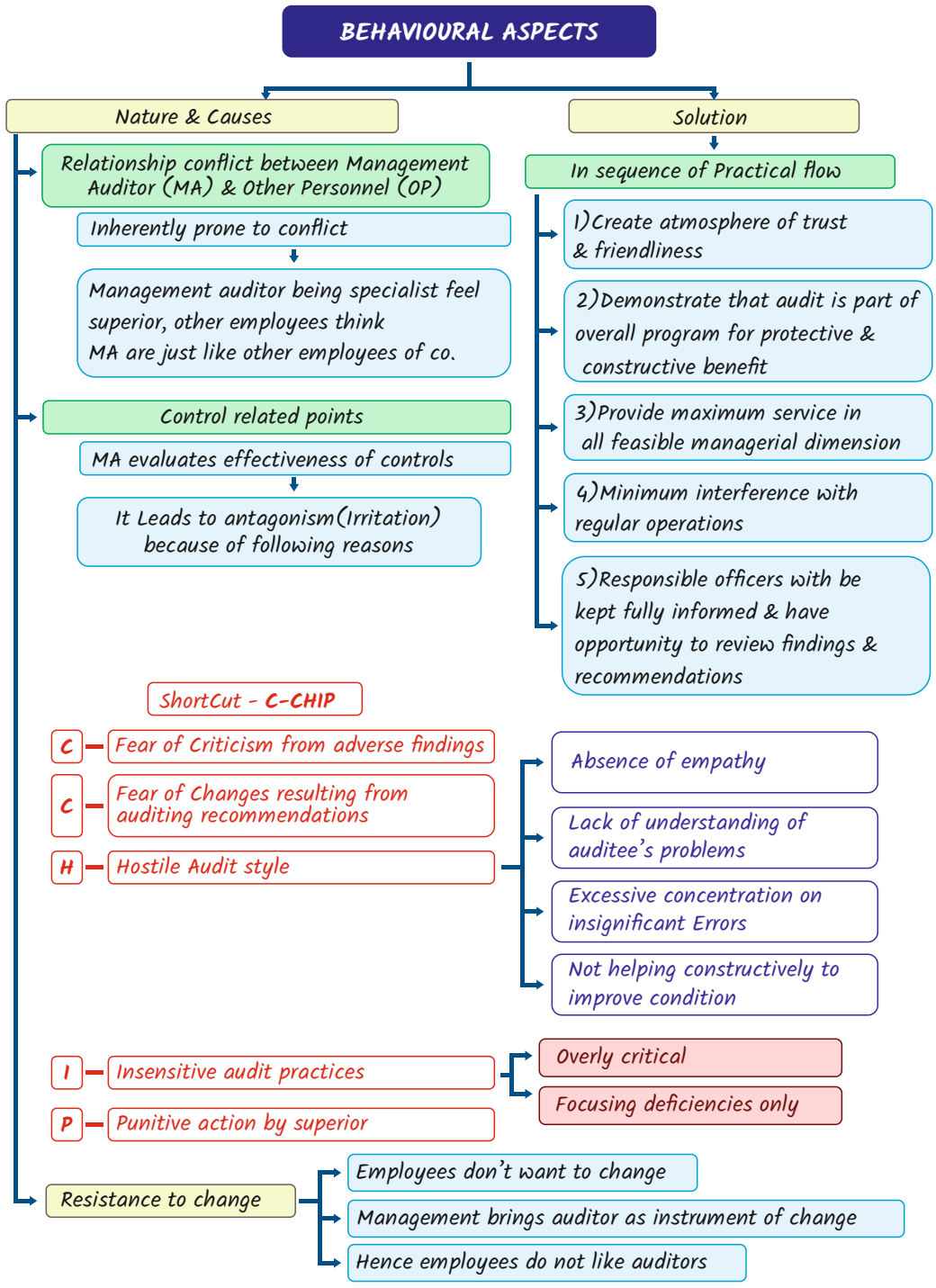
Steps to Prepare the Management Audit Report

(QNO – 609.500)

- ***Planning the Audit Report*** – Before starting the report, the auditor should ask himself, "What do I want to tell the reader about this audit?" The answer will enable him to communicate effectively.
- ***Supporting information*** – The management auditor should supplement his report with appropriate audit evidence which sufficiently and convincingly supports the conclusions.
- ***Preparing draft report*** – Before writing the final report, the auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his report. It would also indicate whether there is any superfluous information or a gap in reasoning.
- ***Writing and issuing the final report*** – The final report should be written only when the auditor is completely satisfied with the draft report. The head of the management auditing department may review and approve the final report. Before issuing the final report, the auditor should discuss conclusions and recommendations at appropriate levels of management. The report should be duly signed and dated.
- ***Follow-up of the audit report*** – The management auditor should review whether follow-up action is taken by management on the basis of his report. If no action is taken within a reasonable time, he should draw management's attention to it.
- ***Action / Response of Management on Audit Report:*** Where management has not acted upon his suggestions or not implemented his recommendations, the auditor should ascertain the reasons thereof. In cases where he finds that non-implementation is due to a gap in communication, he should initiate further discussions to bridge such gaps. The actions and responses to the Management Audit Report reflect management's attitude to the audit. In any case, the auditor to retain the usefulness of the audit function should ascertain from the management, preferably in writing, the reasons for non- implementation. It is possible that because of change in circumstances, the audit observation did not require any action on the part of the management. The auditor should satisfy himself on the appropriateness of such reasons as well to close the issue.

(CNO—MA.040) BEHAVIOURAL ASPECTS (QNO-611.000 / / 611.500 / 612.000)

Chart



Causes

- **Staff/Line conflict: -**
  - Management auditors are staff people, while the members of other departments are line people.
  - Management auditors has superiority complex and they may think that their approach and solutions are the only answers.
  - Staff do not consider the line before advising, as a result Line may not use advise of staff properly.
  - Line does not co-operate with staff and do not provide sufficient information to staff.

- **Change in Control: -**
  - The management auditor is expected to evaluate the **effectiveness of controls,** there is an instinctive reaction from the auditee that the report of the auditor may affect them.
  - There is **fear** that his actions based on the management audit report will affect the line

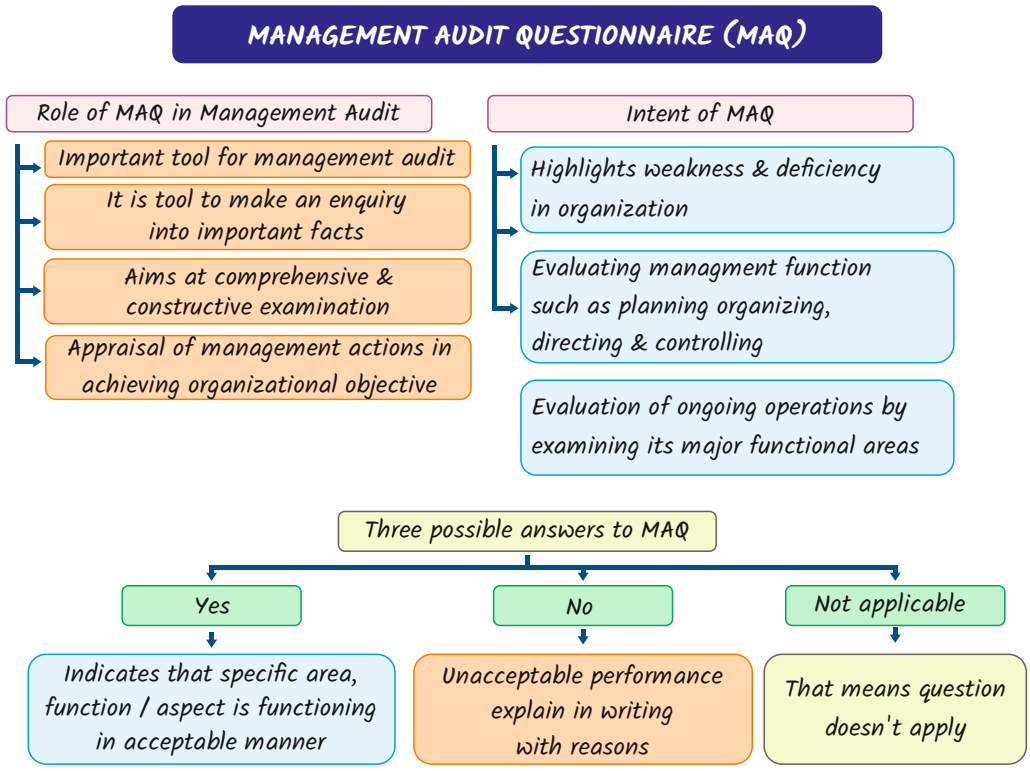
people. The causes are as under;

- Fear of **criticism stemming from adverse audit findings.**
- **Fear of changes** in day-today working habits because of changes resulting from audit recommendations.
- **Punitive action** by superiors prompted by reported deficiencies.
- **Hostile audit style.**

Solution to behavioral problems

- Demonstrate that audit is part of an **overall programme of review for protective and constructive benefit** 2
- Demonstrate the objective of the review is to **provide maximum service** in all feasible managerial dimensions. 3
- Perform the review to ensure with **minimum interference with regular operations** of the operating personnel. 4
- Involve the **responsible officers will be kept fully informed** and have an opportunity to review findings and recommendations **before any audit report is formally released.** 5
- Create an **atmosphere of trust and friendliness.** 1

(CNO—MA.060) MANAGEMENT AUDIT QUESTIONAIRE (MAQ) (QNO – 609.000)



- ***Introduction: –***
  - A management audit questionnaire is an important tool for conducting the management audit.
  - Through these questionnaires' auditors make an inquiry into important facts by measuring current performance.

- ***Objectives: –***
  - Comprehensive and Constructive **examination of an organization's** management and its assigned tasks.
  - **Appraisals of management actions** in accomplishing the organizations objectives.
  - Highlights **Weakness and Deficiencies** of the organization.
  - Review of management functions of planning, organizing, directing, and controlling.
  - Evolution of effectiveness of decision-making process in accomplishing the organization objectives.

- **Working:-**
  - There are three possible answer in management audit questions "YES, NO and N.A.".
  - "YES" answer indicates that the specific area or function under study is functioning in an acceptable manner, no written explanation needed in that case.
  - 'NO' answer indicates unacceptable performance and requires explanation in writing.
  - Those questions which are unacceptable and shall be ignored in the audit are checked in the N.A. column.

- **Importance:-**

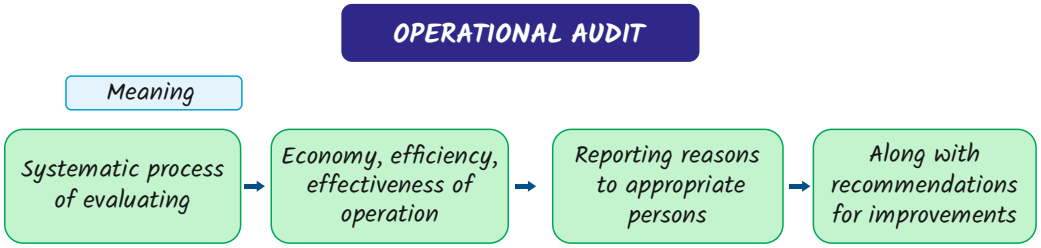
  It not only serves as a management tool to analyze the current situation; but also, it enables the management auditors to identify the elements that are causing organizational difficulties and deficiencies.

Unique Question	
QNO 617.050	Management Audit or the Operational Audit -penal interest payments and the delays in shipping
QNO 619.010	Decreasing Operating Efficiency
QNO 621.000	Working Capital Crunch
QNO 621.300	Review of Systems & Procedures (How to Review ?)

UNIQUE MCQS (Related to Management Audit)	
MCQ No.	IA.33

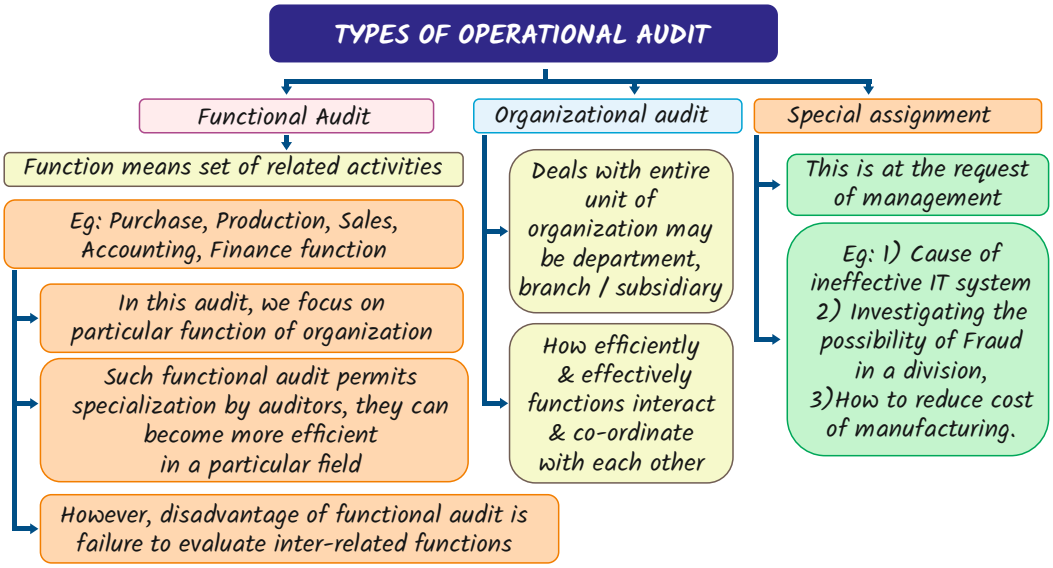
(CNO—OA.020) OPERATIONAL AUDIT

Chart



Meaning (QNO-620.000)

- Operational auditing is a ***systematic process*** involving logical, structured and organized series of procedures.
- It is the review and appraisal of operations of an organization conducted by ***competent Independent Person.***
- It is regular ***operations like production, purchase, sales etc.*** to check whether they are tune with the company's policies, objectives and goal or not.
- It focuses ***qualitative operational aspects rather than regular accounting aspects.***



Types of Operational Audits: - (QNO-615.000)

- ***Functional Audits: -***
  - Functional audit deals with one or more functions in an organization, for example the ***payroll function for a division or for the company as a whole.***
  - A functional audit has the advantage of permitting specialization by auditors. They can more efficiently spend all their time auditing in that area.
  - A disadvantage of functional auditing is the ***failure to evaluate interrelated functions.***

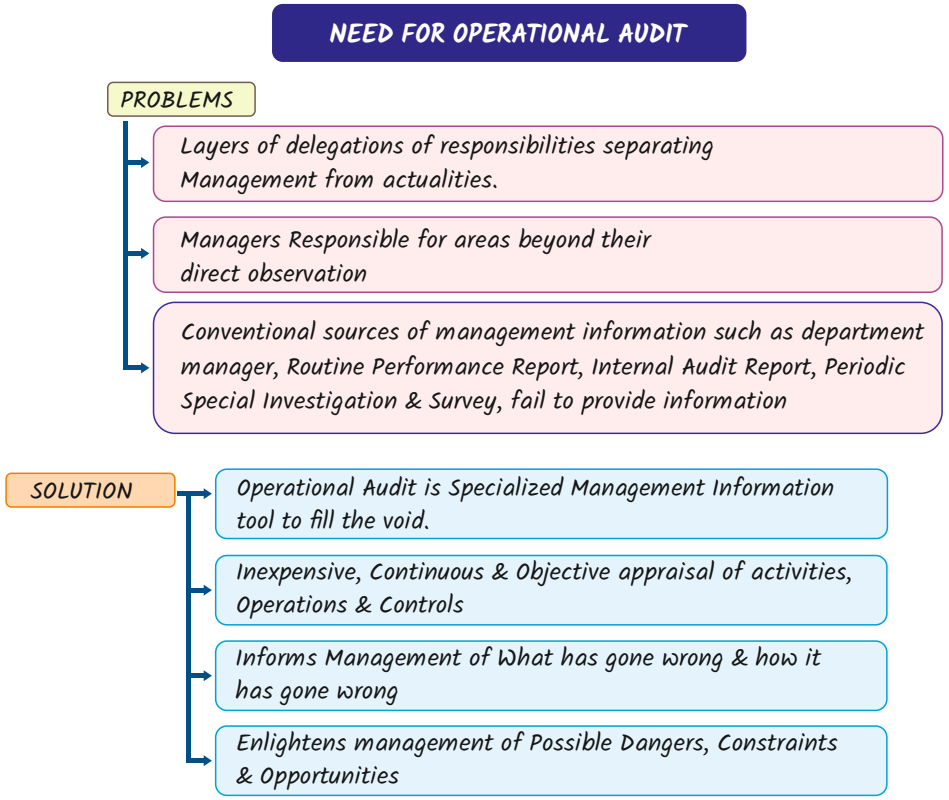
- ***Organizational Audits: -***
  - An operational audit of an organization deals with an entire organizational unit, such as a department, branch, or subsidiary.
  - It emphasizes how ***efficiently and effectively functions interact.*** The plan of organization and the methods to coordinate activities are especially important in this type of audit.

- ***Special Assignments: -***

  In operational auditing, special assignments arise at the request of management. Examples include determining the cause of an ***ineffective IT system,*** investigating the ***possibility of fraud in a division,*** and making recommendations for reducing the ***cost of a manufactured product.***

OBJECTIVES AND SCOPE OF OPERATIONAL AUDIT

(CNO—OA.040) NEED OF OPERATIONAL AUDIT (QNO-615.050)



Inadequacy of Traditional Sources 2

Conventional sources of management information are departmental managers, routine performance report, internal audit reports, and periodic special investigation and survey. These conventional sources fail to provide information for the best direction of the departments all of whose activities do not come under direct observation of managers.

The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company.

Management is at distance & there are many layers of Delegation 1

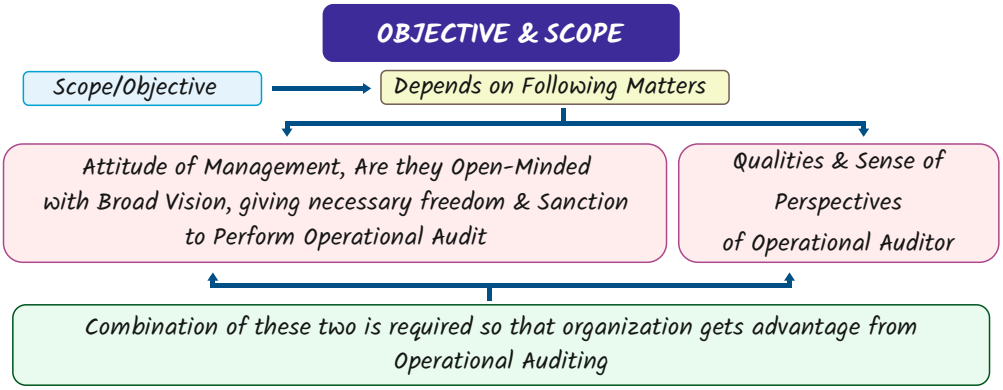
Where the management is at a distance from actual operations due to **layers of delegation of responsibility, separating it from actualities in the organisation.**

Specifically, operational auditing arose from the need of managers responsible for **areas beyond their direct observation** to be fully, objectively and currently informed about conditions in the units under control.

Specialised Management Information Tool 3

Operational audit is considered as a specialized management information tool to fill the void that conventional information sources fail to fill.

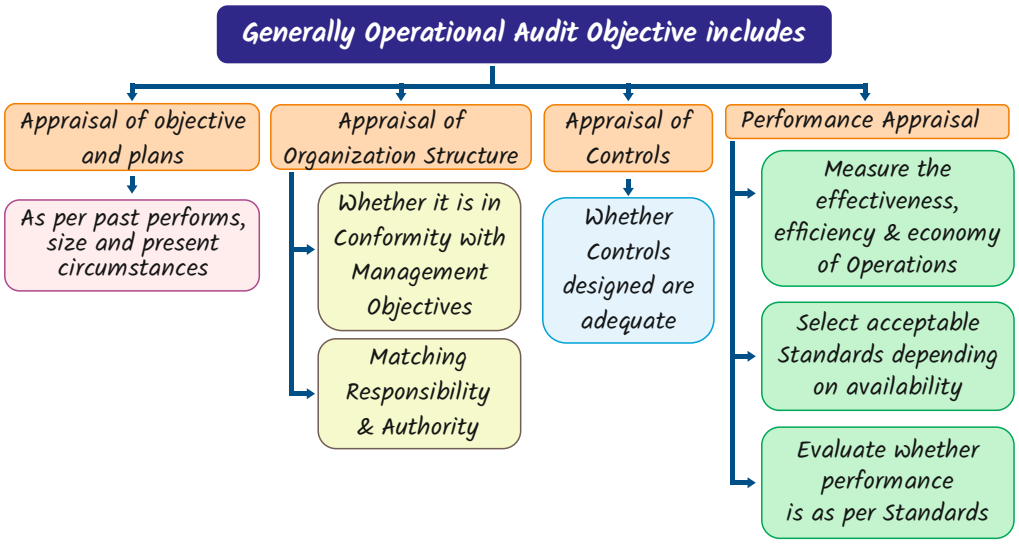
(CNO—OA.060) OBJECTIVE



- ***Appraisal Activity***

  Operational auditing has filled a very significant vacuum; it has come to provide the management with inexpensive, continuous and objective appraisal of activities, operations and controls to inform the management about achievement of standards and, if otherwise, to inform the management about what has gone wrong and how it has gone wrong. Also, it enlightens the management about possible dangers, constraints and opportunities that may be of immense value to the management.

(CNO—OA.080) SCOPE DEPENDS ON MANAGEMENT ATTITUDE (QNO-614.000)



The scope and quality of operational auditing is predominantly dependent upon management attitudes. An open-minded management with broad vision, can appreciate the need of operational auditing and to give it the necessary freedom and sanction to perform what it is capable of performing. Also, the qualities and the sense of perspectives of the operational auditor can mould operational audit in the right shape. Without a combination of these two, operational auditing may not be able to show its distinctively and advantages to the organisation. Therefore, there is a possibility of operational auditing having different objectives to fulfil in different organizations.

Generally, operational audit objectives include:

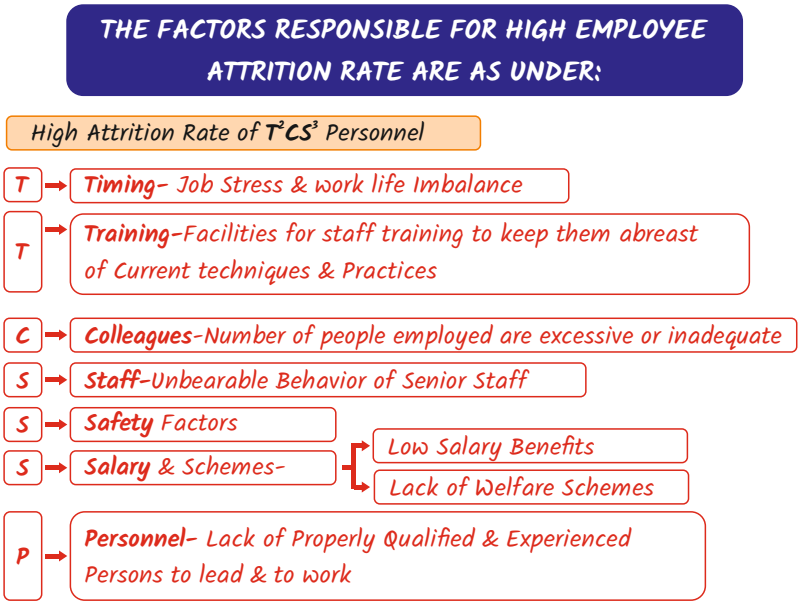
- ***Appraisal of organizational structure:*** *– In evaluating organizational structure, the operational auditor should consider whether the structure is in conformity with the management objectives and it is drawn up on the basis of matching of responsibility and authority. (Packing Department / Dispatch Department / Delivery Department)*

- ***Appraisal of controls:*** *– Operational auditing deals with the administration controls and its purpose is to determine whether the controls are adequate. (System to track delivery of goods ordered online)*

- ***Appraisal of objectives and plans:*** *– In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but accumulating information and evidence to measure the **effectiveness, efficiency and economy** with which the operations are being carried on. (Comparison with what others do, what we promised, cost involved)*

- ***Evaluation of performance:*** *–*
  - *In the task of performance evaluation, an operational auditor is heavily dependent upon availability of **acceptable standards**.*
  - *The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise.*
    (How many parcels returned, average delivery time to various regions)

(CNO—OA.120) CAUSES OF HIGH ATTRITION RATE (QNO-619.000)



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

(Safety)

- Safety factors (Office is at remote location, prone to thefts)

(Timings)

- Job Stress & work life imbalance (12 hours of work & 3 hours of travel, 6 hours of sleep, 2 hours of routine work, 1 hour for family)

(Trainings & Work Culture)

- Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?(Outdated work culture, Using Type Writer)

(Seniors)

- Whether the organization has properly qualified and experienced personnel for the various levels of works? (Inexperienced seniors & HRs)
- Unbearable behaviour of Senior Staff (Shouting & Abusing)

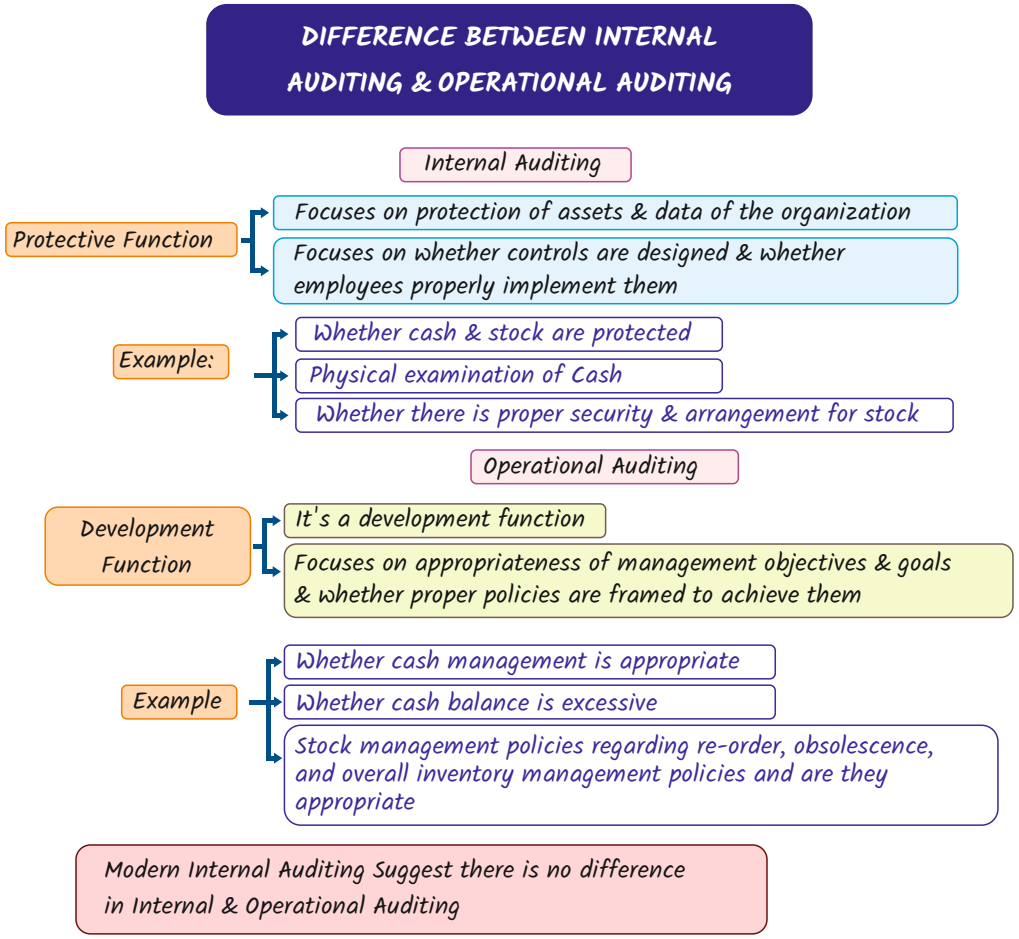
(Colleagues)

- Is the number of people employed at various work centre's excessive or inadequate? (Excess Staffing or Understaffing leading to strain on few)

(Salary & Schemes)

- Low monetary benefits(Salary 30-40% lower than market)
- Lack of labour welfare schemes(No Development & Encouragement)

(CNO—OA.140) DIFFERENCE BETWEEN VARIOUS TYPES OF AUDIT (QNO-617.010/620.000)



(a)Difference between Internal & Operational Audit: *There probably may not be much of difference in viewing operational audit as a review and appraisal of operations of an organization carried on by a competent independent person. Auditing whether carried on by an internal staff or by an external person, should necessarily be an independent activity to maintain its objectivity and usefulness.*

The difference in the approach of both these audits is illustrated below:

- ***Perception related to Internal Audit*** *–Traditionally, internal auditors have been engaged in a sort of* ***protective*** *function, deriving their authority from the management. They view and examine internal controls in the* ***financial and accounting*** *areas to ensure that possibilities of loss, wastage and fraud are not there; they check the accounting books and records to see, whether the internal checks are properly working, and the resulting accounting data are reliable.*

  For example *- when the auditor looks into the vouchers to see whether they corroborate the entries in the cash book or physically examines the cash in hand, he is doing his traditional protective function. The moment he concerns himself to see whether customers' complaints are duly attended to or whether cash balance is excessive to the need, he comes to the operational field.*

  Also, he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would be interested in such matters as reorder policy, obsolescence policy and the overall inventory management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

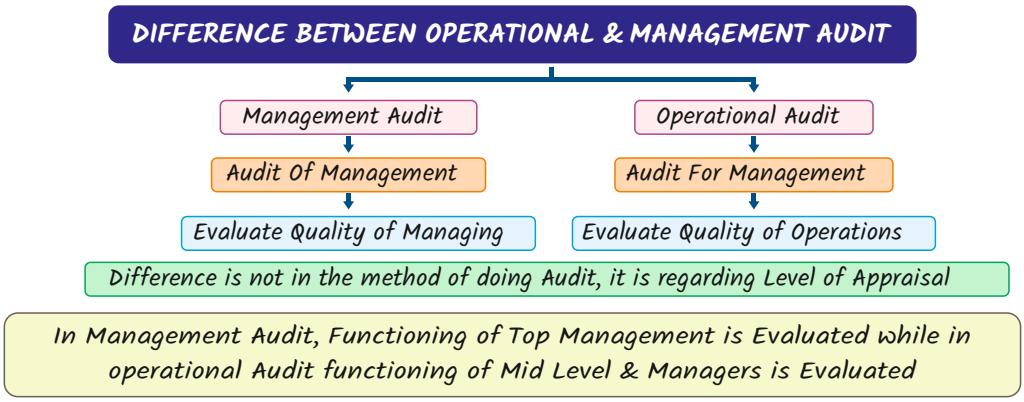
- ***Issues related to Internal Audit*** *–The basic difference that exists in Conceptualization of the technique of operational auditing is in the* ***auditor's role in recommending corrections or in installing***

systems and controls. *According to Lindberg and Cohn, such a situation would be in conflict with the role of operational auditor. In this connection, the views of the Institute of Internal Auditors, in the context of internal audit are relevant. According to that Institute, "the internal auditor should be free to review and appraise policies, plans, procedures and records; but his review and appraisal does not in any way relieve other persons in the organization of the responsibilities assigned to them. However, a further distinction should be observed between traditional internal auditing and operational auditing - this lies in the attitude and approach to the whole auditing proposition. Every aspect of operational auditing programme should be geared to management policies, management objectives and management goals.*

- ***Objectives related to operational Audit****–The main objective of operational auditing is to verify the* ***fulfilment of plans and sound business*** *requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects and grasp technical matters. In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues. The norms and standards should be such as are generally acceptable or developed by the company itself. Performance yardsticks can be found in the management objectives, goals and plans, budgets, records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, association and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments.*

For Example: *The standards relating to objectives for a government company are quite different from those of a private sector company. Similarly, standards of performance of a well-equipped company which also adequately looks after the well-being of employees may be significantly different from a company which offers scanty welfare facilities or is ill-equipped.*

Today, however, the concept of ***modern internal auditing suggests that there is no difference in internal and operational auditing.*** *In fact, the scope of internal auditing is broad enough to embrace the areas covered by operational auditing as well. The modern internal auditing performs both protective as well as constructive functions.*



b) Difference between Management Audit & Operational Audit

- Management audit is concerned with the "Quality of managing", whereas operational audit focuses on the "Quality of operations".
- Management audit is the **"Audit of management"** while operational audit is the **"Audit for the management"**.

The basic difference between the two audits, then, is not in method, but in the level of appraisal. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfilment of plans in conformity with the prescribed policies

DIFFERENCE BETWEEN FINANCIAL & OPERATIONAL AUDITING

Purpose	In Financial Audit purpose is to give opinion; Whether they give True & Fair View
	In Operational Auditing, purpose is to evaluate all the activities regarding Economy, Efficiency & Effectiveness
Focus Area	FST is Focus Area
	All Operating Activities is Focus Area
Report	Report Is sent to all Stakeholders, it is Public Document
	Report is primarily for Management, Its Confidential Document
Suggestions	In Financial Audit we don't give any suggestions to management
	In Operational Audit we give suggestions to management

(c) Differences between Financial and Operational Auditing –The major differences between financial and operational auditing can be described as follows:

- **Purpose** – The financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes on effectiveness and efficiency of operations for future performance.
- **Area** – Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization.
- **Reporting** –The financial audit report is sent to all stockholders, bankers and other persons having stake in the Organization. However, the operational audit report is primarily for the management.
- **End Task** – The financial audit has reporting the findings to the persons getting the report as its end objective; however, the operational auditing is not limited to reporting only but includes suggestions for improvement also

Unique Question	
QNO 615.030	Operational Audit – One time Activity and employee Hostility
QNO 621.350	Review of Systems & Procedures (Whether it fulfills current requirements?
QNO 621.400	Personal Qualities of Operational Auditor

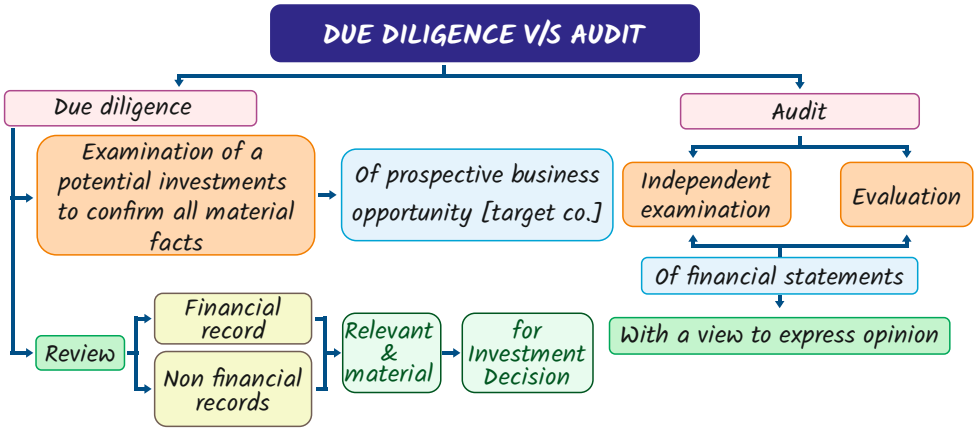
UNIQUE MCQS (Related to Operational Audit)	
MCQ No.	IA.11/IA.12/IA.13 / IA.37

Students Notes

16 DUE DILIGENCE, INVESTIGATION AND FORENSIC AUDIT

PART – I DUE DILIGENCE

(CNO—DD.020) DUE DILIGENCE VS AUDIT (QNO-621.500) (MCQ – DD.11/ DD.16)



Due diligence is different from audit

It needs be underlined that due diligence is different from audit.

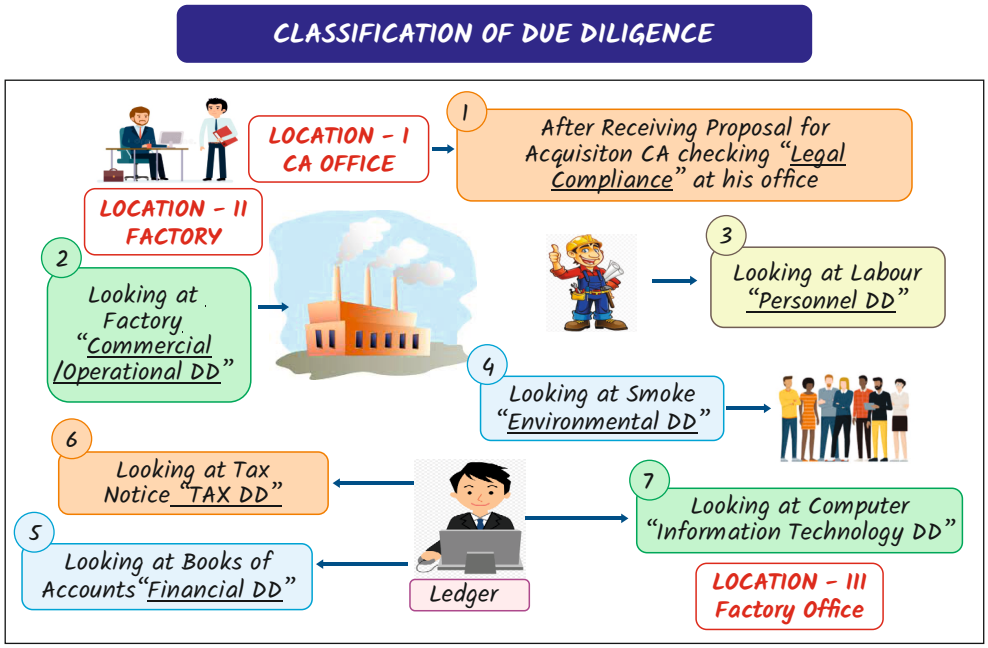
- Audit

  Audit is an independent examination and evaluation of the financial statements on an organization with a view to express an opinion thereon.

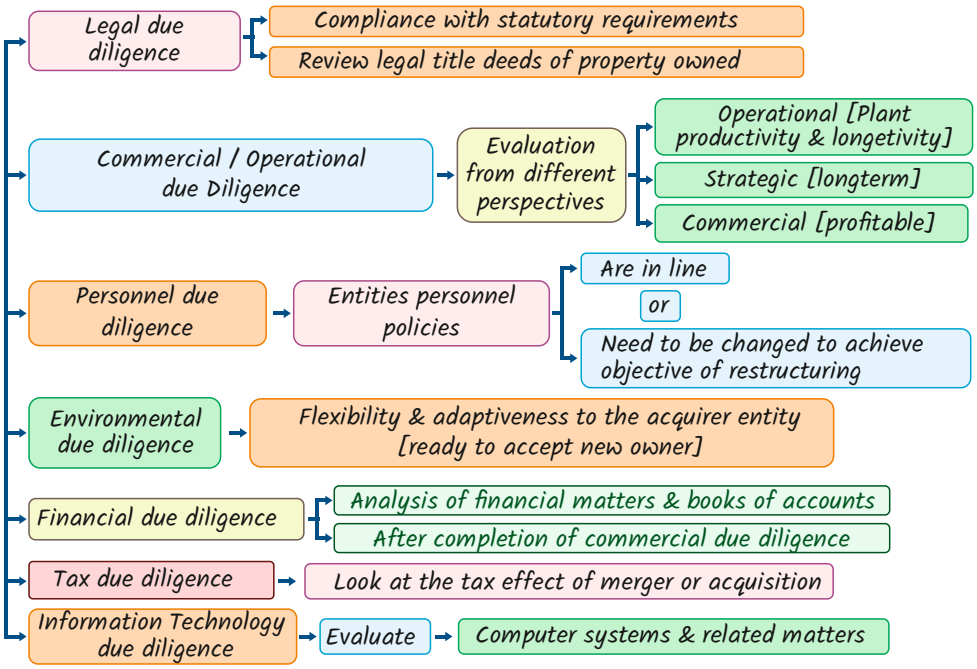
- Due Diligence

  Whereas due diligence refers to an examination of a potential investment to confirms all material facts of the prospective business opportunity. It involves review of financial and non-financial records as deemed relevant and material. Simply put, due diligence aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party.

(CNO—DD.040) CLASSIFICATION OF DUE-DILIGENCE (QNO-622.000) (MCQ-Incs.22.1)



Continue on next Page...



Legal due diligence

Areas in which Due Diligence can take place –

This may be required where legal aspects of functioning of the entity are reviewed. For example, the legal aspects of property owned by the entity or compliance with various statutory requirements under various laws.

Commercial / operational due diligence

It is generally performed by the concerned acquire enterprise involving an evaluation from commercial, strategic and operational perspectives.

For example, whether proposed merger would create operational synergies.

Environmental due diligence: It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity.

Personnel due diligence

It is carried out to ascertain that the entity's personnel policies are in line or can be changed to suit the requirements of the restructuring.

Personnel due diligence

It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence.

Tax Due diligence

It is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. The accountant has to look at the tax effect of the merger or acquisition.

Information systems due diligence

It pertains to all computer systems and related matter of the entity.

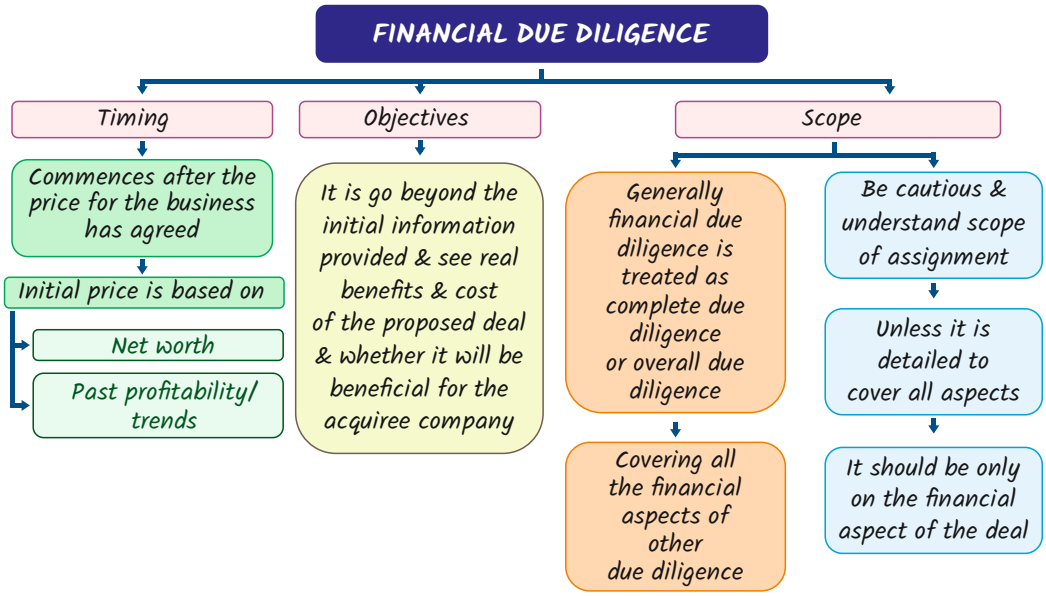
(CNO-DD.060) FINANCIAL DUE DILIGENCE (QNO-623.000/ 628.000) (MCQ-DD.3/ DD.4/ DD.6/ DD.7/ DD.8/ Incs.14.2)

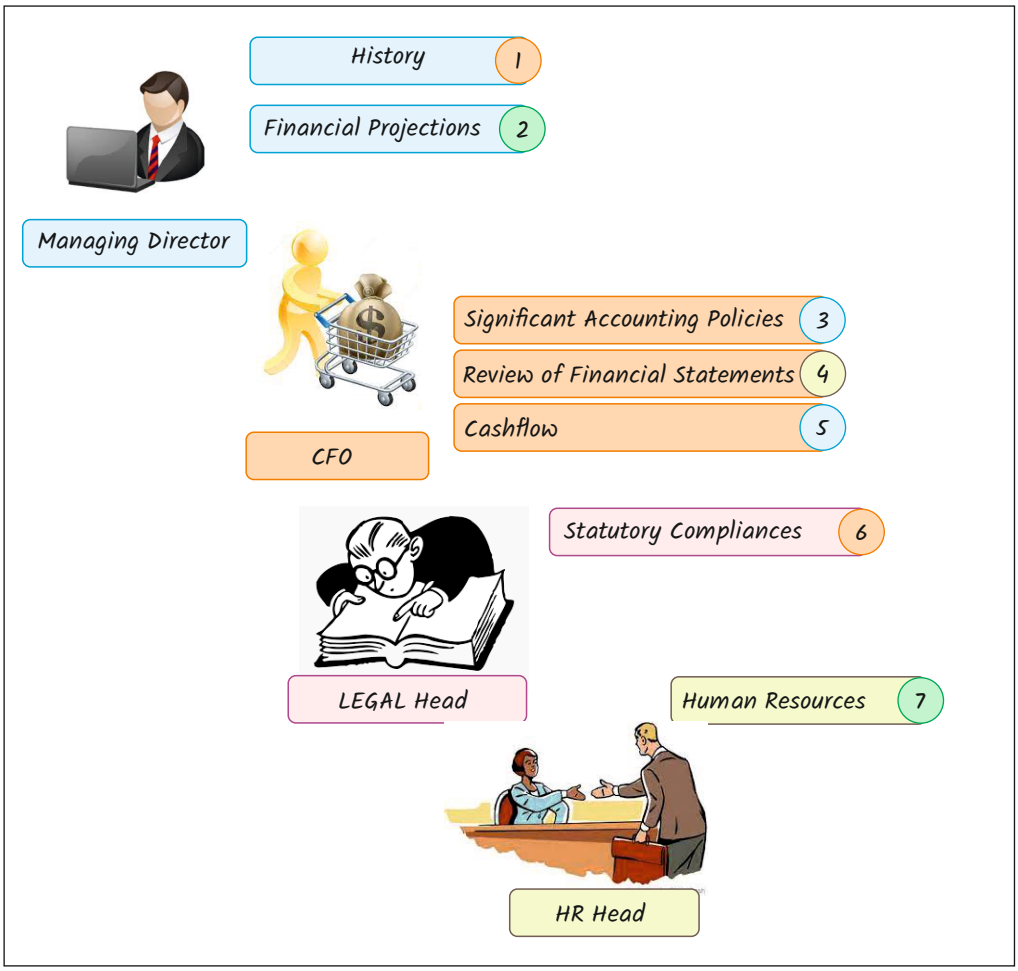
At times, the financial due diligence review is interpreted as complete due diligence review since it is supposed to ascertain the financial implications of all the other due diligence reviews. This is, however, not appropriate. The term 'financial due diligence' should be used with caution. Un less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

It can be understood from the foregoing that the role of financial due diligence commences after a price has been agreed for the business. The initial price and other decisions are taken on the basis of net worth as well

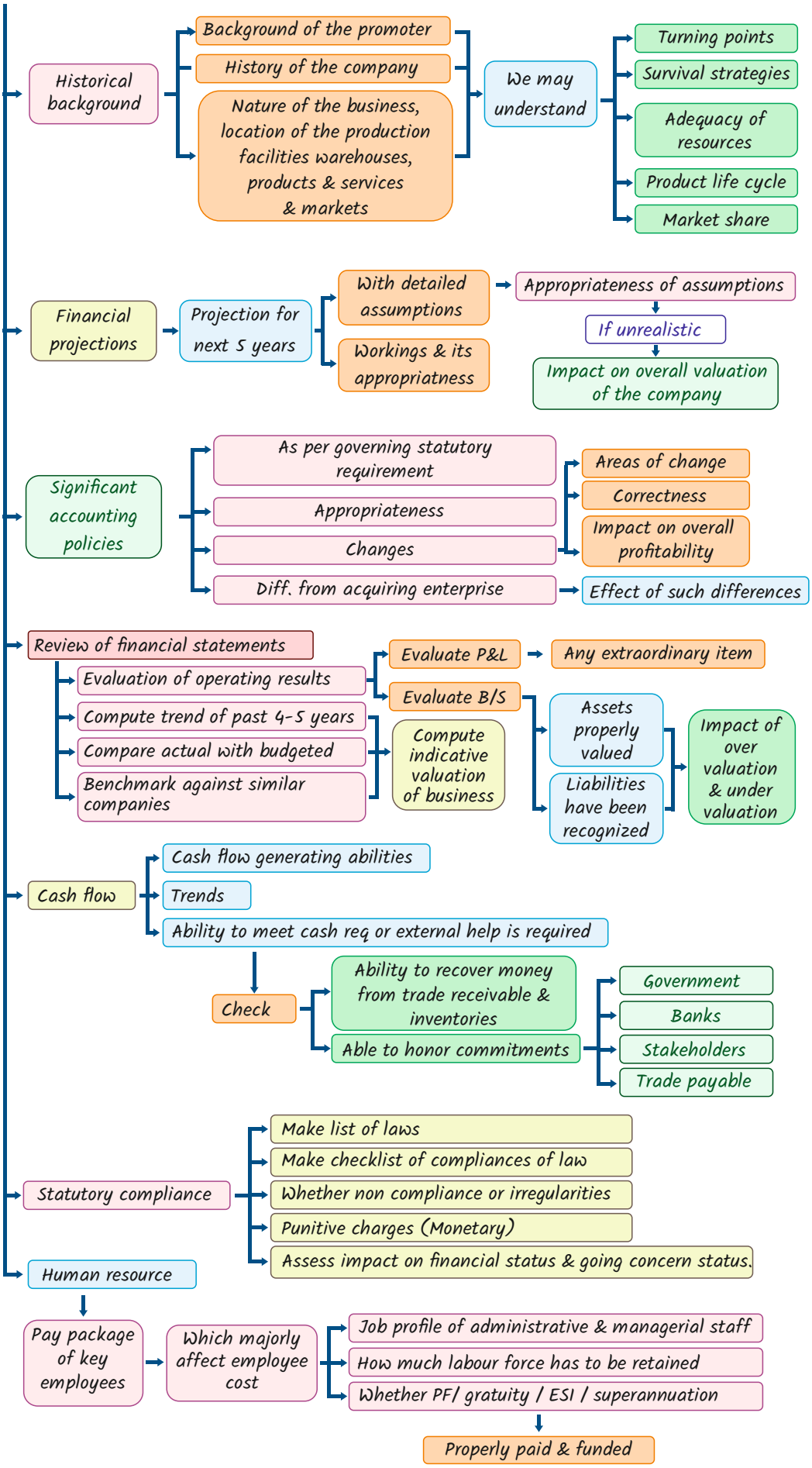
as trend of profitability of the target company, with an assumption that all contingent liabilities that may impact the future of the business have been recorded. The principal objective of financial due diligence, therefore, is usually to look behind the veil of initial information provided by the company and to assess the benefits and costs of the proposed acquisition/merger by inquiring into all relevant aspects of the past, present and future of the business to be acquired/merged with.

Chart





SIGNIFICANT KEY AREAS TO BE COVERED



	Some of the significant key areas which shall be covered under the review are as under:
Historical Background	*The accountant should begin the financial due diligence review by looking into the history of the company and the background of the promoters. The details of how the company was set up and who were the original promoters have to be gone into, before verification of financial data in detail. An eye into the history of the company may reveal its turning points, survival strategies adopted from time to time, the market share enjoyed by and changes therein, product life cycle and adequacy of resources. It could also help the accountant in determining whether, in the past, any regulatory requirements have had an impact on the business of the said company. This could, inter alia, include the nature of business(es), location of production facilities, warehouses, offices, products or services and markets.*
Financial Projections	*The projections for the next five years with detailed assumptions and workings and the appropriateness of assumption used in the preparation and presentation of financial projections. If the accountant is of the opinion that as assumption used by the company are unr ealistic, the accountant should consider its impact on the overall valuation of the company.*
Significant Accounting Policies	*The accounting policies being followed by the company and the appropriateness thereof is another key area. The impact of the recent changes in the accounting policies in the recent past keeping in view its intention of offering itself for sale. The accountant has to look at the main effect of accounting policies on the overall profitability and their correctness. It is also quite important to ascertain significant accounting policies used by the company, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the company are different from those adopted by the acquiring enterprise and the effect of such differences. Finally, examine whether the financial statements of the company have been prepared in accordance with the governing statutory requirements.*
Review of Financial Statements	*An evaluation of the profit reported by the company would be largely based upon its operating results. Any extraordinary item of income or expense that might have affected the operating results would require close examination.* *It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period. It is important that the trading results for the past four to five years are compared and the trend of normal operating profit arrived at. The normal operating profits should further be benchmarked against other similar companies. Besides the above, and based on the trend of operating results, the accountant has to advise the acquiring enterprise, through due diligence report, on the indicative valuation of the business. The exercise to evaluate the balance sheet of the company has to take into consideration the basis upon which assets have been valued and liabilities have been recognized. The net worth of the business has to be arrived at by taking into account the impact of over/under valuation of assets and liabilities.*
Cash Flow	*A review of historical cash flows and their pattern would reflect the cash generating abilities of the company and should highlight the major trends. It is important to know if the company is able to meet its cash requirements through internal accruals or does it have to seek external help from time to time. It is necessary to check:* • *Whether the company is able to honor its commitments to its trade payables, to the banks, to government and other stakeholders;* • *How well is the company able to turn its trade receivables and inventories;* • *How well does it deploy its funds; and* • *Whether any funds are lying idle or is the company able to reap maximum benefits out of the available funds.*

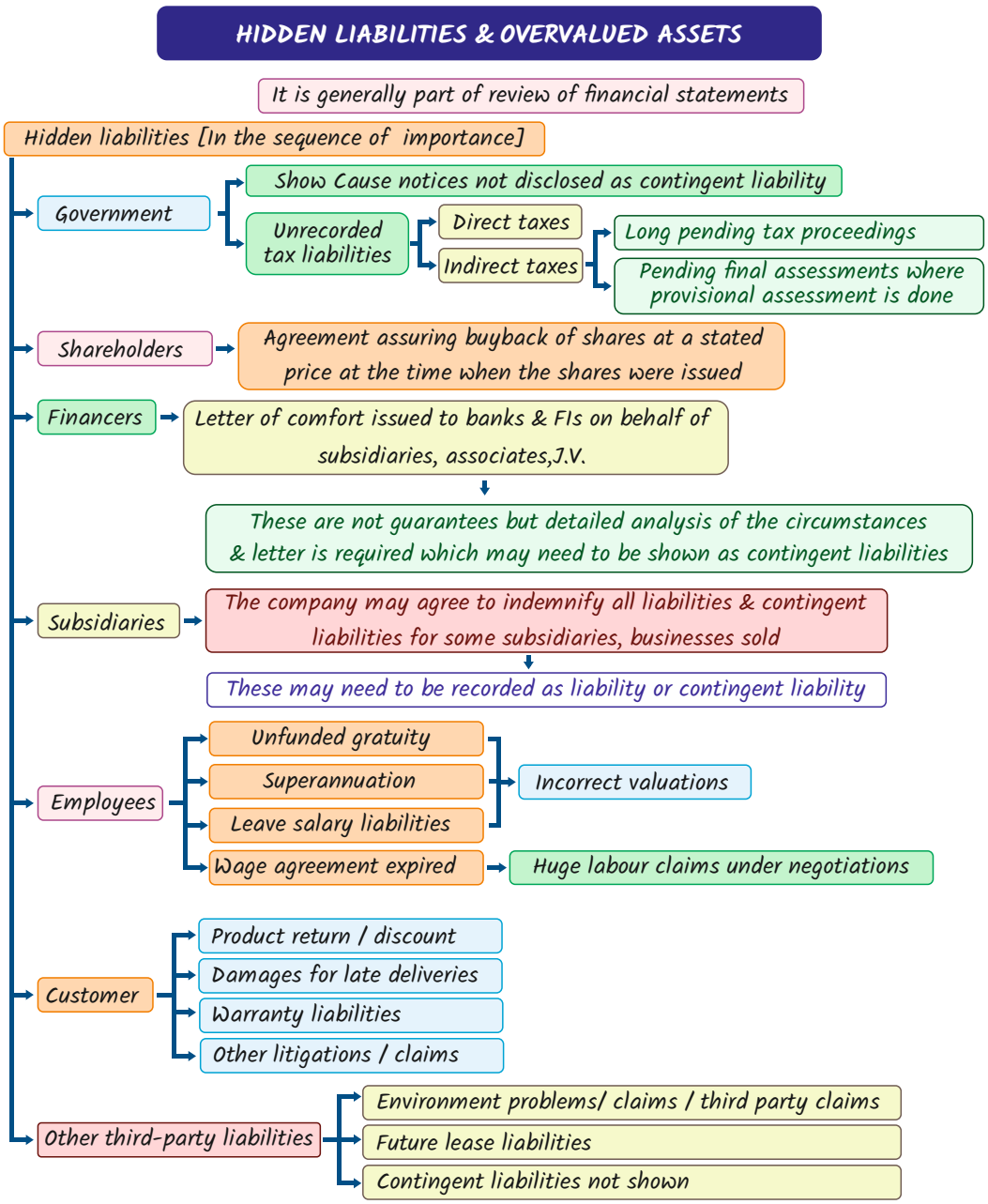
Statutory Compliance (MCQ – Incs.22.3)

This is one area that has to be examined in detail. It is important to make a list of laws that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance, it could lead to punitive charges under the law. The impact on such violations be quantified and assessed in respect of entity; financial status and even on its governing concern status.

Human Resources

In the Indian context, the status of work force, staff and employees is a complex problem. It is important to work out how much of the labour force has to be retained. It is also important to judge the job profile of the administrative and managerial staff to gauge which of these matches the requirements of the new incumbents. The aspects whether all employee benefits like PF, Gratuity, ESI and superannuation have been properly paid/funded. The pay packages of the key employees will be thoroughly reviewed since this can be a crucial factor in future employee costs.

(CNO—DD.100) HIDDEN LIABILITIES AND OVERVALUED ASSETS (QNO-627.000) (MCQ – Incs.14.1)



Different Types

Due diligence is an all-pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter.

Review of Financial Statements

As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review of Financial Statements. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does not involve examination from the viewpoint of extraordinary items, analysis of significant deviations, etc.

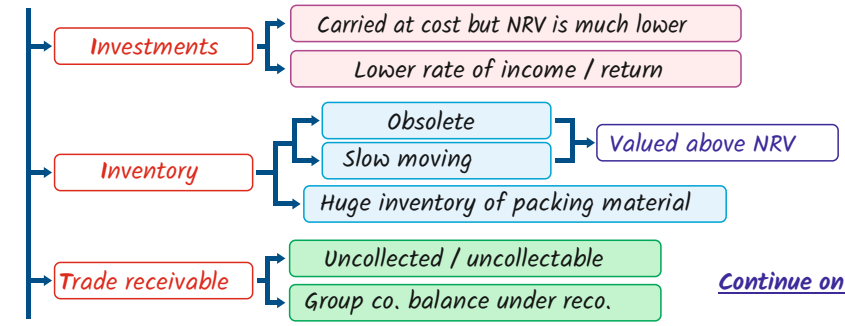
Hidden Liabilities

However, in order to investigate hidden liabilities, the auditor should pay his attention to the following areas:

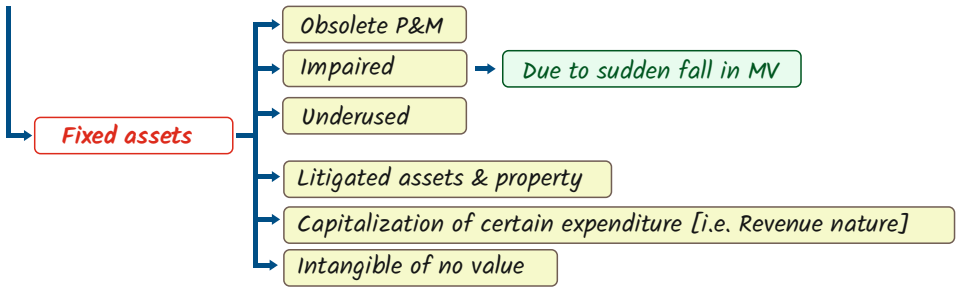
- **Government**
  - The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.1
  - Long pending sales tax assessments.3
  - Pending final assessments of customs duty where provisional assessment only has been completed.4
  - Tax liabilities under direct and indirect taxes.2
- **Share Holders**
  - Agreement to buy back shares sold at a stated price.
- **Financers**
  - The company may have given "Letters of Comfort" to banks and Financial Institutions.
  - Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- **Subsidiaries**
  - The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- **Employees**
  - Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
  - Huge labour claims under negotiation when the labour wage agreement has already expired.
- **Customer**
  - Product and other liability claims; warranty liabilities; product returns/ discounts; liquidated damages for late deliveries etc. and all litigation.
- **Other Third-Party Liabilities**
  - Environmental problems/claims/third party claims.
  - Future lease liabilities.
  - Contingent liabilities not shown in books.

REGULARLY OVERVALUED ASSETS

Shortcut :- **IIT** says **Fixed assets** are overvalued



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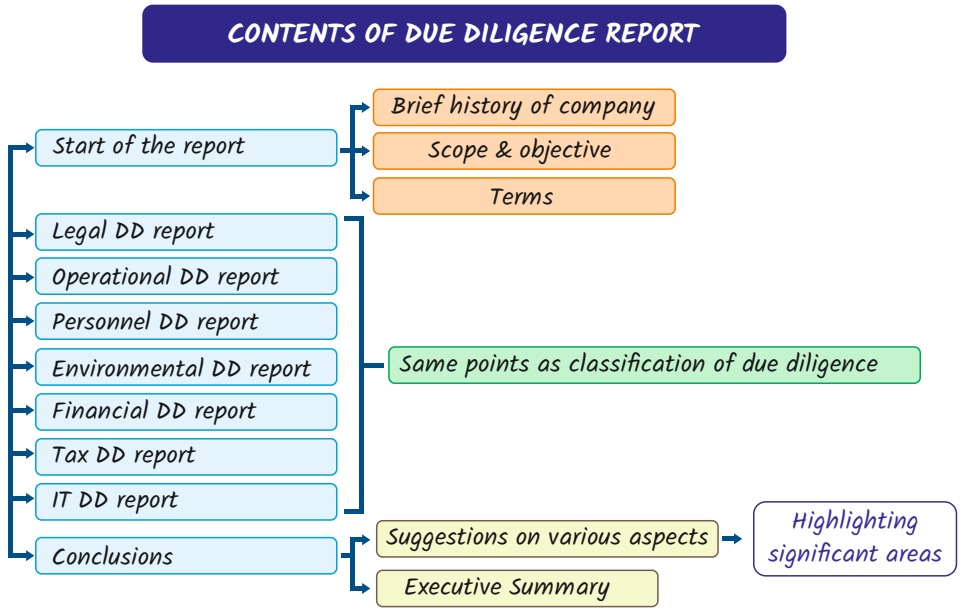


Regularly Overvalued Assets

The auditor shall have to specifically examine the following areas:

- Fixed Assets
  - **Underused or obsolete** Plant and Machinery and their spares; 1
  - Asset values which have been **impaired due to sudden fall in market value etc.** 2
  - Assets carried at much more than current market value due to **capitalization of expenditure/foreign exchange fluctuation, Capitalization of expenditure mainly in the nature of revenue.** 4
  - Litigated assets and property. 3
  - Infructuous **project expenditure/deferred revenue expenditure etc.** 5
  - **Intangibles of no value.** 6
- **Investments**
  - Investments **carried at cost** though realizable value is much lower.
  - Investments carrying **a very low rate of income / return.**
- **Inventory**
  - **Obsolete,** slow non-moving inventories or inventories valued above NRV; **huge** inventories of packing materials etc. with name of company.
- **Trade Receivables**
  - Uncollected / uncollectible receivables.
  - Group Company balances under reconciliation etc.

(CNO—DD.120) CONTENTS OF A DUE DILIGENCE REPORT (QNO-628.000)



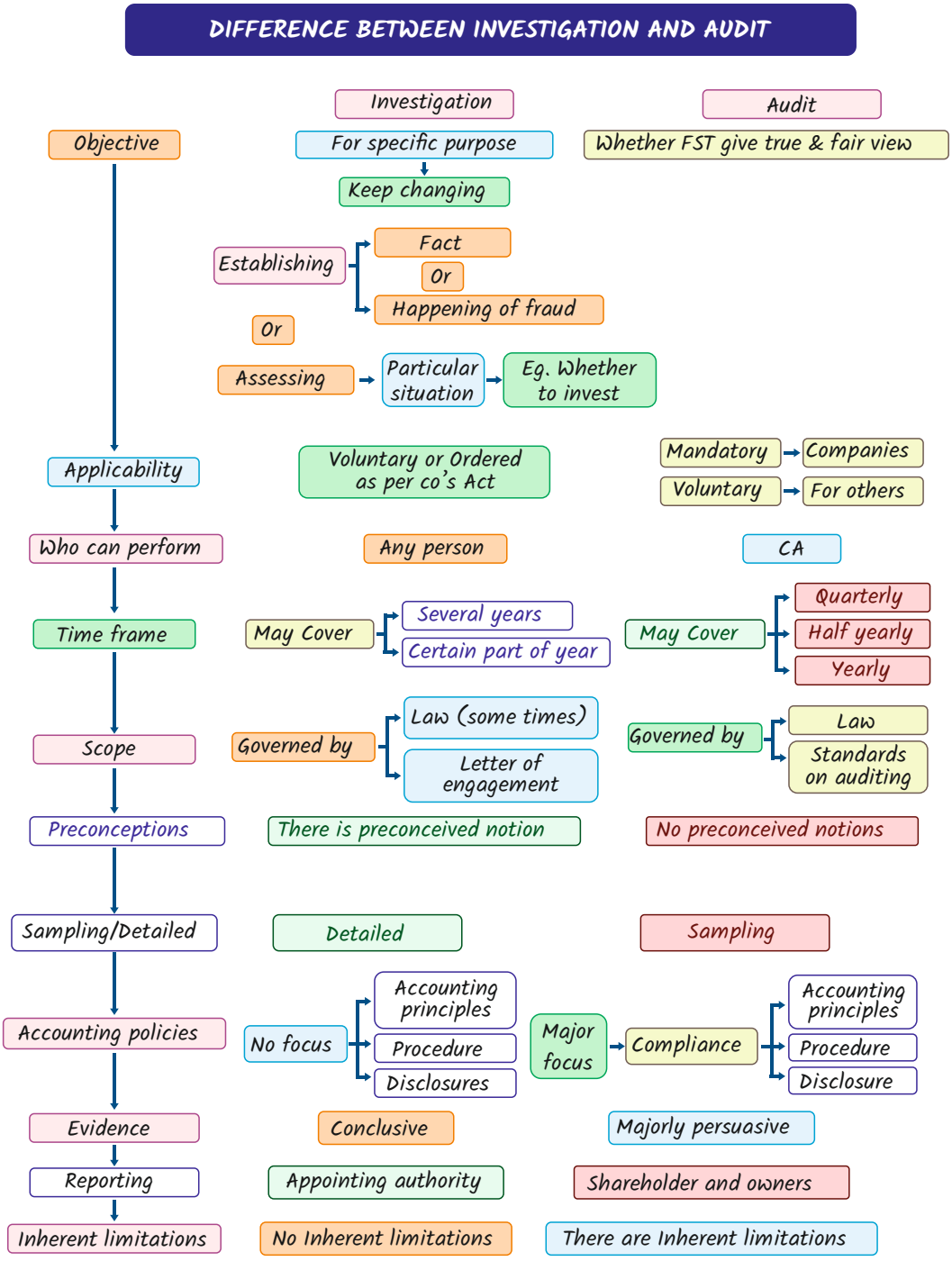
UNIQUE MCQS

MCQ No Incs.22.2 / Incs.22.4

Part – 2 INVESTIGATION

(CNO--INTG.020) INVESTIGATION & HOW IT IS DIFFERENT FROM AUDIT? (QNO-632.000, 643.030)

Chart



Auditing

It involves examination of financial information contained in financial statements to express an opinion whether or not the same have been prepared properly. In essence, auditing involves independent examination of financial information prepared by the management of an entity.

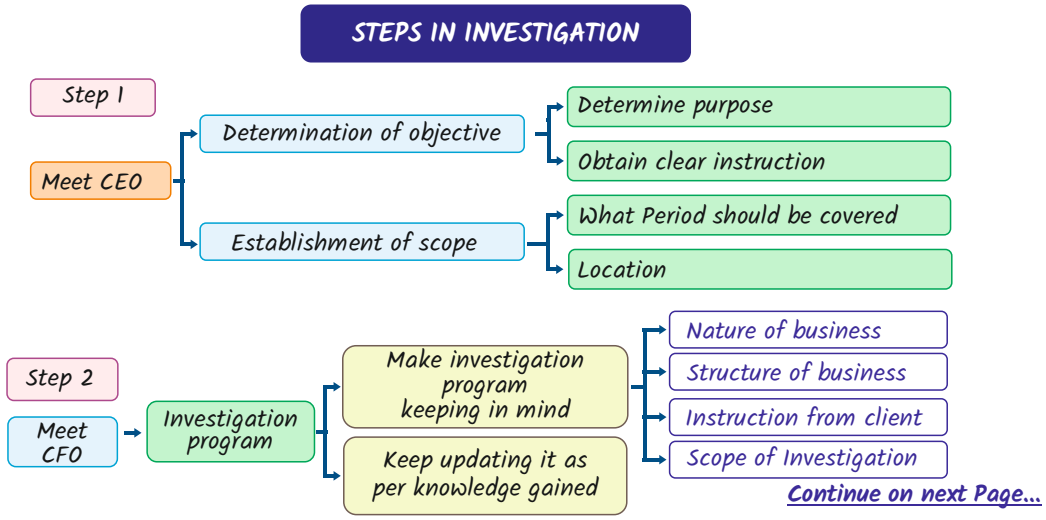
Investigation

- It implies systematic, critical and special examination of the records of a business for a specific purpose.
- The examination conducted under investigation is intensive as well as exhaustive so far as the activities or areas of accounting is concerned.
- Investigation requires a concentrated focus on the subject matter of inquiry and related matters.

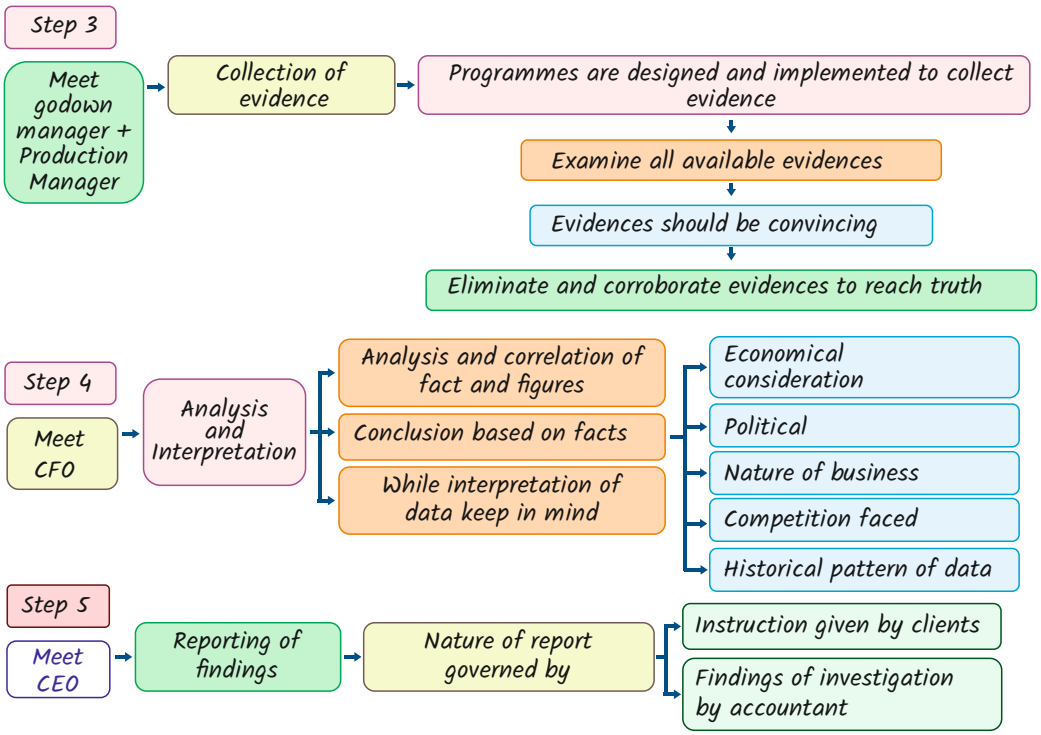
› **How Investigation is different from audit? OR Difference between Investigation and Audit?**

Basis	Investigation	Audit
Objective	It aims at **establishing a fact or a happening or at assessing a particular situation**	To verify whether the financial statements **display a true and fair view** of the state of affairs and the working results of an entity.
Legal Requirement	Voluntary, in some companies it may be ordered as per LAW	Mandatory for Companies. For others, it is voluntary
Who performs / Conducted by	Any person, who may not be a Chartered Accountant.	A **Chartered Accountant** within the meaning of the Chartered Accountants Act 1949.
Scope	The scope of investigation may be governed by statute OR it may be non-statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.
Time Frame (Period Covered)	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain	The audit is carried on either quarterly, half-yearly or yearly.
Nature of activities performed	Requires a detailed study and examination of facts and figures	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion
Evidence	It seeks conclusive evidence	Audit is mainly concerned with prima-facie evidence (Persuasive Evidence).
Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out. (No particular format)	The outcome is reported to the owners of the business Entity. (Format is generally fixed)
Inherent Limitations	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent Limitation.
Pre-Conception	Its essence lies in going into the matter with some pre-conceived notion suited to the objective	Audit is not based on suspicion unless circumstances exist to arouse suspicion

(CNO—INTG.040) STEPS IN INVESTIGATION (How to perform investigation?) (MCQ-DD.1/ DD.2/DD.10)



Continue on next Page...



STEP-1 (CEO)

- ***Determination of objectives & establishments of scope of investigation: -***
  - *The investigation should be absolutely clear about the purpose of Investigation.*
  - *In case of any doubt, it would be proper to discuss the matters with the person on whose behalf it is carried out and obtain clearly written instructions covering the object and the scope of investigations and the issues incidental thereto.*
  - *The period which the investigation should cover should be clearly specified.*

STEP-2 (CFO)

- ***Investigation Programme***
  - *The investigation programme should be drawn up having regard to the nature of the business, the structure of business, the instructions from the client, scope of investigation etc.*
  - *The programme should also be flexible so that knowledge gained with the progress of work can be used to extend, reduce or modify the extent and areas of checking.*

STEP-3 (Godown Manager)

- ***Collection of Evidences***
  - *Investigation requires to perform the procedures as designed in programme so as to collect evidences connected with matter to be investigated.*
  - *The investigator should look for the most convincing evidence; he should seek and examine all the available evidence and by a process of elimination and corroboration, should endeavor to reach at the truth of the matter.*

STEP-4 (CFO)

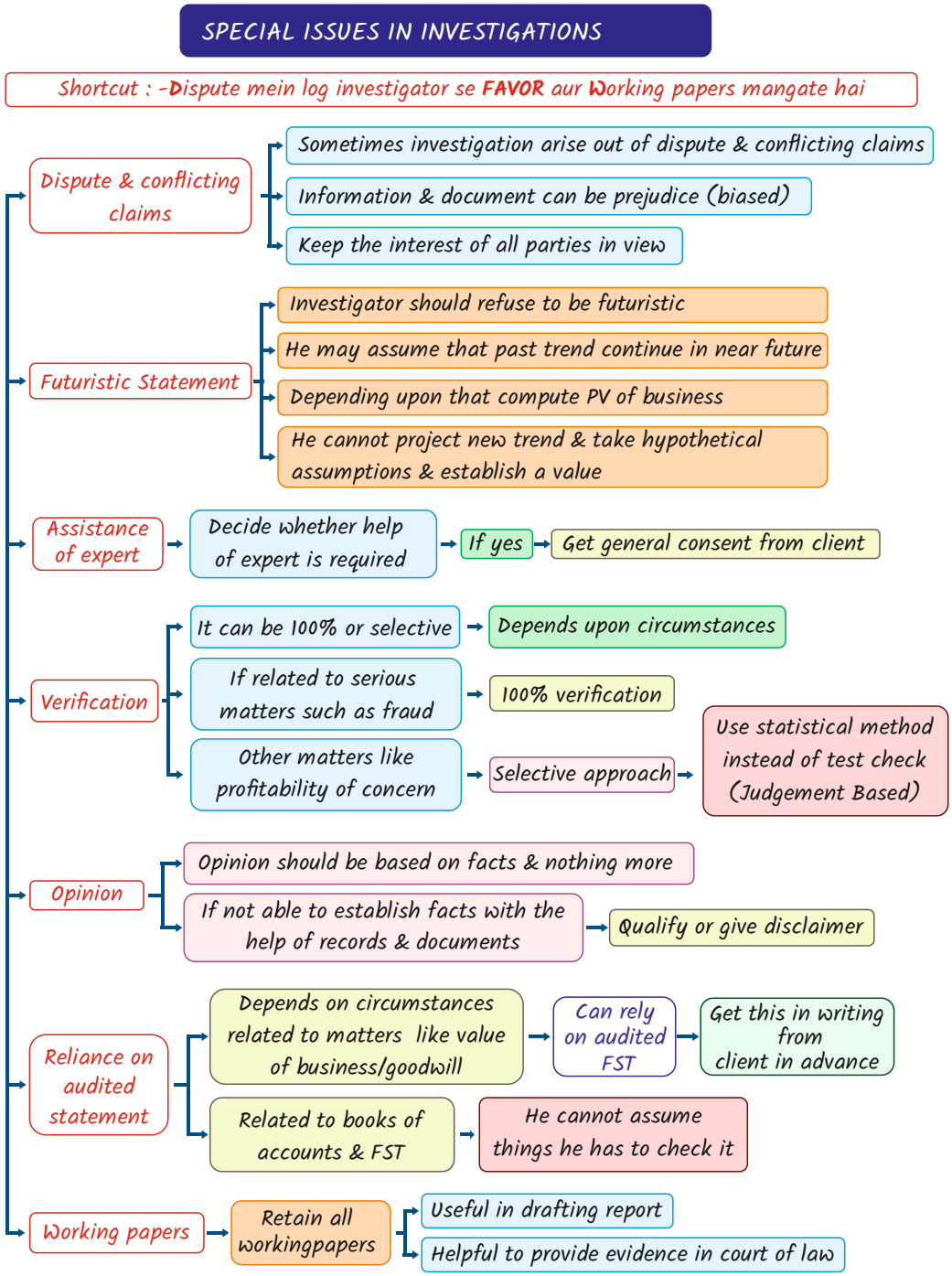
- ***Analysis and Interpretation of Findings***
  - *Before reaching at any conclusion, careful analysis and correlation of facts and figures is required.*
  - *The conclusion should be well reasoned and backed by established facts and data.*
  - *While interpreting the figures, the investigator must keep in mind various factors e.g. the political and economic considerations, competition faced by the business, historical pattern of the data, nature of the business, etc.*

STEP-5 (CEO)

- **Reporting of findings**

The nature of the report is governed mainly by two factors. First, the instructions given by the client as regards the special aspects of the business which are required to be investigated; and second, the findings of the investigating accountant.

(CNO—INTG.060) SPECIAL ISSUES IN INVESTIGATIONS (MCQ-DD.5)



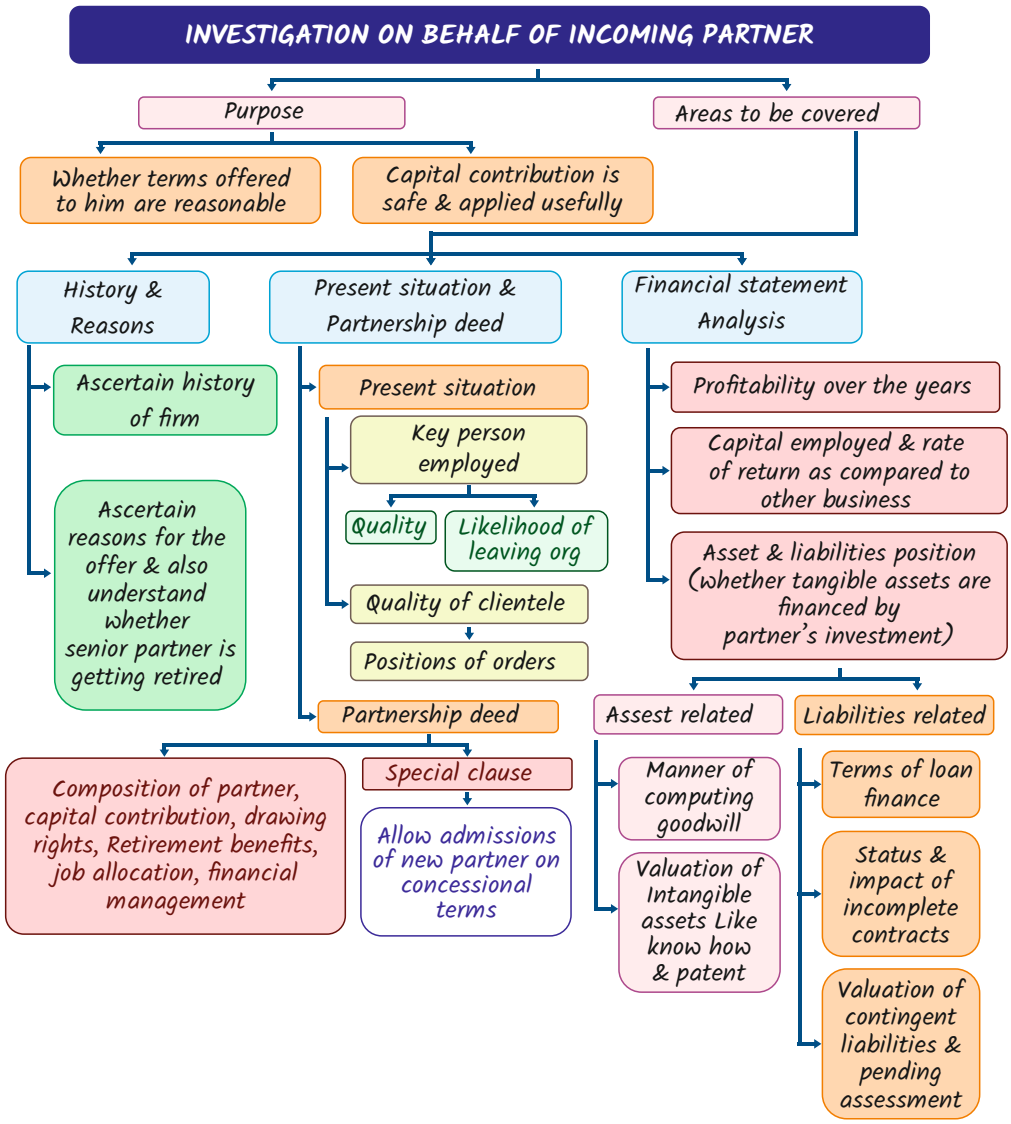
Whether an investigator necessarily requires assistance of expert (QNO-644.030)

It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts.

Whether an investigator is required to undertake a 100% verification or selective verification	➢ It depends on the circumstances of the case under investigation. ➢ For example, If the investigator has to establish the amount of cash defalcated by the cashier, he has probably no option but to carefully examine all the cash vouchers and related transactions. ➢ But, if he is to arrive at the profitability of a concern, he may verify constituent transactions on a selective basis taking extreme care to see that no material transaction that affects. ➢ In investigation, it is advisable to go by statistically recognized sampling methods than to depend on the so-called "test checks" where circumstances permit selective verification.
Whether the investigator can put reliance on the already audited statement of account (QNO-644.020)	➢ It depends on the circumstances of the case under investigation. ➢ However, if the investigation has been carried out for other purposes like to establish value of a business or a share or the amount of goodwill payable by an incoming partner, the investigator would be entitled to put reliance on audited accounts. ➢ Short & Compton v. Bracket- An accountant, when making an investigation for an incoming partner, was entitled to assume that the figures appearing in the books were correct. ➢ It is advisable for the investigator to ascertain from the client, in advance, in writing, whether the audited statements of account produced to him should be taken as correct.
Investigation out of disputes and conflicting claims	➢ Sometimes cases for investigation sometime arise out of disputes and conflicting claims. Investigator is required be alert to the possibilities of the information or documents made available to him to be prejudiced. ➢ Investigator should keep the interest of all the involved parties in view. This work requires not only the best of skill but of a high degree of maturity and experience.
Whether an investigator can make futuristic statements	➢ The investigator should refuse to be futuristic. ➢ He may assume that the established trend in the business will continue in the near future, in the absence of any contrary evidence, in arriving at the present value of a business. ➢ He, however, should not project the trend into any future years to establish a value.
Basis of opinion of an investigator	➢ The investigator should confine his opinion to the established facts and nothing more. ➢ If the facts, as conveyed through the books, records, papers and other evidence, are not capable of being properly established, he should qualify the opinion or issue disclaimer.
Whether to retain working papers or not	➢ Investigating accountant should retain all working papers. ➢ Such papers help him to give evidence in a court of law to support his figures. ➢ Working papers will also be of immense help to the investigator in correlating facts and events and later in drafting the report.
(CNO—INTG.080) TYPES OF INVESTIGATION	
Non-Statutory Investigations	➢ Investigation on behalf of an incoming partner. ➢ Investigation on behalf of a bank proposing to advance loan to a company. ➢ Investigation of frauds.
Statutory Investigation	(Please cover this part as per law notes) As an Inspector under provisions of Companies Act, 2013.

(CNO—INTG.100) INVESTIGATION ON BEHALF OF INCOMING PARTNER (QNO-625.000) (MCQ – DD.1)

Chart



Purpose

- To know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of the existing partners, socio-economic setting, etc.
- To ascertain whether the capital to be contributed by him would be safe and applied usefully.

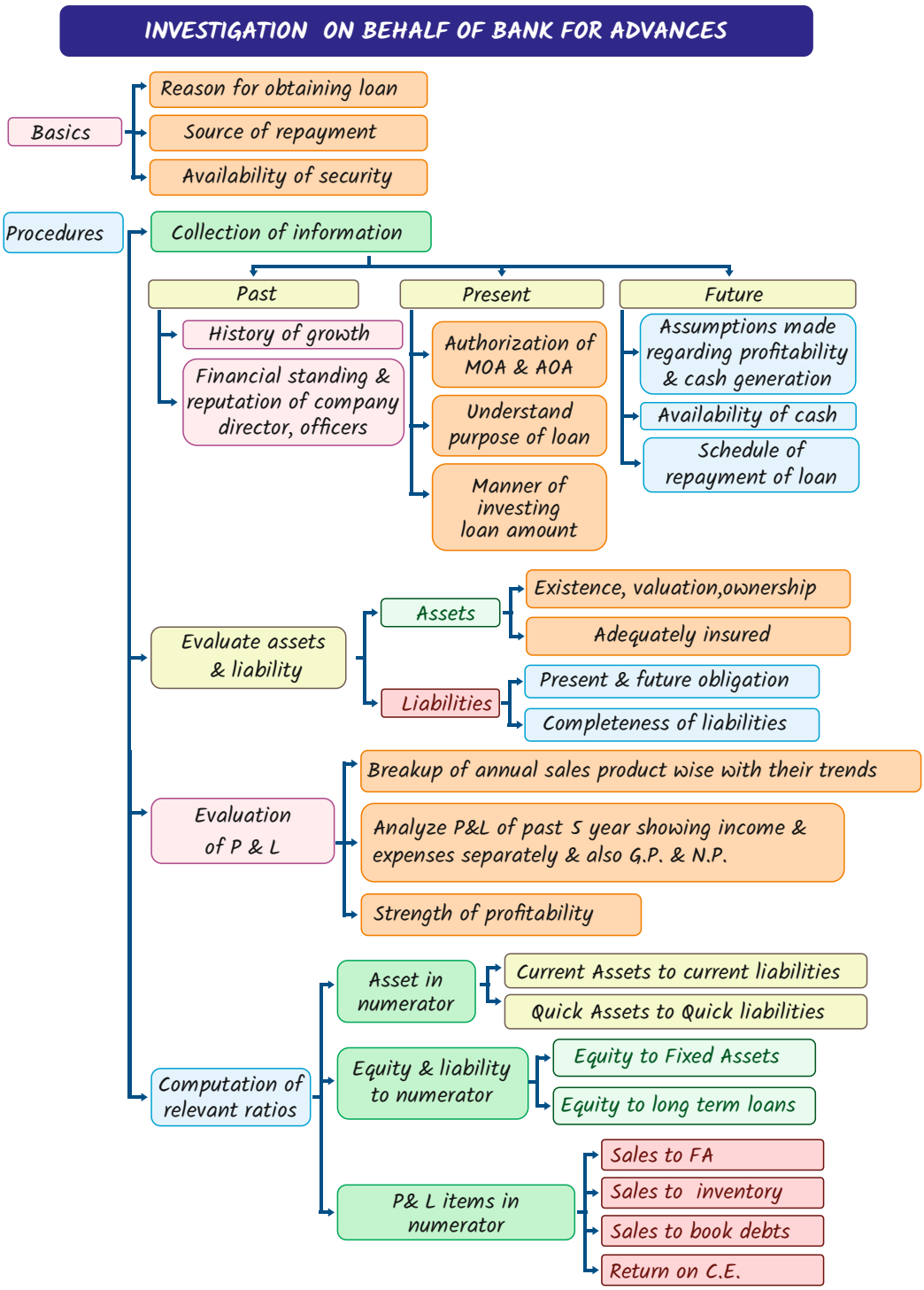
Areas to be covered

- ***Reasons & History***
  - Ascertain ***reasons*** for the offer of admission to a new partner should be ascertained and it should be determined whether the same synchronizes with the retirement of any senior partner whose association may have had considerable bearing on the firm's success.
  - Ascertainment of the ***history of the firm***, since inception and growth of the firm.
- ***Present Situation & Partnership Deed***
  - Study the composition and ***quality of key personnel employed*** by the firm and any likelihood of their leaving the organization.
  - Assess ***position of orders*** at hand and the range and quality of clientele should be thoroughly examined, which the firm is presently operating.
  - Studies of the provisions of the ***Deed of partnership,*** particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.
  - Examine whether any ***special clause*** exists in the deed of partnership to allow admission in future of a new partner, who may be specified, on concessional terms.

- ***Financial Statement Analysis***
  - *Appraisal of the record of **capital employed** and the rate of return. It is necessary to have a comparison with alternative business avenues for investments.*
  - *Ascertain manner of computation of **goodwill** on admission as also on retirement, if any*
  - *Scrutinize **terms of loan finance** to assess its usefulness and implication for the overall financial position.*
  - *Examine whether the **incomplete contracts** which will be transferred to the reconstituted firm will be a liability or a loss.*
  - *Scrutiny of the record of **profitability** of the firm's business over a suitable number of years.*
  - *Examination of the **asset and liability position** to determine the tangible asset backing for the partner's investment, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and those for pending tax assessment.*

(CNO—INTG.120) INVESTIGATION ON BEHALF OF THE BANK FOR ADVANCES (QNO-643.000)

Chart



Purpose

- Reason for obtaining the loan.
- Determining of sources of repayment.
- Availability of security, if borrower fails to repay.

Procedures

- ***Collection of Information:*** –

  Investigator is required to collect the information with respect to;

  Past

  - ***History of growth and development*** of the company and its performance during the past 5 years.
  - ***The financial standing and reputation*** for business integrity enjoyed by directors and officers of the company.

  Present

  - ***Authorization*** under Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
  - ***The purpose*** for which the loan is required.
  - Manner in which the borrower ***proposes to invest the amount of the loan.***

  Future

  - ***Schedule of repayment of loan*** submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case.

- ***Examination of Financial Statements:*** –
  - From the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned, and taxes paid annually during each of the five years.
  - The purpose is to ascertain strengths of profitability

- ***Computation of relevant Ratios:*** –
  - Equity to Fixed Assets.`
  - Equity to Long Term Loans. 7
  - Sales to Fixed Assets. 2
  - Sales to Average Inventories held. 3
  - Sales to Book Debts. 4
  - Current Assets to Current Liabilities.5
  - Quick Assets (the current assets that are readily realizable) to Quick Liabilities. 6
  - Return on Capital Employed.0

- ***Break-up of annual sales:*** –

  Product-wise to show their trends.

- ***Schedule of assets and liabilities:*** –
  - ***Assets:*** –
    - To ensure their existence, ownership and proper valuation.
    - To examine whether assets have been adequately insured.
  - ***Liabilities:*** –
    - To determine present and future obligations.
    - To ensure completeness of recording.

(CNO—INTG.130) DIFFERENT TYPES OF FRAUD

Fraud for Personal Gains

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

Corporate Frauds/ Irregularities (MCQ – Incs.43.4)

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

  Use of Shell Company, false vendors, purchases of personal nature booked as official expenses enable falsification of accounts and diversion of funds for purposes other than an intended purpose. These could also be mechanism for employees or cartel of employees engaging in personal gain at the cost of the company. In the former incident this could be termed as management fraud.
- **Shell/ Dummy Company Schemes:**
  Generally, represents a fictitious company or a 'Paper company' to transfer profits or funds from the main company. This could also involve fictitious bills (mostly for services rendered or consultancy charges that cannot be corroborated) which are used in the name of dummy companies diverting the funds taken from banks and financial institutions.
  The books could be falsified by wrong classification of expenses, inflating the expense claims, fictitious expenses or multiple reimbursements. A review of controls, normally, leads to the uncovering of expense booking that are prima facie not incurred.
- **Money-Laundering Activities:**
  As per the Prevention of Money-Laundering Act, 2002, "whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering."

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

Fraud at Operational Level Employees

- **Tampering of Cheques/Drafts/On-line payments/receipts:**
  Tampering of cheques, payee name being altered, or preparation of cheques without the same being issued to payee, etc., are methods that may also lead to falsification of accounts.
  On-line payments generally are considered a transparent mechanism to prevent the above frauds. The ATM is a popular technological advancement that has inherent control gaps. For example, credit cards once swiped the transaction is put through in the system without the need for a signature of the payer. Similarly, unauthorised credits in bank accounts through ATMs are an immense source of threat to recipients including bribery allegations, unless they lodge a complaint with the bankers or the regulatory authorities in a prompt manner of such unauthorised credits to their accounts/or company bank accounts.

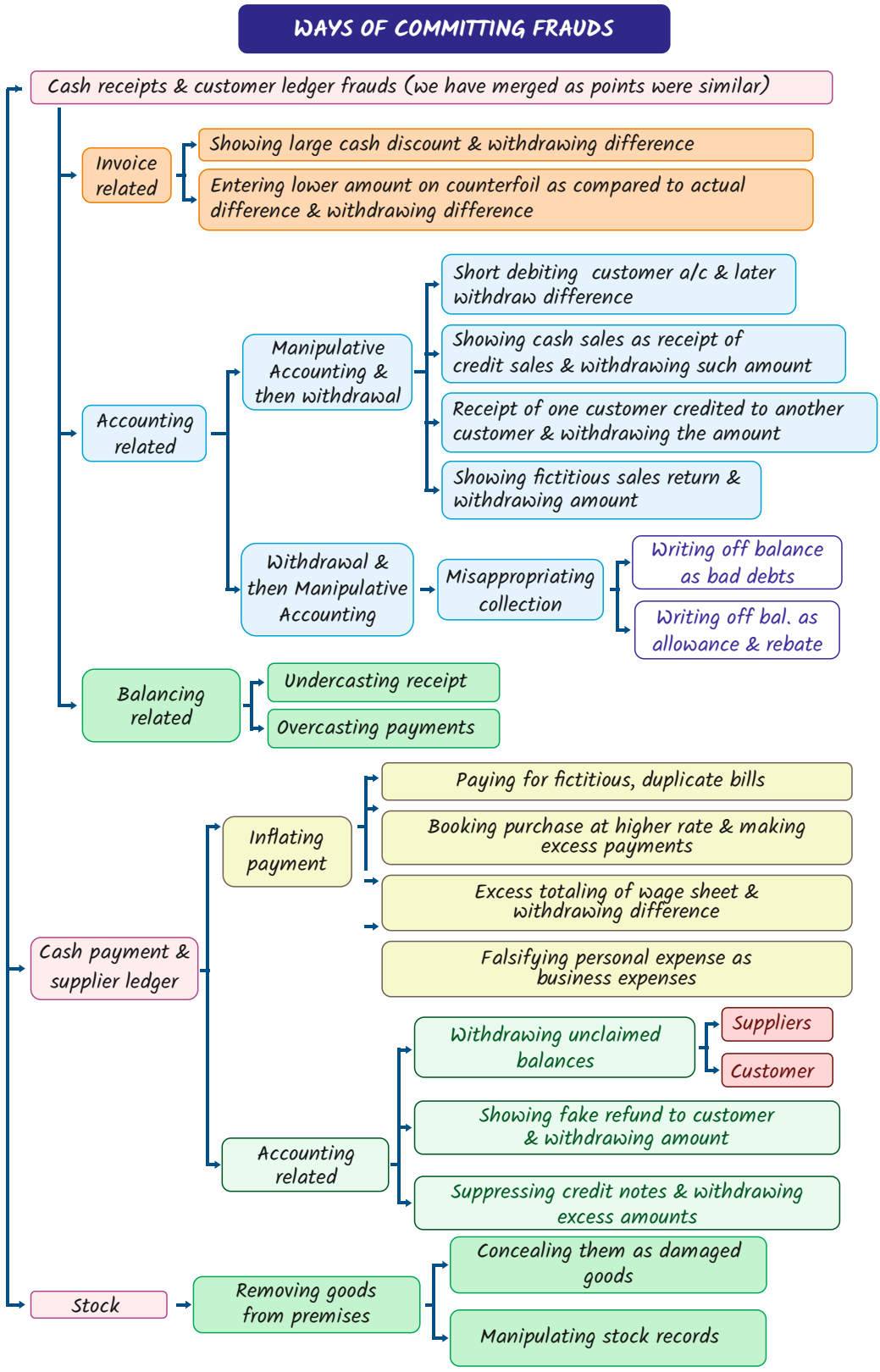
Care should be taken that the name of the payee in the payment transactions in books and cheque issued therein for payment is not fabricated to wrongly codify and book against an improper account head.

- **Off Book Frauds:**
  In off book frauds, the fraud perpetrator misappropriates the cash before these are recorded in the books or before the sale is recorded in the books. These frauds are difficult to unearth as the cash or collection is taken off before the accounting entries are made in the books. This situation arises especially in unorganized markets and in rural economies where banking habits are relatively underdeveloped. These are difficult to establish due to absence of audit trails and are more prevalent in businesses that have extensive cash dealings. These are difficult to uncover as the means adopted could include printing of receipts/ bills outside the system.
  The above fraudulent schemes can be established based on circumstantial evidence or validation through external sources such as, customer balance confirmations (where feasible) and customer copy of the receipts or other documents that are retained by them. These are also further supplemented by external evidence in the form of background checks and surveillance mechanism. Verification of all the receipts and issues of stock recorded in stock register is another way to identify this type of fraud.
- **Cash Misappropriation:**
  Cash is misappropriated after the accounting entries are already passed in the books. These are identified through surprise checks and through shortages in cash balances. These occur when there are delays in accounting of cash collections and there are no laid down cash flow controls. Unaccounted money in any form in an entity is a serious red flag in uncovering of irregularities. Improper daily fund monitoring mechanism is another factor that results in creating unauthorised float by employees in their personal account or in fictitious surrogate (proxy) entities by fraudsters.
- **Teeming and Lading:**
  This is also achieved through cash deposits or cheques collected from customers being overlapped with the collections from subsequent customers and the amount collected is diverted to personal account. Reconciliation of customer accounts at a single point of time and confirmation from customers for amounts outstanding in their accounts helps in identifying any leakage in collections.
- **Fraudulent Disbursements:**
  Fraudulent disbursements or reimbursements take place either by issuing or submission of false bills, or personal expense bills being converted into official expenses bills. The other method that is resorted to by the perpetrator of fraud is to inflate the refunds due to a customer and skim the excess refunds.
- **Expense Reimbursement Schemes:**
  These fraudulent schemes involve employees resorting to treating their personal expenses as incurred for business purpose and claiming reimbursement. In some cases, employees may get reimbursed by third parties (such as distributors) as well as by claiming these expenses from the company. Multiple expense claims based on duplicate bills or photostat copies.
- **Payroll Fraud:**
  The payroll fraud could include payment to non-existent employees or in a contractual arrangement inflating of the manpower resources than those actually deployed while billing the client. It may also include showing higher pay than actual disbursement to employees/ workers, etc. The process would require a detailed review of statutory declarations/filings under various labour law statutes including disclosures in financial statements of retirement benefits such as P.F, Gratuity and Superannuation benefits from evidence gathering perspective.
- **Commission Schemes:**
  The salesman exaggerates the sales through fictitious billings to earn higher commission or alter the sales prices of the products sold from those stipulated by the company or share the sales volumes achieved with other employees to share higher commission. Commission schemes in

mega deals backed by legal documents are often tools used to camouflage kickbacks. These are often difficult to uncover and would need to be supplemented by the monetary trails across entities and geographies.

(CNO—INTG.140) CASH RECEIPTS / CASH PAYMENT FRAUDS OR DEBTOR LEDGER / CREDITOR LEDGER FRAUDS

Chart



Cash Receipts (QNO-633.000)

Invoice Related

- *Showing a **larger cash discount** than actually allowed.*
- *Issuing a receipt to the payee for the full amount collected and **entering only a part of the amount on the counterfoil.***

Accounting Related

	➢ Adjusting a **fictitious credit in the account of a customer** for the value of goods returned. 1 ➢ Adjusting a **cash sale as a credit sale and raising a debit in the account of the customer.** 4 ➢ Writing off a **good debt as bad and irrecoverable** to cover up the amount collected. 2 ➢ **Short debiting the customer's account** in the ledger with an intention to withdraw the difference when the full amount payable. 3 **Balancing Related** ➢ **Under-casting the receipts** side of the Cash Book. ➢ **Over-casting the payment side** Cash Book.
Cash Payments	**Inflating Payments** ➢ Making **double payment** of an invoice or paying a false invoice. ➢ Paying **personal expenses** out of the business by falsifying details. e.g., showing betting losses as advertisement charges. ➢ **Wrong totaling of the wage sheets** and misappropriating the excess amount withdrawn from the bank for payment of wages. **Accounting Related** ➢ **Withdrawing unclaimed credit balances of customers or amounts falsely credited** in the accounts of parties. ➢ **Falsely adjusting a refund in the account of a customer and withdrawing** the credit balance.
Supplier Ledger (QNO-635.000)	➢ **Suppressing the Credit Notes** issued by suppliers and withdrawing the corresponding amounts not claimed by them. 3 ➢ **Accepting purchase invoices at prices considerably higher** than their market prices and collecting the excess amount, paid in cash, from the suppliers. 2 ➢ Adjusting **fictitious or duplicate invoices** as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices. 1 ➢ **Withdrawing amounts unclaimed by suppliers,** for one reason or another by showing that the same have been paid to them. 4
Customers Ledger	➢ By the , **"teeming and lading"** method. 1 ➢ Misappropriating the amount collected from a customer and subsequently **adjusting his account by crediting the amount on account of allowance or a rebate for excess price charged.** 3 ➢ **Crediting the amount received from a customer to the account of another customer and subsequently withdrawing the amount wrongly credited.** 2
Stock (QNO-637.010)	➢ Employees may **simply remove goods** from the premises. ➢ Theft of goods may be **concealed by writing them off as damaged goods, etc.** ➢ **Stock records may be manipulated** by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

(CNO—INTG.150) INDICATORS OF FRAUD (SAME AS WE STUDY IN IN SA 240)

Discussion

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

➢ Discrepancies in Accounting Records including non-recording or partial recording or incorrect recording or delayed recording of amounts, misclassifications, etc.

➢ Conflicting or missing evidence including missing documents, altered documents, significant unexplained items in reconciliations, discrepancies between entity's records and confirmations received etc.

- Unacceptable management responses such as – denial of access to records/facilities/employees, undue time pressure to resolve complex issues, unusual delays in providing requested information, denial for use of Computer Assisted Audit Techniques, unwillingness to address identified deficiencies in internal control etc.
- Other indications such as – Accounting Policies in variance with Industry Norms, Frequent changes in accounting estimates etc.

(CNO—INTG.160) INVESTIGATION U/S 210 AND 213 INTO THE AFFAIRS OF COMPANY

(QNO – 640.000 / 641.000) (MCQ – Incs.14.3)

Chart

INVESTIGATION U/S 210 & 213 INTO THE AFFAIRS OF THE COMPANY

[CNO 640.000 & CNO 641.000]

[NOTE – Common answer if question is for investigation into affairs of the company or there are financial irregularities in the company by interested parties]

Sec 213 & 210 governs investigation into affairs the company

Affairs of the company may include everything from source of financing investment made, assets acquired, contracts entered, income & expenses etc.

Step - 1

Appointing authority issues order specifying terms of reference for investigation

Terms of reference should be in writing

He should clearly understand terms of reference if there is any doubt obtain explanation

If there is ambiguity, ask for exact points & understand limitation

Step - 2

Defining scope

- Decoding which companies should be covered like subsidiaries, associates, JV's
- Deciding areas to be covered book of accounts, financial matters, production related matters
- Whether transaction with all the related parties & subsidiaries to be covered

Step - 3

Decide time period → It should as per terms of reference

Step - 4

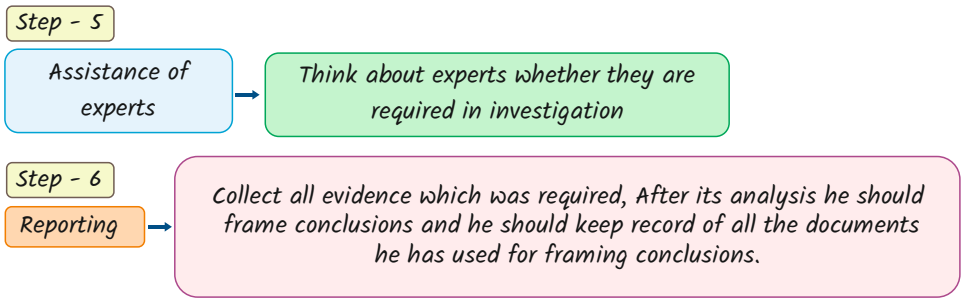
Frame programme

- Programme is a detailed step by step instructions on what investigator team should do
- Whether it should cover noncompliance of company's act
- Whether it should cover diversion of funds.
- Whether it should cover losses incurred by the company

Programme should be changed whenever there is additional revelations

Documents should be maintained as programme is executed

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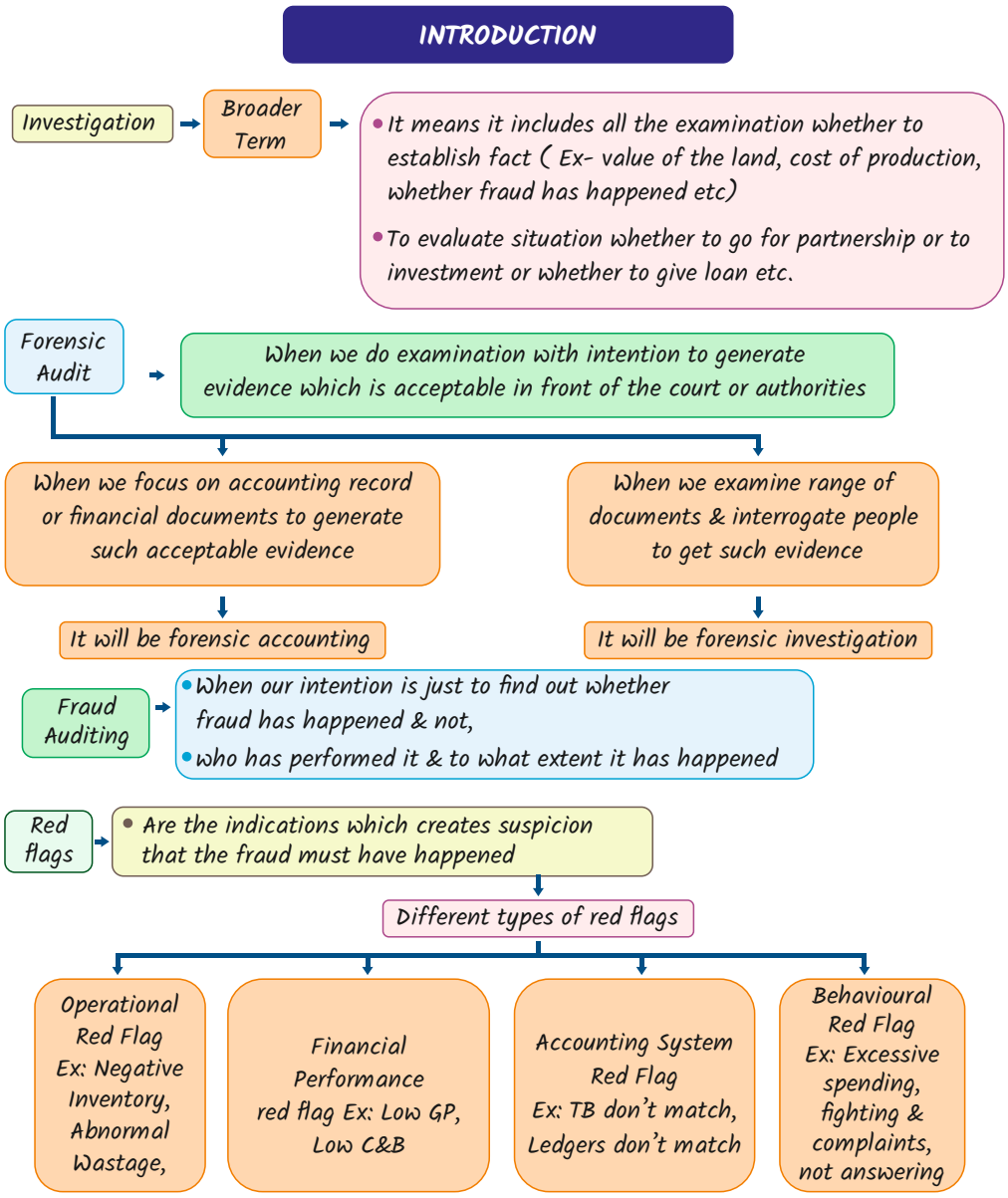
UNIQUE QNO's	
QNO -639.000	Investigation (Future Maintainable Turnover)
QNO -643.020	Investigation of borrower-Special Focus on Assets & liabilities
QNO -643.050	Investigation (Propriety Business)

UNIQUE MCQs	
MCQ	DD.12/ DD.14 / Incs.43.1/ Incs.43.2/ Incs.43.3

PART- 3 FORENSIC ACCOUNTING

(CNO—FA.020) DEFINITIONS

Chart



Forensic

The word forensic comes from the Latin word forensic, meaning "of or before the forum." It is –

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

(Bank Entries in Tally Data are generally not acceptable in court of law but bank entries in bank statement are acceptable)

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

(CNO—FA.040) AUDIT V/S. FORENSIC ACCOUNTING (QNO-629.000 / 629.500)

Chart

DIFFERENCE

		FINANCIAL AUDIT	FORENSIC ACCOUNTING
Preliminary points	Objective	Express True & Fair View	Financial Investigation to Generate Evidence Acceptable in Court of Law
			Mostly used in context of Fraud
	Applicability	Mandatory	Response to an event (Voluntary)
Process related points	Mindset	Professional Skepticism	Investigative Mentality
	Period	Normal Accounting Period	No such limitations
	Transaction Examined	Material & which can become material	Material as well as Immaterial
	Technique	▪ Test of control & substantive procedures ▪ Dependance on Audit trail & Sampling	Investigative, Substantive Procedures or In Depth Checking
	Evidence	Persuasive	Conclusive
Others points	Verification of stock, estimated realizable of value of assets, provisions, liabity	Sometimes Management Representation used as Evidence	Independent verification of selected items
	Off balance sheet items	Used to check Compliance Procedure & Arithmetic Accuracy	Regulatory & propriety examined
	Adverse findings	We may modify opinion. Quantify subject to availability of data	Legal determination of fraud, perpetrators of fraud, Amount of fraud

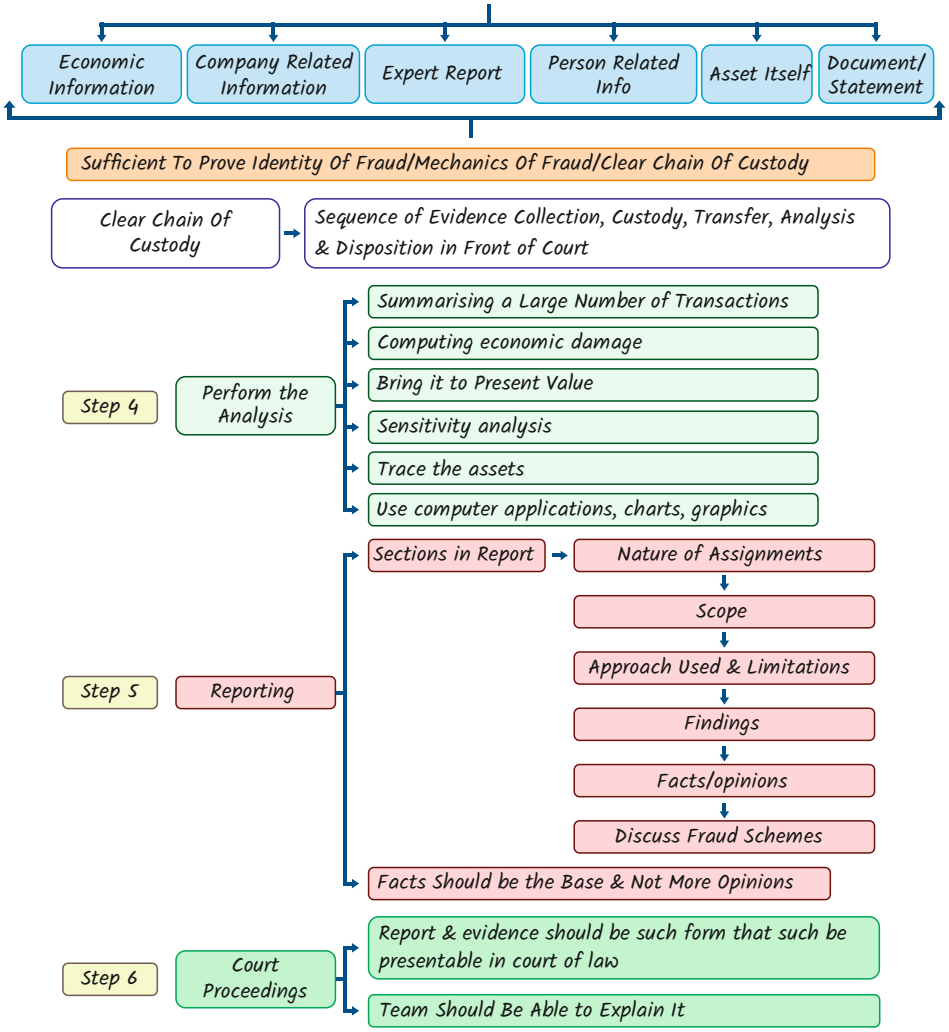
(CNO—FA.060) PROCESS OF FORENSIC ACCOUNTING (QNO-630.000)

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

PROCESS OF FORENSIC ACCOUNTING

Step 1	Initialization	Purpose of the assignment Preliminary investigation Conflict check
Step 2	Develop plan	Set objectives, Scope Methodology
Step 3	Obtain Relevant evidence	Evidence May Include

Continue on next Page...



Step 1. Initialization

- **Purpose**
  It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment.
- **Meet Client**
  It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand.
- **Conflict Check**
  A conflict check should be carried out as soon as the relevant parties are established. (Whether it will affect other assignment of firm and vice versa)
- **Preliminary Investigation**
  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

- **Set Objectives & Methodology**
  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

- **Economic Information / Documents / Assets / Person / Expert / Company**
  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.
- **Depends on Nature of Fraud**
  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.

- ***Sufficient to Prove Identity of Fraudster / Mechanics of Fraud / Amount of Fraud / Clear Chain of Custody / Usable in Court***
  The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis (CNO-630.100)

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

- Summarizing a large number of transactions;
- Calculating economic damages;
- 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;
- utilizing charts and graphics to explain the analysis.
- performing a tracing of assets;

Step 5. Reporting

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence and a conclusion as to the amount of loss suffered as a result of the fraud.

- ***Sections in Report***
  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.

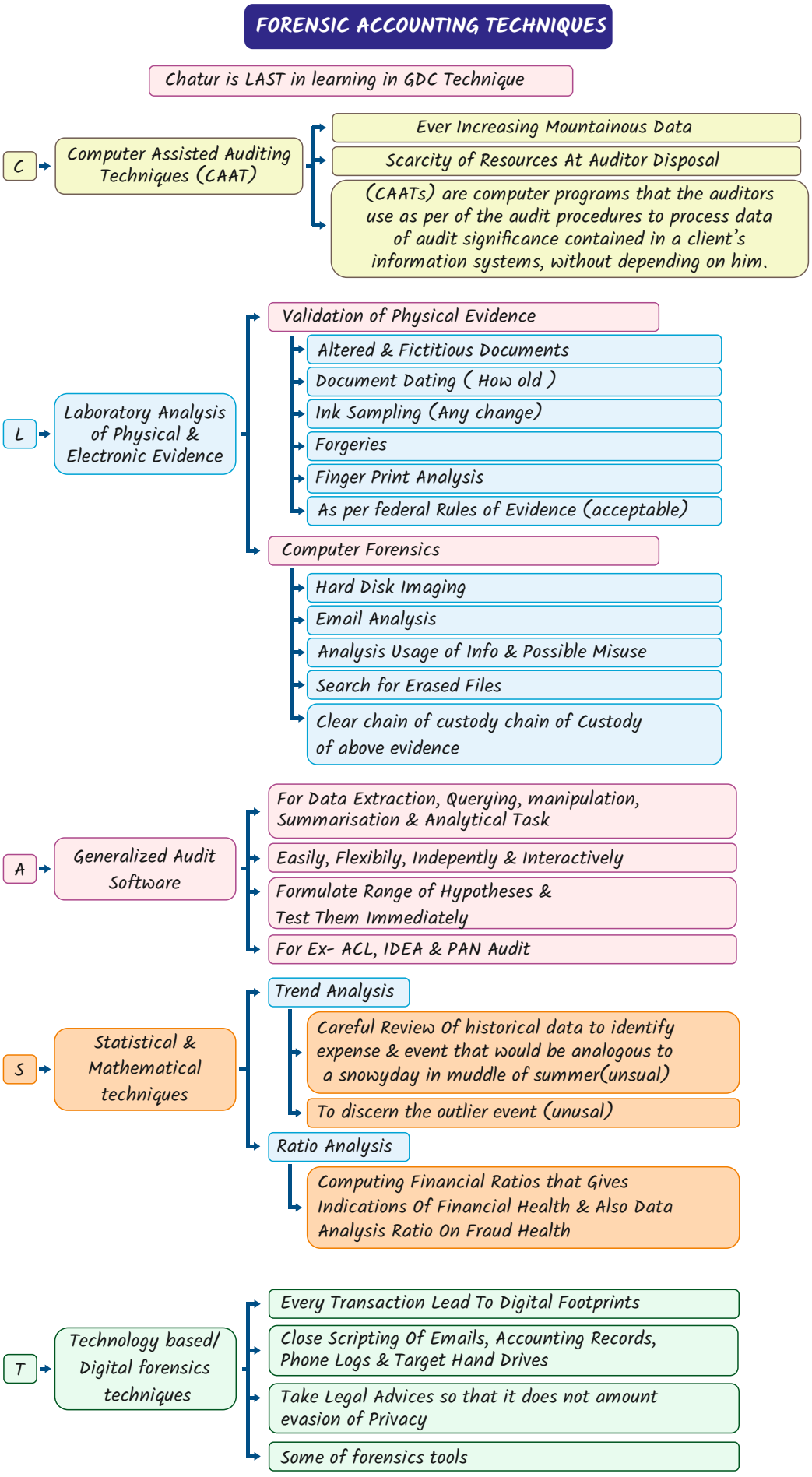
  The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

- ***Facts should be the base and not mere Opinions***
  The forensic accountant 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.

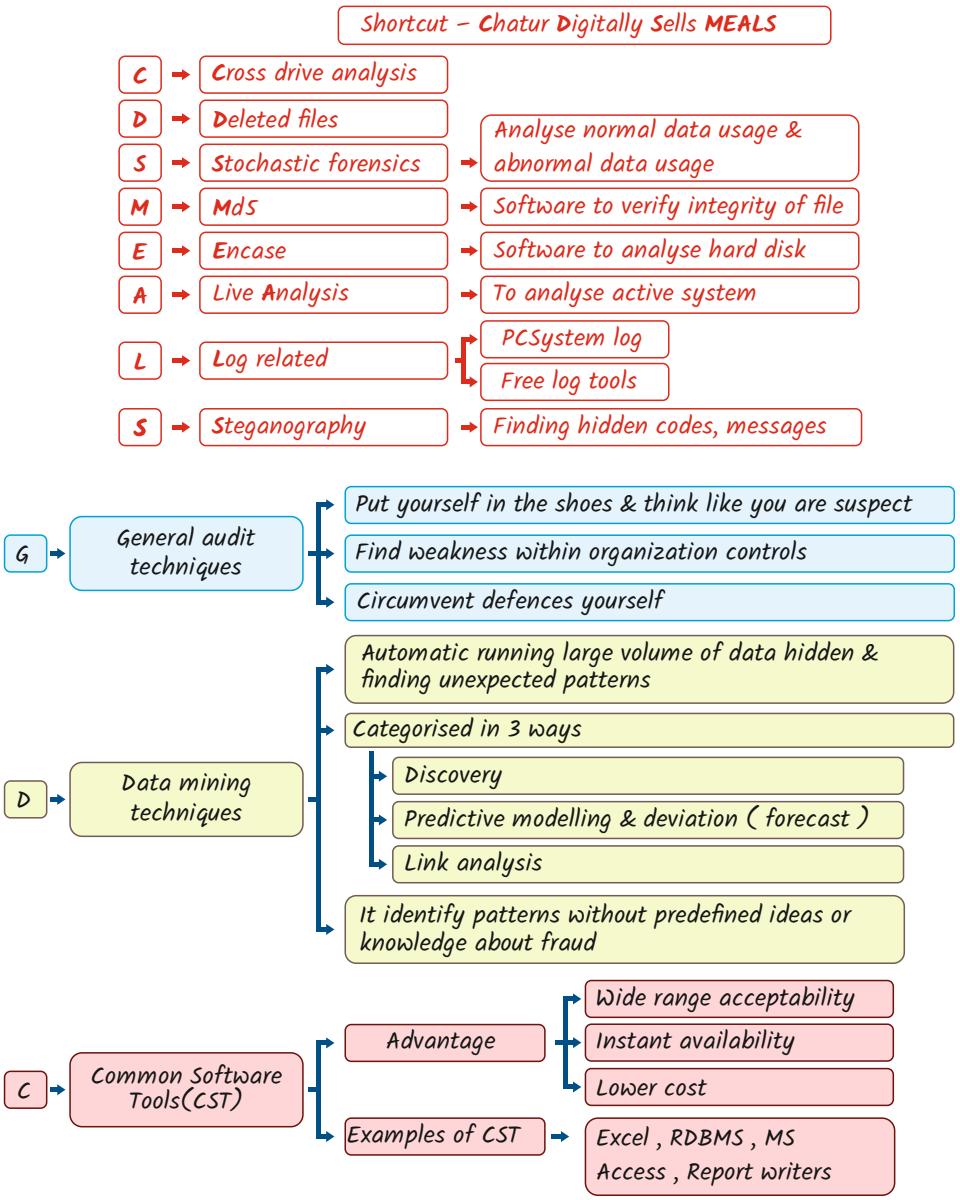
Step 6. Court proceedings

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.

(CNO—FA.080) FORENSIC ACCOUNTING TECHNIQUES (QNO-631.000)



Continue on next Page...



- ***Fraud can be in any corner of financial statements***

  Detecting fraud is difficult, especially frauds involving material financial statement misstatements, which occur only in about 2 percent of all financial statements.

- ***Concealed – Omission or Falsification & Collusion***

  Fraud is generally concealed and often occurs through collusion. Normally, the documents supporting omitted transactions are not kept in company files. False documentation is often created or legitimate documents are altered to support fictitious transactions.

  While fraud detection techniques will not identify all fraud, the use of sound techniques can increase the likelihood that misstatements or defalcations will be discovered on a timely basis.

Techniques

*Forensic Accounting Technique will be very important technique as per **GST - Live at CCD***
Some of the techniques that a forensic auditor may use are listed below:

General Audit Techniques

Testing defenses

A good initial Forensic Accounting technique is to attempt to circumvent these defenses yourself. The weaknesses you find within the organizations control will most probably guide you down the sea path taken by suspected perpetrators. This technique requires you to attempt to put yourself in the shoes and think like your suspect.

Generalized Audit Software (GAS)

Generalized Audit Software (GAS) is a class of CAATs that allows auditors to undertake data extraction, querying, manipulation, summarization and analytical tasks. GAS focuses on the fully exploiting the data available in the entity's application systems in the pursuit of audit objectives. GAS support auditors by allowing them to examine the entity's data easily, flexibly, independently and interactively in data-based auditing.

Using GAS, an auditor can formulate a range of alternative hypotheses for a particular potential misstatement in the subject matter and then test those hypotheses immediately. "What if" scenarios can be developed with the results and the auditors can examine the generated report rapidly. Currently, the latest versions of GAS include the **Audit Command Language (ACL), Interactive Data Extraction and Analysis (IDEA) and Pan audit.**

Statistical & Mathematical Techniques

- **Trend Analysis:** Businesses have cycles and seasons much akin to nature itself. An expense or event within a business that would be analogous to a snowy day in the middle of summer is worth investigating. Careful review of your subject organization's historical norms is necessary in order for you to be able to discern the outlier event should it arise within your investigation.

- **Ratio Analysis:** Another useful fraud detection technique is the calculation of data analysis ratios for key numeric fields. Like financial ratios that give indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud.

Technology based / Digital Forensics Techniques

Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target hard drives is a requisite facet of any modern Forensic Accounting. Before taking steps, such as obtaining data from email etc. the Forensic Accountant should take appropriate legal advice so that it doesn't amount to invasion of privacy. Digital investigations can become quite complex and require support from trained digital investigators. However, many open-source digital forensics tools are now available to assist you in this phase of the investigation.

CD should be checked by S²MELL technique



- Cross Drive Analysis (Earlier each hard disk / pen drive etc. were analyzed one by one, in this approach they are analyzed at the same time)
- Deleted Files
- Stochastic Forensics (Analyzing change in pattern, to detect insider data theft)
- Steganography (Understanding hidden message in electronic file, images, communication)
- MDS (Software used to investigate computers)
- Encase (Software used to extract evidence from sized hard drives etc.)
- Live Analysis (When cyber-attack takes place)
- Log Related
    - Tracking Log Files
    - PC System Log
    - Free Log Tools (To extract meaningful information form logs)

Data Mining Techniques

It is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns. Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud. It explains various affinities, association, trends and variations in the form of conditional logic.

Computer Assisted Auditing Techniques (CAATs)

Changing patterns of businesses, regulatory framework, scarcity of resources at auditors' disposal on one side and the ever-increasing mountainous data on other hand is making audit a complex process. Use of CAATTs is, thus, indispensable to the Auditors and forensic accountant. Computer-assisted audit techniques (CAATs) or computer-assisted audit tools and techniques (CAATTs) are computer programs that the auditors use as part of the audit procedures to process data of audit significance contained in a client's information systems, without depending on him.

Common Software Tool (CST)

Due to shortcomings of GASs, CSTs have become popular over a period. Spreadsheets (like MS Excel, Lotus, etc.), RDBMS (like MS Access, etc.) and Report writers (like Crystal reports, etc.) are few examples of CSTs. Their widespread acceptability is due to its instant availability and lower costs. While spreadsheets may be extremely easy to use due to its simplicity and versatility, other CSTs may need some practice.

Whether one uses GAS or CST, it is imperative that the auditor is aware about the manner and processes that have led to the data generation, the control environment revolving around the data and the source from where the data samples are imported into the GAS/CST.

Laboratory Analysis of Physical and Electronic Evidences

- **Computer Forensics**
  - Chain of Custody
  - Hard disk imaging
  - Search for erased files
  - E-mail analysis
  - Analyze use & possible misuse
  - Computer software to analyze data
- **Protection/Validation of Evidence**
  - Altered & Fictitious Documents
  - Physical examination
  - Document dating
  - Ink sampling
  - Fingerprint analysis
  - Forgeries
  - Federal Rules of Evidence

(CNO—FA.100) FORENSIC ACCOUNTING REPORT (QNO - 631.500)

FORENSIC ACCOUNTING REPORT

↓

Statement of Observation Gathered & Considered While Proving Conclusion Evidence

↓

To Give Clear & Concise Information To Persons

↓

Factors To Be Considered For Various Presentation Of Reports

Shortcut – **BSP** is **MAD** for forensic report

- **B** → Nature of Business
- **S** → Nature of Subject or aspect appraised
- **P** → Purpose for which report is prepared
- **M** → Management attitude, directives & needs
- **A** → Forensic accountant Approach & calibre
- **D** → Extent of Details required by auditor & management

A Report is a statement of collected & considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report.

The Forensic Accounting Report is nothing, but statements of observation gathered & considered while proving conclusive evidence. It is a medium through which an auditor expresses his opinion under audit. It is an important part of the audit as it provides the results of the audit conducted by the auditor.

The main factors to be considered for the various ways for presentation of reports are:

- Nature of business of the Organization (Real Estate Related Business)
- Nature of subject or aspect appraised (Ownership of Property)
- Purpose for which report is prepared (For Understanding & Not Legal Use)
- For whom report is Intended (Directors)
- Management attitude, directives or needs (No Specific Request)
- Forensic accountant approach and caliber (MCA Records & Interviews)
- Extent of details required by auditee and management (Flow of Events)

(CNO—FA.120) RETAINERS / REGULAR WORK / IMPORTANCE OF FORENSIC ACCOUNTING

Chart

RETAINERS / USERS OF FORENSIC ACCOUNTING

(In the sequence of Importance)

- Courts
- Government/Regulatory Bodies & Agencies
- Police Forces
- Banks
- Insurance Companies
- Lawyers
- Business Communities

Retainers / Users of Forensic Accountant

(In Sequence of Importance)

- Courts (E.g. To Determine Compensation)
- Government Regulatory Bodies & Agencies (E.g. To Determine Tax fraud)
- Police Forces (E.g. To Catch Fraudster)
- Banks (E.g. To Decide Whether Fraud Has Happened)
- Insurance Companies (E.g. To Assist in Insurance Fraud)
- Lawyers (E.g. To Gather Evidence in Dispute)
- Business Community (E.g. To Recover Lost Money)

Regular Work / Involvement of Forensic Accountant

REGULAR WORK / INVOLVEMENT OF FORENSIC ACCOUNTANT

- Fraud Prevention
  - Verify Adequacy, Implementation of ICS
  - Then Provides Consultation in Development as per Organization risk Profile
- Fraud Detection
  - Investigate & Analyse Evidence Detect Frauds
  - Trace Unappropriated Funds
- Providing Expert Testimony
  - Assist in Legal Proceedings
  - Testify
  - Prepare Visual Aids to Support Trial Evidence
- Computer Forensics
  - Developing Computer Application To Assist in Recovery, Analysis, & Presentation Of Financial Evidence

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

(CNO—FA.140) SERVICES RENDERED / PERFORMED BY FORENSIC ACCOUNTANTS IN DIFFERENT AREAS (QNO - 628.500)

Criminal Investigation :	Matters relating to financial implications the services of the forensic accountants are availed of. The report of the accountants is considered in preparing and presentation as evidence.
Professional Negligence Cases :	Professional negligence cases are taken up by the forensic accountants. non conformities to Generally Accepted Accounting Standards (GAAS) or non compliance to auditing practices or ethical codes of any profession, Forensic Accountant need to measure the loss due to such professional negligence or shortage in services.
Arbitration service:	Forensic accountants render arbitration and mediation services for the business community. Their expertise in data collection and evidence presentation makes them sought after in this specialized practice area.
Fraud Investigation and Risk / Control Reviews:	Forensic accountants render such services both when called upon to investigate specific cases as well for a review of or for implementation of Internal Controls. Another area of significance is Risk Assessment and Risk Mitigation.
Settlement of insurance claims:	Insurance companies engage forensic accountants to have an accurate assessment of claims to be settled. In case of policy holders seek the help of a forensic accountant when they need to challenge the claim settlement as worked out by the insurance companies. A forensic accountant handles the claims relating to consequential loss policy, property loss due to various risks, fidelity insurance and other types of insurance claims.
Dispute settlement:	Business firms engage forensic accountants to handle contract disputes, construction claims, product liability claims, infringement of patent and trademarks cases, liability arising from breach of contracts and so on.

(CNO—FA.160) POINTS SHOULD BE KEPT IN MIND BY THE MANAGEMENT WHILE APPOINTING A FORENSIC ACCOUNTANT (QNO-629.800)(MCQ - DD.13)

Matters to be considered

- A Forensic Accountant is often retained to analyze, interpret, summarize and present complex financial and business-related issues in a manner which is both understandable and properly supported.
- Forensic Accountants are trained to look beyond the numbers and deal with the business reality of the situation.
- A Forensic Accountant must initially consider whether his/her firm has the necessary skills and experience to accept the work.
- Forensic Accounting is highly specialized, and the work requires detailed knowledge of fraud investigation techniques and the legal framework.
- Forensic accountant needs to have an understanding on various frauds that can be carried off and how evidence need to be collected.
- Forensic Accountnat can be engaged in public practice or employed by insurance companies, banks, police forces, government agencies and other organizations.

Characteristics& Skills

Note: 6 points given in earlier row are sufficient for 4-5 marks question. Just take overview of characteristic and skills.

Characteristics- Forensic Auditor	Skills - Forensic Auditor should possess
✓ Out of the Box Thinking	✓ Auditing standards, procedures and related methodologies
✓ Strong Visualization and Imagination	✓ Accounting & Business reporting systems
✓ Curiosity	✓ Information Technology
✓ Persistence	✓ Data Analytics
✓ Detail-oriented	✓ Criminology
✓ Inquisitiveness	✓ Legal Framework
✓ Creativity	✓ Litigation processes & procedures
✓ Discretion	✓ Investigative Techniques
✓ Skepticism	✓ Evidence gathering
✓ Confidence and	✓ Network of professional contacts in related fields' viz. enforcement, regulatory bodies, law, industry, peers etc.
✓ Sound professional judgement	
✓ Objectivity and credibility	

UNIQUE MCQS	
MCQ No.	DD.9/ DD.15

Students Notes

17 PEER REVIEW & QUALITY REVIEW

Part I-PEER REVIEW

(CNO—PR.020) SIGNIFICANCE OF PEER REVIEW OF AUDITORS

Chart

Note :- Guidelines on Peer Review has been issued in 2022, but there are no substantial changes

SIGNIFICANCE/ ADVANTAGE / IMPORTANCE OF PEER REVIEW

- For Auditor (In the sequence of Imp points)
  - It is first line of defense (that work was performed as per applicable auditing practices)
  - It is stamp of approval about his competence
  - His regular audit work doesn't get disturbed
  - Audit work can be easily subjected to peer review
- For society
  - There is Gap between society's expectation of what Auditor should do & what Auditor does
  - Society comes to know whether audit is done satisfactorily

***Other Imp Point: ICAI has made Peer Review Mandatory for everyone (Not many professional bodies have implemented concept effectively)

Revised

The Guidelines on Peer Review has been issued in 2022

Significance of Peer Review

Peer review of attest function has a special significance.

- First of all the nature of work is such that it can be **easily subjected to peer review.** It is possible to review the work subsequent to its completion; which means that one does not get disturbed while doing the work because of the peer review.
- Secondly, the business environment is changing so fast that it is necessary for an auditor to **keep improving his audit techniques and seek a stamp of approval about his competence.**
- And thirdly, the **question of whether an auditor has performed his function satisfactorily or not is arising more frequently now.** There is a considerable gap between what the society as a whole expects the auditors to do and what the auditors are actually required perform; by law and as per the terms of their engagement.

Can act as defence for auditors

Therefore, if the work of any auditor is questioned, the auditor's **first line of defence** would be that the work has happened as per auditing practices which have been peer reviewed.

Good work by ICAI

It is important to note that in spite of the advantages of peer review, not many professional bodies have implemented the concept effectively. In this background, **it is very creditable that ICAI has, over a period, made peer review compulsory for all auditors.**

(CNO—PR.040) OBJECTIVES OF PEER REVIEW (QNO-645.000) (MCQ-PR.2)

OBJECTIVES OF PEER REVIEW

Evaluate quality of audit performed by Practicing Unit (P.U.)
(Below are the points in the sequence of importance)

- Quality control system (QCS) → To ultimately enhance the reliance of users on Audit Report & FST. Whether there is proper system for Maintaining quality of audit
- Quality Audit
  - Work → To ensure adherence to various statutory & regulatory requirements
  - Report → Whether audit is performed as per technical standards

- To ensure that such a member has in place **proper system** (including documentation system) for maintaining the quality of attestation services performed by him;
- To ensure **adherence to various statutory and regulatory requirements** and
- To ensure that members while performing **attestation services** comply with **technical standards** issued by the Institute;
- To **enhance the reliance placed by the users** of financial statements from economic decision making.

(CNO—PR.060) PEER REVIEW BOARD (MCQ- Incs.05.5)

PEER REVIEW BOARD

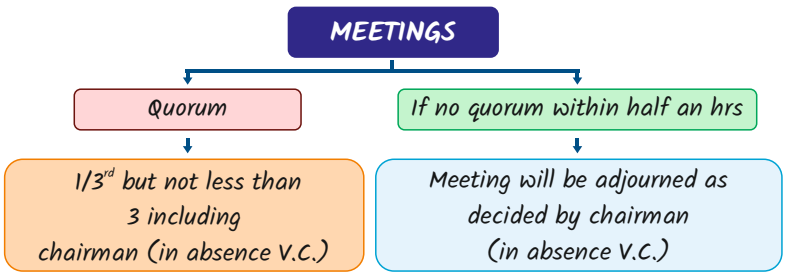
- Members
  - Min 6 Members / Max 12 members
  - Not less than 50% from council
  - Remaining from outside bodies & Prominent individuals of high Integrity & Reputation
  - Who cannot become member. → Disciplinary committee; Board of discipline
  - Casual vacancy → By Council
- Constitution → By council of ICAI → Chairman & Vice-Chairman (V.C.) → Appointed by Council from board; Rotated every year
- Tenure
  - Members
    - 2/3rd → Tenure 3 years or their term in council which ever is earlier
    - 1/3rd → As prescribed by council → Generally for longer period → For Continuity

Establishment and Appointment

- The Board shall be **constituted by the Council.**
- The Board shall consist of a **Minimum 6 Members & Maximum of twelve members** to be appointed by the Council, of whom **not less than 50% shall be from amongst the members of the Council** as defined in Section 9 of the Chartered Accountants Act, 1949, as amended from time to time.
- The Council **may nominate members** to the Board from outside bodies and from amongst prominent individuals of high integrity and reputation, including but not limited to, regulatory authorities, bankers, academician's economists, legal Professionals and business executives.

- The Council shall appoint the **Chairman and the Vice-Chairman** from amongst its Elected **Council members** appointed on the Board.
- The Chairman and the Vice Chairman of the Board may be rotated every year by the Council of the Institute
- The term of **two third members** shall be for **three years** or end of the term of the member in the Council whichever is earlier, or such other period as may be prescribed by the Council from time to time.
- **Casual vacancies** on the Board shall be filled by the Council.

A Member of the **Disciplinary Committee** or the **Disciplinary Board** of the Institute of Chartered Accountants of India shall not be a member of the Board.



***Note: 1 meeting be held in every 3 months

Meetings

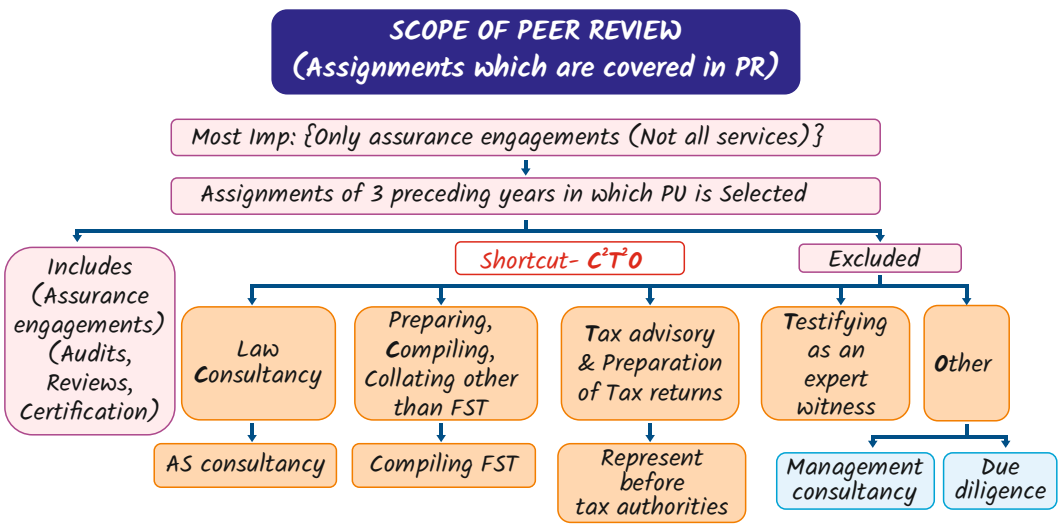
- No business shall be transacted at any meeting of the Board unless there are present at **least one third members of the Board but not less than three members, including the Chairman or, in his absence, the Vice-Chairman.**
- In the absence of quorum within **half an hour of the time fixed** for the meeting, the meeting shall stand adjourned to a date, time and place fixed by the Chairman or, in this absence, the Vice-Chairman.
- The Board shall meet as and when required for transaction of the business before it. **However, at least one meeting shall be held in every every calendar quarter.**



Reporting

- The Board shall submit a report to the Council prior to the date of every meeting of the Council

(CNO--PR.080) SCOPE OF REVIEW (QNO-647.000 / 647.500) (MCQ – PR.4,Incs.05.1)



Peer Review period

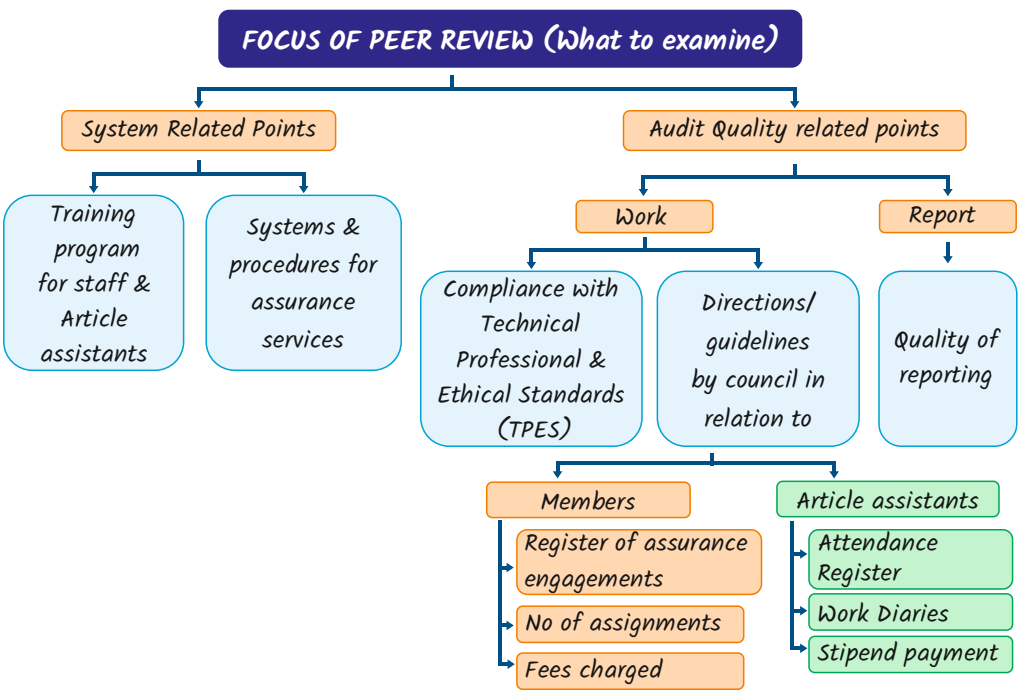
Peer Review period "means **3 years preceding the year in which the Practice Unit is selected** or such other period or any period as may be prescribed by the Peer Review Board for conducting a Peer Review."

Assurance services

Assurance services which shall be subjected to peer review means **assurance engagements** services but **does not include:**

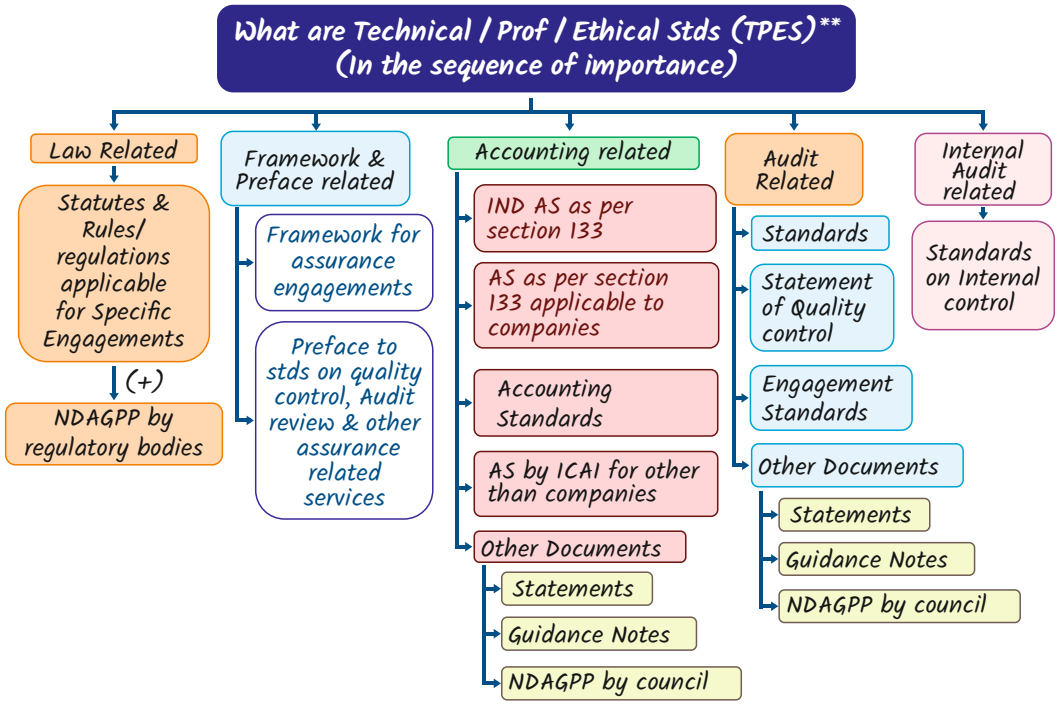
- Providing expert opinion on points of principle, such as **Accounting Standards** or the **applicability of certain laws,** on the basis of facts provided by the client.
- Engagements solely to assist the client in **preparing, compiling or collating** information other than financial statements
- Engagements for the **compilation of financial statements**
- Engagements to prepare **tax returns or advising clients in taxation matters**
- **Representation** before various Authorities
- Testifying as an **expert witness** (Courts take help of experts in law, tax, fraud etc.)
- **Management Consultancy Engagements**
- Engagement for **Due diligence**

(CNO—PR.100) WHAT TO EXAMINE? / FOCUS OF PEER REVIEW (QNO-646.000)(MCQ-PR.8,PR.9)



- Compliance with **Technical, Professional and Ethical Standards:** 4
- Quality of **reporting.** 5
- Systems and procedures for carrying out **assurance services.** 3
- **Training programmes for staff** (including articled and audit assistants) concerned with assurance functions, including availability of appropriate infrastructure. 2
- Compliance with **directions and / or guidelines issued by the Council** to the Members, including Fees to be charged, Number of audits undertaken, register for Assurance Engagements conducted during the year and such other related records. 6
- Compliance with directions and / or guidelines issued by the Council in relating to **article assistants and/ or audit assistants,** including attendance register, work diaries, stipend payments, and such other related records 1

(CNO—PR.120) WHAT ARE TECHNICAL STANDARDS? (QNO-648.000)



*(NDAGPP) :- Notification / Direction / announcements / Guidelines / Pronouncements/ Professional Standards

** It also includes Audit Quality Maturity Model

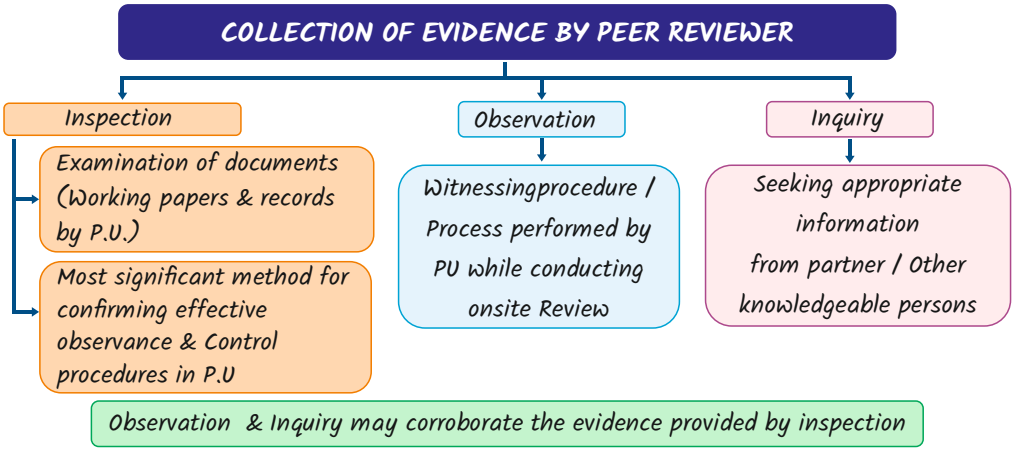
As per the Guidelines, Technical, Professional and Ethical Standards – means

- **Accounting Standards** 3
  - Accounting Standards issued by ICAI that are applicable for entities other than companies under the Companies Act, 2013;
  - Accounting Standards prescribed under section 133 of the Companies Act; 2013 by the Central Government based on the recommendation of ICAI and in consultation with the National Financial Reporting Authority (NFRA) and notified as Accounting Standards Rules 2006, as amended from to time to time
  - Indian Accounting Standards prescribed under section 133 of the Companies Act 2013 by the Central Government based on the recommendation of ICAI and in consultation with NFRA and notified as Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time.
- Standards issued by the Institute of Chartered Accountants of India including
  - **Engagement and Quality Control Standards** 4
  - **Statements** 5
  - **Guidance notes** 7
  - **Standards on Internal Audit** 6
  - Notifications / Directions / Announcements / Guidelines / Pronouncements /Professional standards **issued from time to time by the Council** or any of its committees. 8
- **Framework** for the preparation and presentation of financial statements, Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services and Framework for Assurance engagements; 2

- Provisions of the relevant ***statutes and / or rules or regulations*** which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements I

**It also includes Audit Quality Maturity Model

(CNO—PR.140) COLLECTION OF EVIDENCE BY PEER REVIEWER. (QNO-649.000)



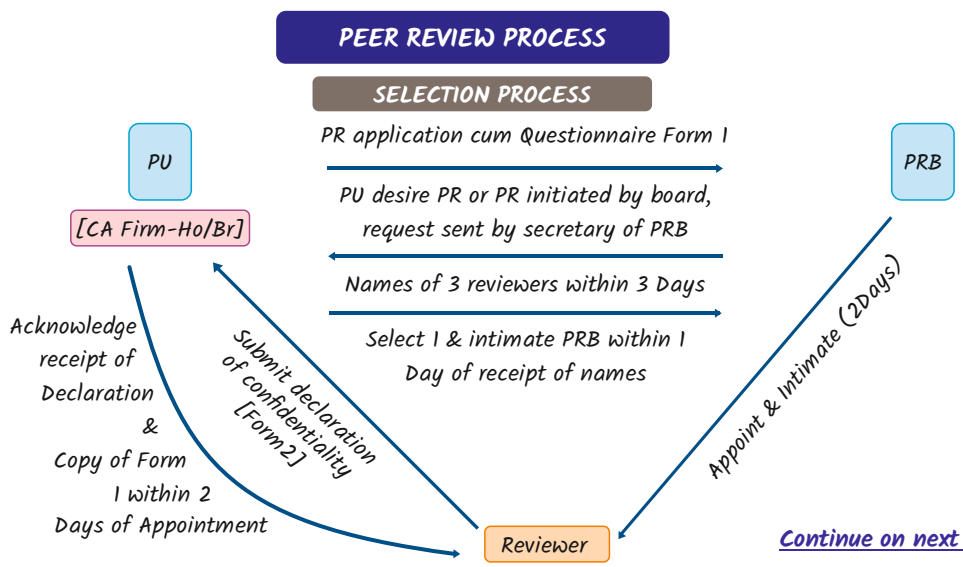
A Peer Reviewer collects evidence by applying the following methods:

- ***Inquiry*** -Inquiry consists of seeking appropriate information from the partner (designated by the practice unit for the purpose)/sole proprietor or other knowledgeable persons within the practice unit. The inquiries may originate from the responses to the questions given in the questionnaire. The inquiries may also arise from the inspection of documentation maintained by the practice unit.
- ***Observation***- Observation consists of witnessing a procedure or process being performed by others. For example, while conducting on-site review, the reviewer may review the performance of internal control.
- ***Inspection*** - Inspection mainly consists of examination of documentation (working papers) and other records maintained by the practice unit.

While observation and inquiry may be considered as external independent sources of review evidence, inspection remains the most significant method for confirming the effective observance of control procedures in the practice unit. Observation and inquiry may also corroborate the evidence provided by inspection. The reviewer, in order to carry out the review effectively, should have an understanding of the documentation maintained by the practice unit.

(CNO—PR.160) PEER REVIEW PROCESS

Amendment



Continue on next Page...

Planning Process

PU ⟷ Reviewer

- Intimate about proposed visit
- ← & proposed sample in Form 5 [Within 2 working Days] & give atleast 2 days
- ← Further/ Additional clarification in form 6
- → Send form 6 info within 1 Day

PU ⟷ Reviewer

- ← Plan & intimate about "On site review" give at least 2 Days to keep records ready
- *on site review max 6 days
- ⟷ Mutually Co-operate + Entire process to complete within 20 Days from Dt of receipt of Application or Dt of intimating PU

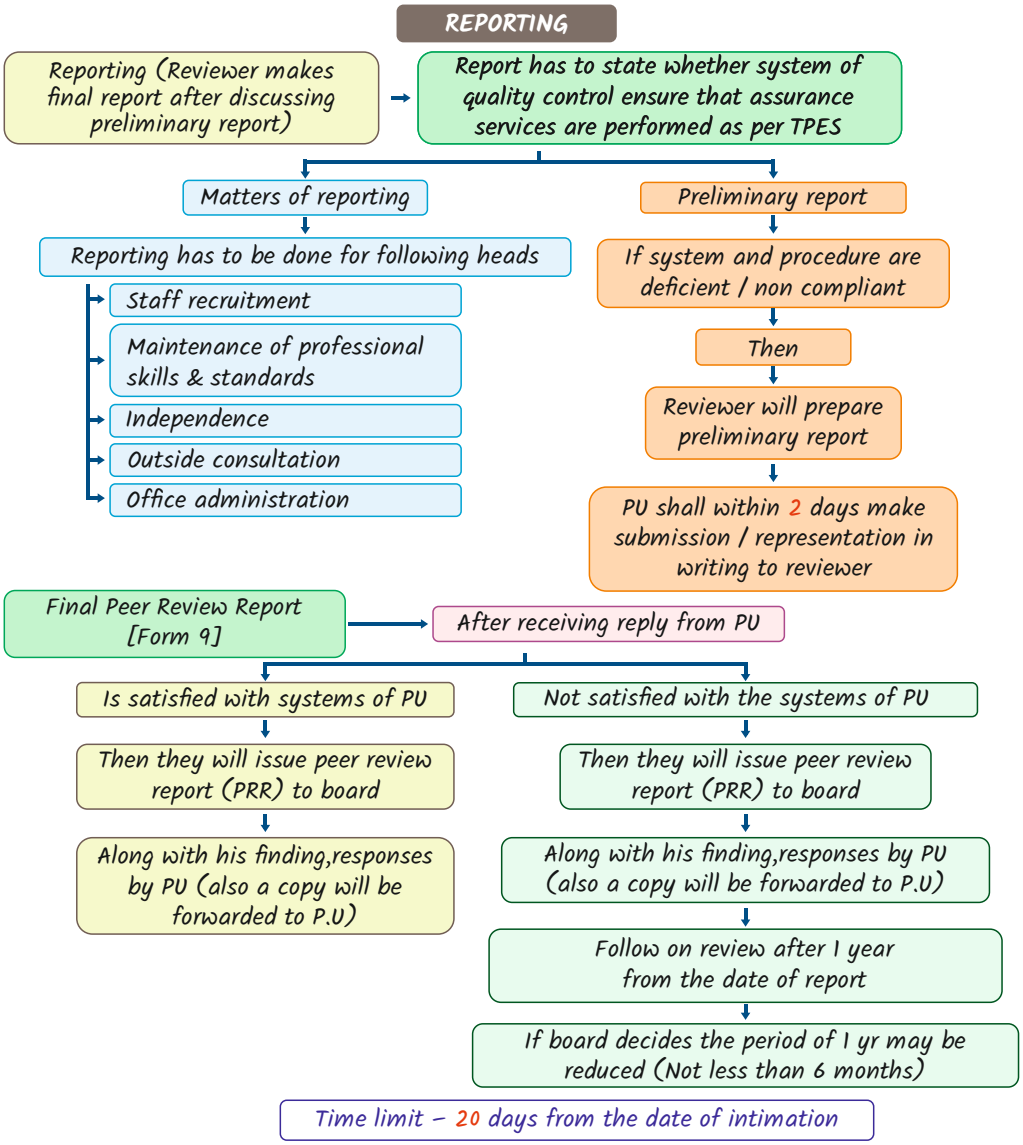
***If its new unit then 7 Days

New unit
- -On site review 1 Day
- -Only see antecedents of partners & policy parameters from Form 1

3 Execution (Reviewer & PU together ensures smooth process) → On site Review of HO / and Branch should not extend beyond 6 working days

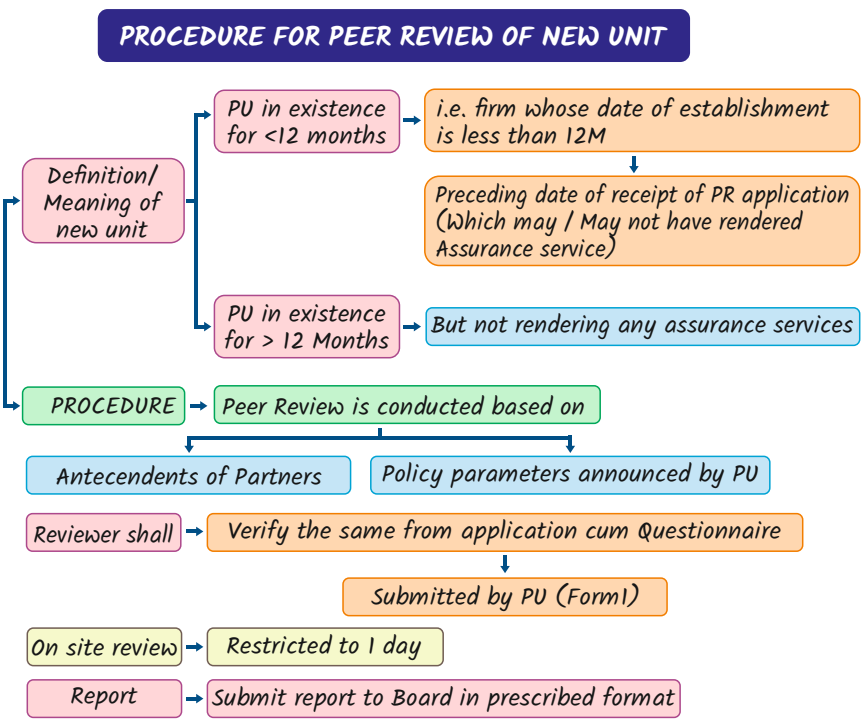
- Compliance review of general controls
  - Staff recruitment
  - Maintenance of professional skills & standards
  - Independence
  - Outside consultation
  - Office administration → Non audit work
- Selection of assurance Services engagements for Review (Final sample)
  - How big is the firm
    - Size & Nature
    - No. of partners / members
    - No. of locations / branches
  - How they work
    - Prevailing standards of quality control
    - Methodology adopted by PU
    - Fees charged / received/ GST paid
- Review of records (Approaches in review process)
  - Compliance approach → Assess control procedure which are established to conduct assignments as per Technical, professional and ethical standards
    - Control procedures regardingfollowing areas
      - Review & evaluation of system of internal control
      - Substantive tests
      - Presentation of FST
      - Conclusion & reporting
      - Maintainace & Administration of assurance service records
  - Substantive approach → We focus on working papers of the assurance engagements & we check whether they are as per Technical, Professional and Ethical Standards

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(CNO—PR.170) PROCEDURE FOR PEER REVIEW OF NEW UNIT

AMENDMENT



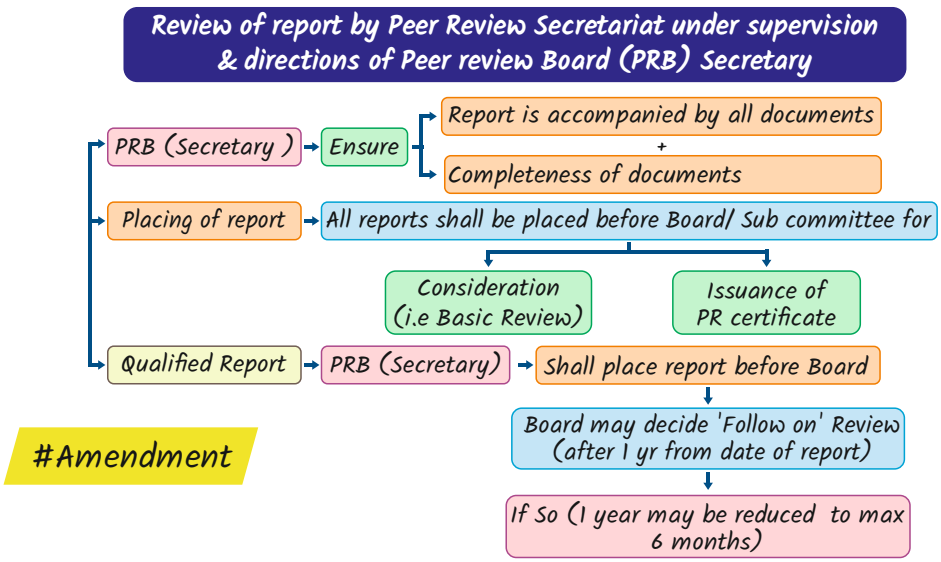
New Unit - means a firm whose date of establishment is less **than 12** months immediately **preceding the date of receipt of application** of Peer Review

and

which may or may not have rendered any assurance service during the said period or a Practice Unit in existence for a period exceeding 12 months but not rendering any assurance services.

1. Peer Review of a New Unit is to be conducted based on the antecedents of partners and policy parameters announced by the Practice Unit for conduct of attest function.
2. The Reviewer has to verify the same from the Application cum Questionnaire submitted by the Practice Unit in Form 1 as well as an onsite visit to the Practice Unit which shall be restricted to one day.

(CNO—PR.175) Review of report by Peer Review Secretariat



Review of report by the Peer Review Secretariat under the supervision and directions of Peer Review Board Secretary

(1) The Peer Review Board Secretary shall ensure that the Peer Review report is accompanied by all the documents as mentioned under Clause 9 (7) of the Guidelines. It shall also ensure that the documents are complete in all aspects.

(2) All reports shall be placed before the Board or its Sub-Committee for its consideration and issuance of Peer Review Certificate.

(3) In case of a qualified report, the Peer Review Board Secretary shall place the report before the Board for consideration. The Board may decide for a "Follow On" Review after a period of one year from the date of issue of report by the Peer Reviewer. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report.

(CNO—PR.180) THE PEER REVIEW PROCESS (THEORY)

The Peer Review process will include-

- Selection of Practice Unit and appointment of Reviewer,
- Planning
- Execution and
- Reporting.

Selection of Practice Unit & appointment of Reviewer

SELECTION PHASE (Procedure for initiating Peer Review)

(1) Practice Units which desire to get Peer Reviewed shall make an application for Peer Review in the Application cum Questionnaire in Form I.

(2) In case the Peer Review is initiated by the Board, the Application cum Questionnaire in Form I should be submitted by the Practice Unit on the request of the Peer Review Board Secretary.

(3) The Application mentioned above received by the Board shall be duly numbered.

(4) On receipt of the said Application cum Questionnaire, names of three (3) Reviewers shall be recommended by the Board to the Practice Unit within three working days.

(5) The Practice Unit shall select one out of the three recommended Reviewers and intimate to the Board within one working day of receipt of the names.

(6) The Board shall appoint the Peer Reviewer selected by the Practice Unit in accordance with these Guidelines.

(7) The Board shall intimate the Reviewer so selected to submit a Declaration of Confidentiality in Form 2 to the Practice Unit within two working days from the receipt of choice of name of the Reviewer from the Practice Unit.

(8) The Practice Unit shall also provide a copy of the Application cum Questionnaire in Form I to the Reviewer within two working days of the appointment of the Reviewer.

Planning (QNO-650,500)

PLANNING PHASE (Peer Review Procedure to be followed by the Peer Reviewer)

(1) Before commencement of Peer Review, the Peer Reviewer shall ensure that the Declaration of confidentiality is furnished to the Practice Unit and acknowledgement of receipt thereof is obtained by him.

(2) On receiving the Application cum Questionnaire in Form I from the Practice Unit, the Peer Reviewer shall initiate the Peer Review by intimating the Practice Unit of proposed visit and the proposed samples selected to be kept ready by the Practice Unit. The proposed samples selected are to be intimated by the Peer Reviewer in Form 5 prescribed by the Board.

(3) The Reviewer may seek further/ additional clarification in Form 6 from the Practice Unit on the information furnished/ not furnished by the Practice Unit in the Questionnaire. The Practice Unit shall provide this additional information to the Reviewer within one working day.

(4) The Reviewer shall, within two working days of receiving the information from the Practice Unit, select assurance service engagements that he would like to review and intimate the same to the Practice Unit and the Peer Review Board in Form 5.

(5) The Reviewer shall plan for an "on-site review" visit for initial meeting in consultation with the Practice Unit. The Reviewer shall give the Practice Unit at least two working days to keep ready necessary records of the selected assurance services in Form S.

(6) The Reviewer and Practice Unit shall mutually co-operate and ensure that the entire review process is completed within twenty working days from the date of receipt of application from the Practice Unit for being Peer Reviewed or from the date of notifying the Practice Unit about its selection for Review as the case may be.

(7) In case of Peer Review of a New Unit, the Reviewer and Practice Unit shall mutually co-operate and ensure that the entire review process is completed within seven working days from the date of receipt of application cum questionnaire from the Practice Unit for being Peer Reviewed

Execution (MCQ-PR.5, Incs.05.3)

(QNO-650.600)

AMENDMENT

- Peer Review visits will be conducted at the Practice Unit's head office or /and branch(es) or any other locations. **This on-site Review should not extend beyond 6 days working days based on the size of the Practice Unit**
- **Compliance Review-General Controls**
  - The Reviewer is required to carry out a compliance Review of the following General Controls for evaluating the degree of reliance to be placed upon them for effective Review:
    - Independence
    - Maintenance of Professional Skills and Standards
    - Outside Consultation
    - Staff recruitment, Supervision and Development
    - Office Administration
- **Selection of Assurance Service Engagements for Review**
  - The number of assurance service engagements to be Reviewed shall depend upon:
    - Its size and nature 1(Big Bigger Sample & More Banks More Bank Audits)
    - Generally prevailing standards of quality control 4(Poor Standards Bigger Sample)
    - Methodology adopted by PU 5 (Manual Vs Computer Based)
    - Number of partners/members involved 2(More Partners Bigger Sample)
    - Number of locations/ branch offices 3 (Ensure selection from all locations / branches)
    - Fees charged / received / gst paid6 (All range of assignments)
  - From the initial sample selected at the planning stage, the Reviewer, in consultation with the Practice Unit, may reduce or enlarge the initial sample size of assurance service engagements for Review.

Review of Records. (Approaches in Review Process)

The Reviewer is required to adopt a combination of compliance approach and substantive approach in the Review process.

- **Compliance Approach – Assurance Service Engagements**

  The compliance approach is to assess whether proper control procedures have been established / followed by the Practice Unit to ensure that assurance services are being performed in accordance with Technical, Professional and Ethical Standards.

  The following areas shall be considered:

  - Review and Evaluation of **System of Internal controls.**
  - **Substantive Tests.**
  - Financial Statements **Presentation and Disclosures**
  - Assurance Services **Conclusions.**
  - Assurance Services **Reporting.**
  - Assurance services **records for Administration.**

- **Substantive Approach – Assurance Service Engagements: –**

  This approach requires a Review of the assurance working papers in order to establish the extent of compliance, whether the assurance work has been carried out as per the Technical, Ethical, and Professional Standards.

Reporting (QNO-651.000) (MCQ-PR.3 / Incs.05.6)

AMENDMENT

After completing the on-site review, the Reviewer, shall submit the Peer Review Report to the Board along with Form 9 if in his opinion, the Practice Unit has adequate systems and procedures in compliance with the Technical, Professional and Ethical Standards. A copy of the report shall also be forwarded to the Practice Unit.

1. In case, in the opinion of the Peer Reviewer, the systems and procedures of the Practice Unit are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification, he shall communicate his findings to the Practice Unit, in a Preliminary Report issued by him.

2. The Practice Unit shall, within two working days of the date of receipt of the findings, make its submissions or representations, in writing to the Reviewer.

3. If the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit an unqualified Peer Review Report to the Board along with Form 9. A copy of the report shall also be forwarded to the Practice Unit.

4. In case the Reviewer is of the opinion that the response submitted by the Practice Unit under clause 9(4) above is not satisfactory, the Reviewer shall submit a Qualified Report to the Board incorporating his reasons for the same along with Form 9. A copy of the report shall also be forwarded to the Practice Unit.

5. The Peer Review Report should state that the system of quality control for the assurance services of the Practice Unit for the period under Review has been designed so as to carry out the assurance services in a manner that ensures compliance with Technical, Professional and Ethical Standards.

6. The Peer Reviewer shall ensure to submit the following documents along with the Peer Review Report:
   (i) Copy of Questionnaire as received from the Practice Unit
   (ii) List of samples selected by him in accordance with the criteria prescribed by the Board
   (iii) Preliminary Report, if issued, along with Practice Unit's submissions on the same.
   (iv) Annexures to the Report as prescribed by the Board

7. The Practice Unit as well as the Reviewer shall ensure that all documents submitted to the Board are duly dated, signed and complete in all aspects.

8. The Reviewer and Practice Unit shall mutually co-operate and ensure that the entire review process is completed within twenty working days from the date of receipt of application from the Practice Unit for being Peer Reviewed or from the date of notifying the Practice Unit about its selection for Review as the case may be.

9. In case of Peer Review of a New Unit, the Reviewer and Practice Unit shall mutually co-operate and ensure that the entire review process is completed within seven working days from the date of receipt of application cum questionnaire from the Practice Unit for being Peer Reviewed.

Discussion / Communication of Findings (QNO-651.000) (MCQ-Incs.05.4)

- After completing the on-site review, the Reviewer, before making his Report to the Board, shall communicate his findings to the Practice Unit if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification.
- The Practice Unit shall, within 5 days of the date of receipt of the findings, make its submissions or representations, in writing to the Reviewer (i.e. Response to the Preliminary Report).

Peer Review Report of Reviewer (QNO-651.000)

- At the end of an on-site Review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.
- In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings (i.e. Preliminary Report), response by the Practice Unit (Response to Preliminary Report) and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

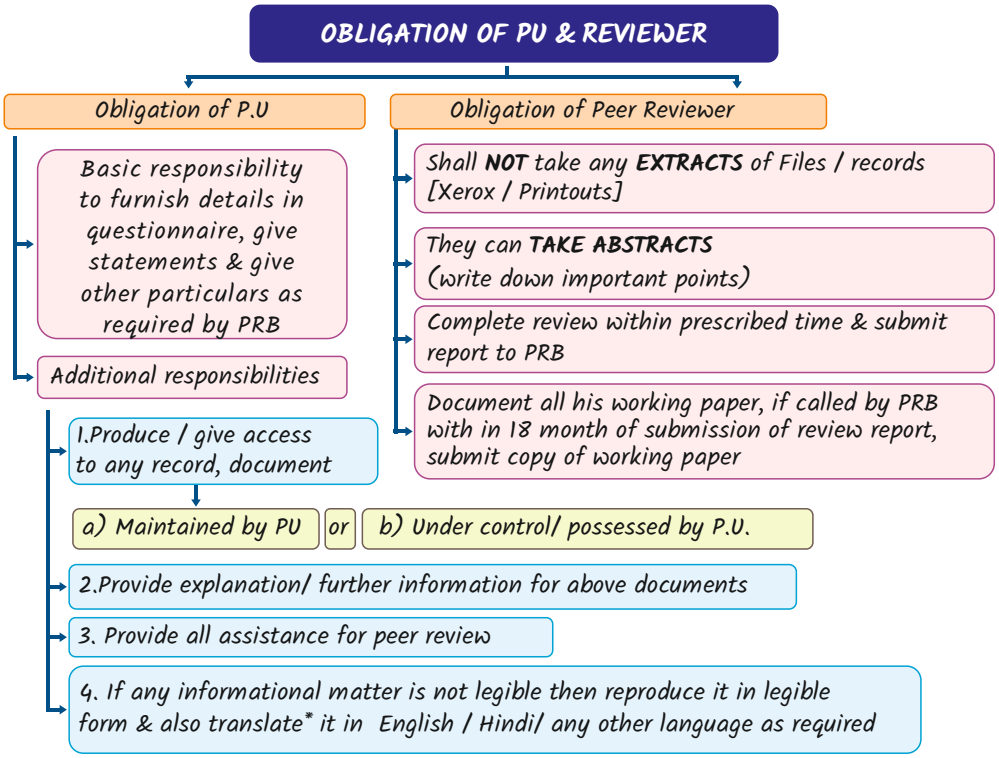
Follow On

- In case of a modified report, The Board shall order for a **"Follow On" Review after a period of one year from the date of issue of report as mentioned in (b) above. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report.**

Time Limit

- Peer review should be completed **within 60 days** of intimating practicing unit

(CNO—PR.200) OBLIGATION OF PU &REVIEWER (QNO - 653.025)



*PU shall be responsible & accountable for accuracy & truthfulness of translation

Obligation of PU

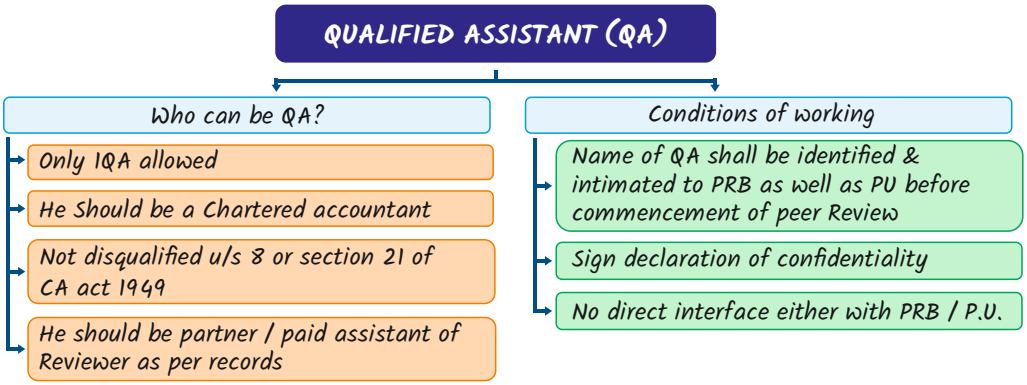
Any Practice Unit, in addition to the prescribed information to be furnished including the questionnaire, statements and such other particulars as the Board may deem fit, shall comply with the following.

- **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.
- **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.
- **Provide to the Reviewer all assistance** in connection with Peer Review;
- 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 are production 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.

Obligations of the Peer Reviewer

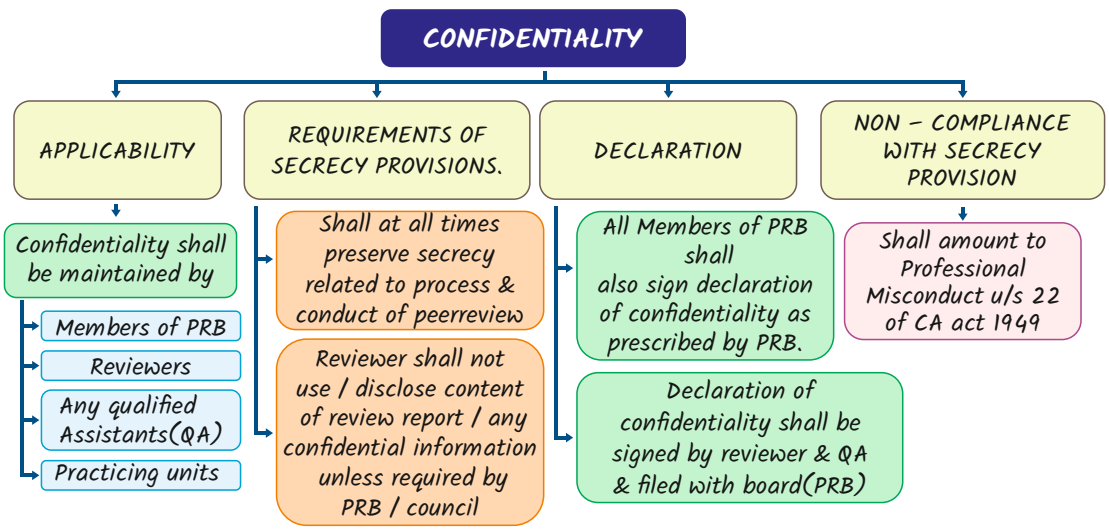
- The Reviewer **shall not take any extracts** of the Practice Units clients' file or records examined by him while conducting Peer Review, as a part of his working papers.
- The Reviewer shall complete the Review within the prescribed time frame and submit the report to the Board.
- The Reviewer shall document all his working papers and submit a copy of his working papers to the Board, if called for by the Board within 18 months of submission of Review Report.

(CNO—PR.220) QUALIFIED ASSISTANT



- The reviewer may take the help of a qualified assistant while carrying out peer review. In this context, the Board decided to clarify that a reviewer is permitted to take the assistance of only one assistant who shall be a chartered accountant and a person who does not attract any of the dis-qualifications prescribed under Section 8 or Section 21 of the Chartered Accountants Act, 1949
- The name of the qualified assistant which the reviewer would like to assist him shall be identified and intimated to the Board as well as the practice unit before the commencement of the peer review
- Such a qualified assistant shall also have to sign the declaration of confidentiality as annexed to the Statement
- He shall have no direct interface either with the practice unit or the Board. Further the person chosen for assisting the reviewer shall be from the firm of the reviewer as a partner or paid assistant as per the records of ICAI

(CNO—PR.230) CONFIDENTIALITY



Discussion

- Strict confidentiality shall be maintained by all those involved in the Peer Review process, namely, Reviewers, members of the Board, any Qualified Assistants or Practice Unit.
- All persons governed by the secrecy provisions:
  - shall at all times preserve and aid in preserving secrecy with regard to any matter arising in the performance or in assisting in the performance of any function, directly or indirectly related to the process and conduct of Peer Reviews;
  - Reviewer shall not make use of or disclose the contents of Review report or and confidential information about the process of Review unless as required by the Board or the Council.

- Non-compliance with the secrecy provisions in the above clause shall amount to professional misconduct as defined under Section 22 of the Chartered Accountants Act, 1949.
- A Declaration of Confidentiality shall be signed by the persons who are responsible for the conduct of Peer Review i.e., Reviewers and his Qualified Assistants and be filed with the Board. A Declaration of Confidentiality (Form 4) shall be signed by all members of the Board and the Board's Secretariat.

(CNO—PR.240) APPLICABILITY

AMENDMENT

MANDATORY PEER REVIEW (APPLICABILITY)

4 Phases

Dt of Applicability	Partner criteria	OR	Other Criteria (Proposal to undertake following stat Audit)
1st April 22	NA		Debt/ Equity listed in India/ Abroad
1st April 23	5 or more partners		Unlisted public co PC >= 500 crore *** Loan/ Deb/ Deb >= 500 crore To >= 1000 crore
1st April 24	4 or more partners		Raised Funds from public/ Bank/ FI > 500 crore during the period under review or corporate/ Trust considered public Interest public Interest extities
1st April 25	3 or more partners		Audit of Br of PSU Banks

Practice Units subject to Review

Earlier practice units were classified under Level -I and Level-II category. However, under Peer Review Guidelines this has been replaced with **Peer Review Mandate implementation.** As per Clause 5 of Peer Review Guidelines, 2022, criteria of Peer Review are defined on following basis:

a) **Mandatory** – Peer Review can be mandated for such Practice Units as may be **decided by the Council.** Or,

b) **Voluntary** – Any Practice Unit may, **Suo motu,** apply to the Board for the conduct of its Peer Review. Or,

c) **Special Case** – The Board, **based on specific information** received from Secretary, ICAI or Disciplinary directorate or any other Regulator, which in the **opinion of the Board requires a special Peer Review** of the Practice Unit, may conduct a special Peer Review of the Practice Unit for such a period determined by the Board.

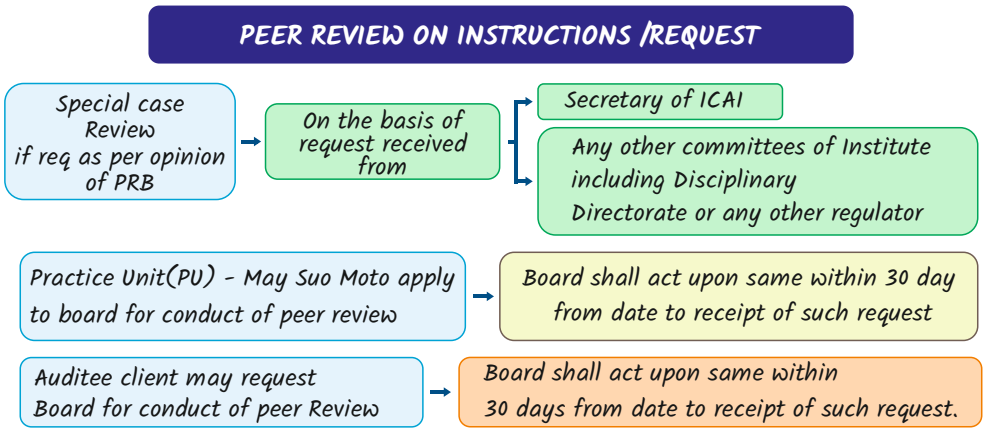
Also, it was clarified that holding a valid Peer Review certificate by Practice Units should be a prerequisite for undertaking audit of all entities falling under phase I; II; III and IV of the mandate from respective dates of mandate becoming operative.

4 Stages of Peer Review Mandate (Revised)

Phase	Category of firms covered for Mandatory Peer Review	Date from which Peer Review is Mandatory
I(*)	Practice Units which propose to undertake Statutory Audit of enterprises whose **equity or debt** securities are **listed in India or abroad** as defined under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015: For these Practice Units, there is a **pre-requisite** of having **Peer Review Certificate.**	**1st April 2022**
II	Practice Units which propose to undertake Statutory Audit of **unlisted public companies** having **paid-up capital** of not less than rupees five hundred crores (500) or • having **annual turnover** of not less than rupees one thousand crores(1000) or • having, in aggregate, **outstanding loans, debentures and deposits** of not less than rupees five hundred crores (500) as on the 31st March of immediately preceding financial year: For these Practice Units, there is a prerequisite of having Peer Review Certificate. OR Practice Units rendering attestation services and having **5 or more partners**: For these Practice Units, there is a pre-requisite of having Peer Review Certificate before accepting any Statutory audit.	**1st April 2023**
III	Practice Units which propose to undertake the **Statutory Audit** of entities which have raised funds **from public or banks or financial institutions** of over **Fifty Crores rupees** during the period under review or of anybody **corporate including trusts** which are covered under **public interest entities** : For these Practice Units, there is a pre-requisite of having Peer Review Certificate. OR Practice Units rendering attestation services and having **4 or more partners**: For these Practice Units, there is a pre-requisite of having Peer Review Certificate before accepting any Statutory audit	**1st April 2024**
IV	Practice Units which propose to undertake audits of branches of **Public Sector banks** : For these Practice Units, there is a pre-requisite of having Peer Review Certificate. OR Practice Units rendering attestation services and having **3 or more partners**: For these Practice Units, there is a pre-requisite of having Peer Review Certificate before accepting any Statutory audit.	**1st April 2025**

*) for auditors from this category, Peer Review is **already mandatory by SEBI**; this mandate is a further requirement stipulated by the ICAI

Thus, at each phase, **before undertaking statutory audit**, the concerned Practice Unit should **possess Peer Review Certificate.**



*NOTE: - Board may with the approval of council, modify any of the above criteria.

Peer Review on Instructions or Request

- The Board, based on specific information received from
  - Any Regulator,
  - Secretary, ICAI or
  - Disciplinary Directorate or

  which in the opinion of the Board requires a special review of the Practice Unit, may conduct a special review of the Practice Unit for a period to be determined in each case.
- Any Practice Unit not selected for Peer Review, may Suo motto apply to the Board for the conduct of its Peer Review. The Board shall act upon the same within 30 days from the date of receipt of such request.
- An Auditee (Client) may request the Board for the conduct of Peer Review of its auditor (Practice Unit). The Board shall act upon the same within 30 days from the date of receipt of such request.

  The Board may with the approval of the Council, modify any of the above criteria.

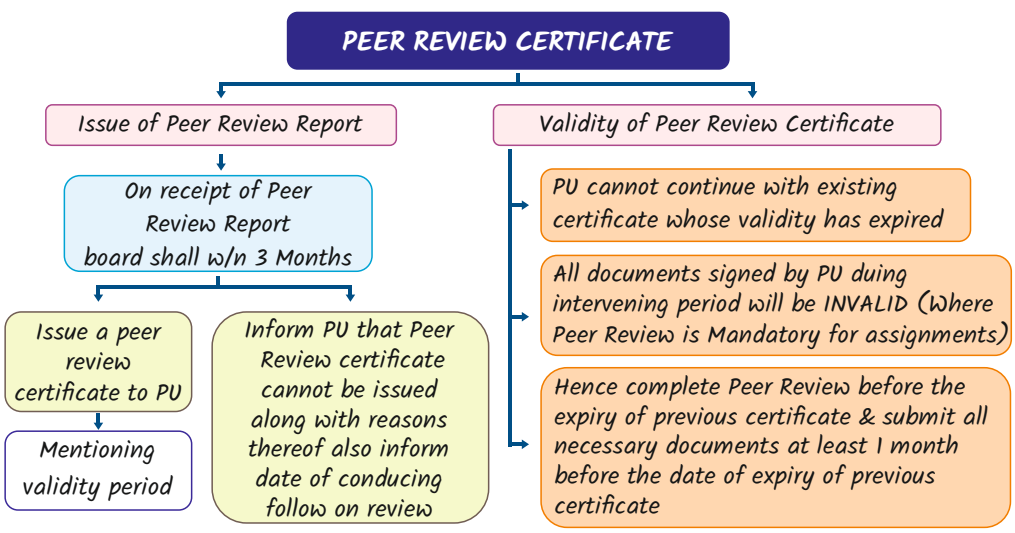
Periodicity of Peer Review

- The Periodicity of Peer Review will be:

  (a) Level - I Practice Units – Once in 3 years.

  (b) Level - II Practice Units – Once in 4 years

(CNO—PR.260) PEER REVIEW CERTIFICATE



1) In case of an unqualified report issued by the Peer Reviewer, the Peer Review Board Secretary shall place the report before the Board or its Sub-Committee for consideration and issuance of Peer Review Certificate to the Practice Unit, but only after the Peer Reviewer confirms the fee receipt from the Practice Unit by him.

2) A Peer Review Certificate shall be issued to New Units subject to the Procedures followed by the reviewer as prescribed under Clause 8 of these Guidelines and other clauses of these Guidelines, as the case may be.

NOTE

3) The Certificates so issued by the Board or the Sub-Committee shall be noted by the Board at its meeting.

SIGN

4) The Certificate shall be duly signed by the Chairman, Vice Chairman and Secretary of the Board mentioning the validity period.

SECURE

5) The Peer Review Board Secretary shall serve the Peer Review Certificate upon the Practice Unit.

LIST

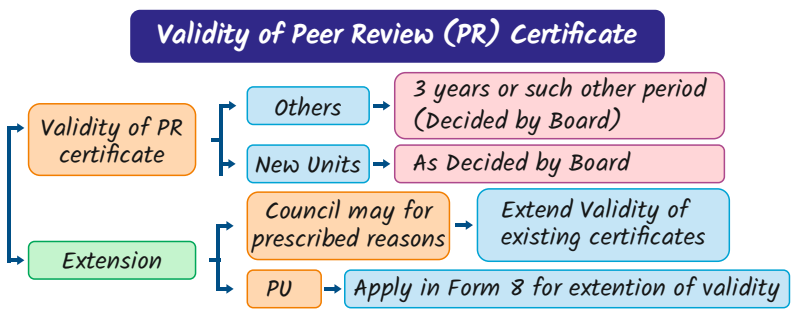
6) The Peer Review Board Secretary shall update the List of Practice Units having a valid Peer Review certificate incorporating the names of Practice Units to whom the Peer Review certificates have been issued on the ICAI website.

QUALIFIED

7) In cases where a Qualified Report has been issued by the Reviewer and has been considered by the Board, the Peer Review Board Secretary shall inform the Practice Unit that a Peer Review certificate cannot be issued along with the reasons therefor as well as inform about the due date for conducting a follow on review as may be decided by the Board.

(CNO—PR.26S) VALIDITY OF PEER REVIEW CERTIFICATE

AMENDMENT



Validity of Peer Review Certificate

A Practice Unit cannot continue with the existing certificate, whose validity has expired. All documents signed by the Practice Unit during the intervening period (i.e. expiry of previous certificate and issuance of new certificate) will be invalid. Therefore, it is the responsibility of the Practice Unit to complete the Peer Review of the firm and submit all necessary documents at least one month before the date of expiry of the previous certificate.

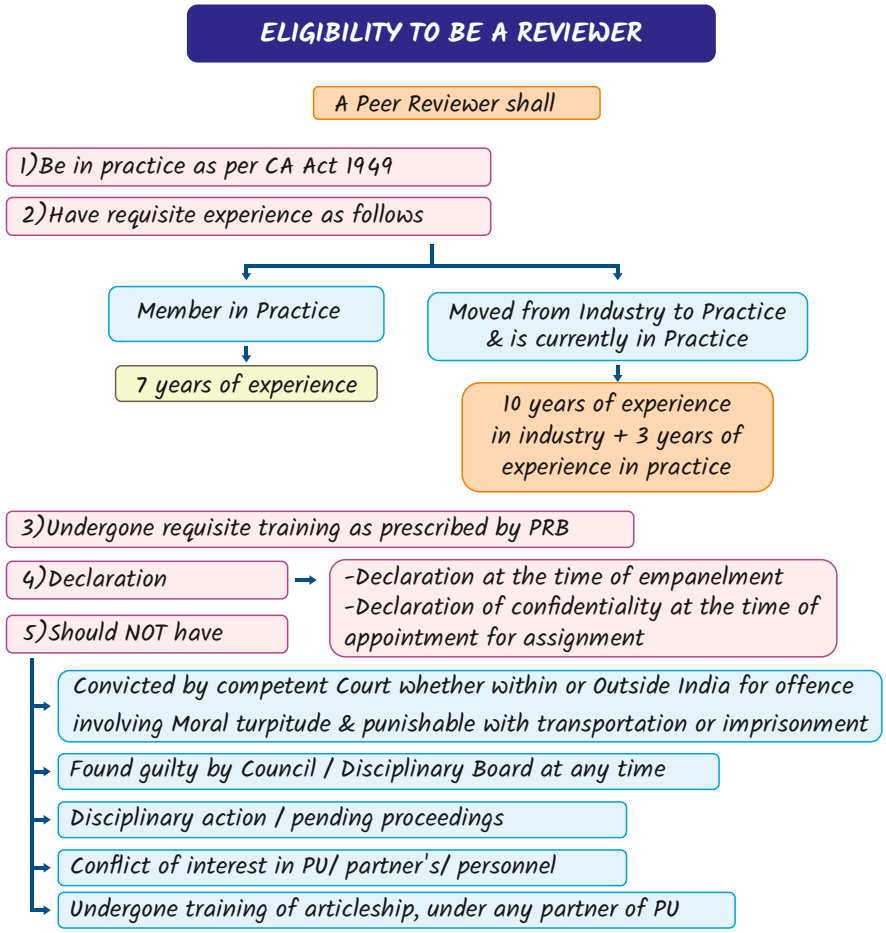
The Peer Review Certificate issued to a Practice Unit shall be valid for a period of three years or such other period as may be decided by the Board commencing from the date of receipt of Peer Review report by the Board.

The validity of the Peer Review Certificate issued to New Units shall be decided by the Board.

The Council may for such reasons as may be prescribed by it extend the validity of existing Peer Review certificate granted to a Practice Unit.

The Practice Unit shall make an Application in Form 8 requesting for extension of validity

(CNO—PR.280) ELIGIBILITY TO BE A REVIEWER (QNO-653.010, 653.020) (MCQ-PR.6)



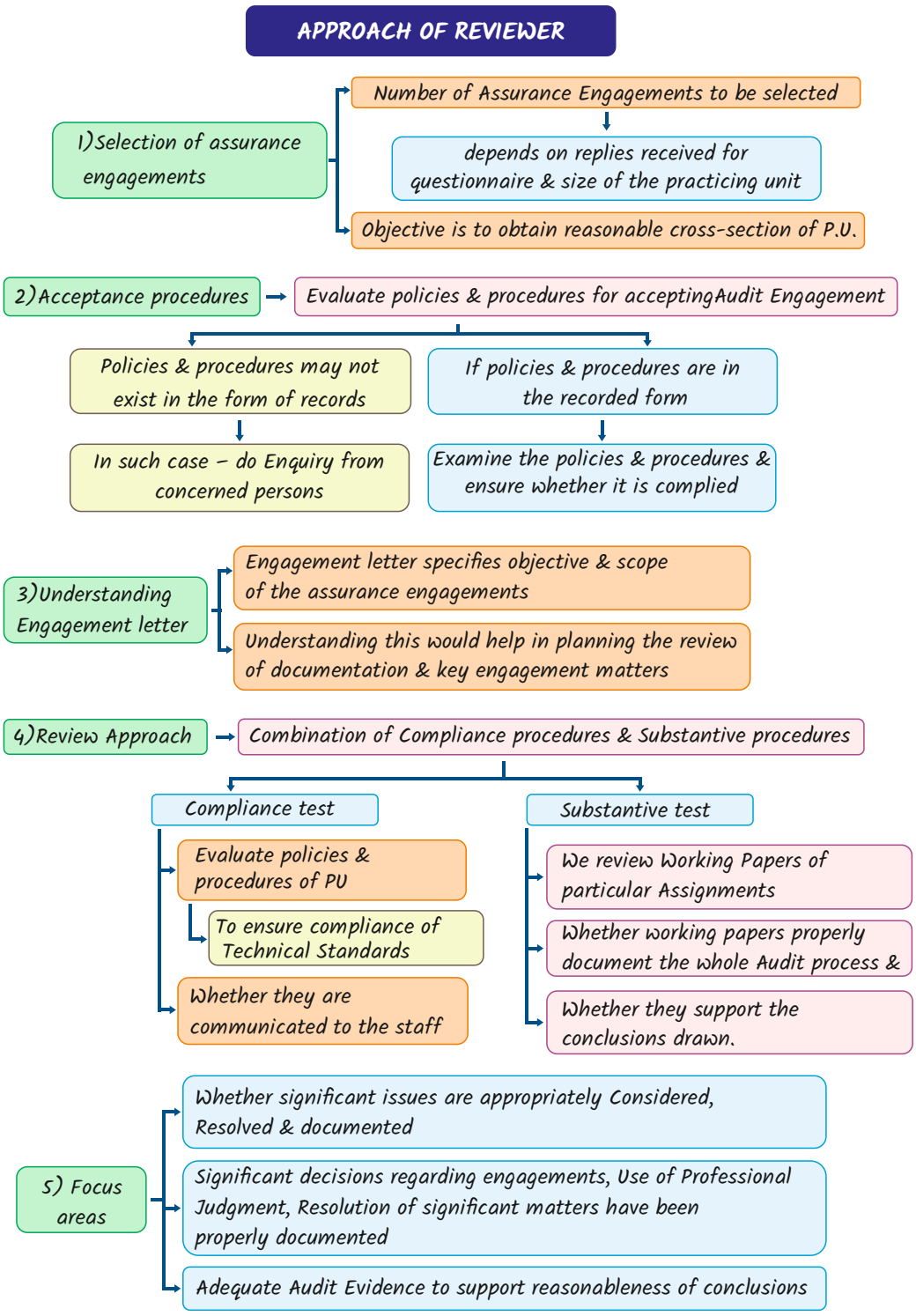
A Peer Reviewer shall:

- Experience 2
  - Shall be a member in practice with at least 7 years of assurance practice experience.
  - In case a member has moved from industry to practice and is currently in practice he should have at least 10 years of audit experience in industry and at least 3 years audit experience in practice.
  - Should have undergone the requisite training and cleared the requisite test for Peer Review as prescribed by the Board. Is in Practice as per the Chartered Accountants Act, 1949. 1
- Should have undergone the **requisite training as prescribed by the Board.** 3
- Declaration 4
  - a declaration as prescribed by the Board, at the time of Empanelment as a Peer Reviewer.
  - a Declaration of Confidentiality as per Annexure A to this Statement while giving consent for appointment as a Peer Reviewer.
- For being a Reviewer, a member should not have: - 5
  - Disciplinary action / proceedings pending against him
  - been found guilty by the Council or the Disciplinary Board or Committee at any time.

- been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with transportation or imprisonment.
- any Obligation or conflict of interest in the Practice Unit or its Partners / Personnel.
- He has undergone training/articleship under any of the partner of Practice Unit.

➢ A Reviewer shall not accept any professional assignment from the Practice Unit for a period two years from the date of appointment. Further, he should not have accepted any professional assignment from the Practice Unit for a period of two years before the date of appointment as reviewer of that Practice Unit.6

(CNO—PR.300) APPROACH OF REVIEWER (QNO-653.000)



Approach of the Reviewer: *Briefly, the stepwise approach which may be adopted by the reviewer is discussed in the following paragraphs:*

- *The reviewer should gain an* ***understanding of the engagement letter*** *since an assurance engagement or for that matter any other kind of engagement should begin with an engagement letter. Engagement letter is an important document as it defines the nature and scope of the assurance engagement, practice unit's responsibilities with regard to the engagement. This understanding would help him in* ***planning the review of documentation.*** *The reviewer should focus the review primarily on the key engagement matters. The reviewer should also consider the materiality of the matter while planning the review.3*

- *The* ***number of assurance engagements*** *to be selected requires the exercise of judgement by the reviewer based on the evaluation of replies given in the* ***questionnaire and the size of the practice unit.*** *The objective is to obtain a reasonable cross-section of the practice unit's clients although greater weight may be given to large clients. 1*

- *The practice unit may have* ***policies and procedures for accepting a particular engagement.*** *These policies and procedures may not exist in the form of records in each practice unit. In such a case the reviewer should consider enquiring from the concerned persons about such policies and procedures. The reviewer should, wherever possible, examine that the policies and procedures for acceptance of audit have been complied with and necessary documentation with regard to the same exists. 2*

- *The reviewer may follow a combination of* ***compliance procedures and substantive procedures*** *throughout the peer review process. The mix of compliance and substantive procedures depends upon the professional judgement of the reviewer. The reviewer may consider the following:4*

  - *In* ***carrying out the compliance tests,*** *the reviewer may evaluate whether the policies and procedures of the practice unit are sufficient to ensure compliance of technical standards and whether these policies and procedures are adequately communicated to all staff who are involved in carrying out the assurance work.*

  - ***In performing substantive tests,*** *the reviewer should evaluate whether the practice unit's working papers relating to the client adequately document the findings and conclusions and whether the report of practice unit is in consonance with the findings and conclusions drawn.*

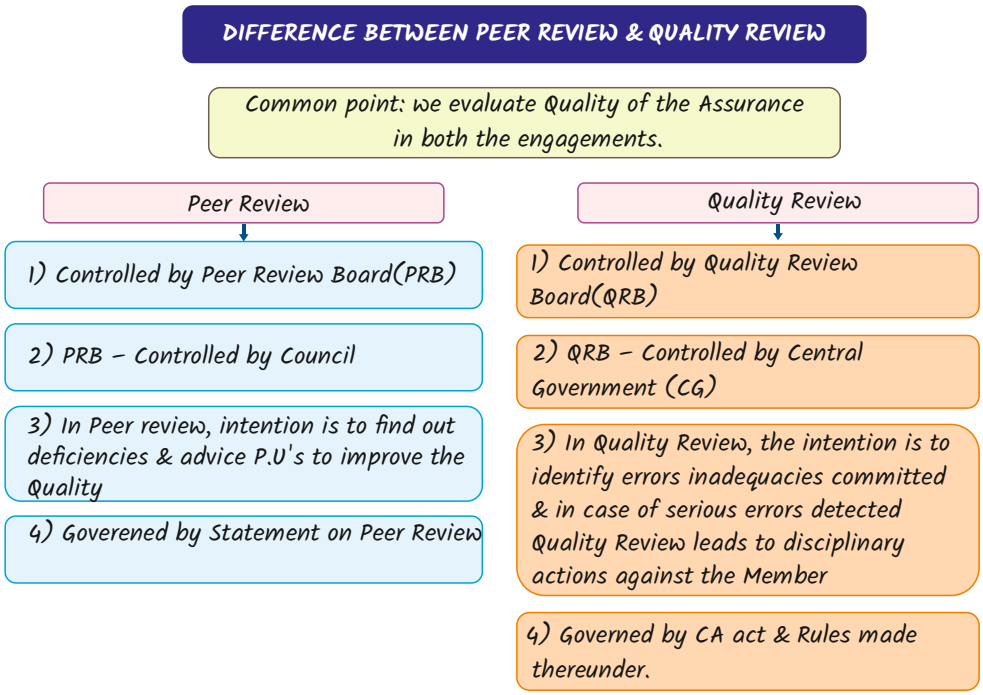
- *Finally, the reviewer while* ***evaluating records*** *may consider the following:*

  - *determine that any* ***significant issues,*** *matters, problems that arose during the course of the engagement have been appropriately considered, resolved and documented;(i)*

  - *determine that* ***adequate audit evidence*** *or other relevant evidence in relation to the engagement is obtained to support the reasonableness of the conclusions drawn; and(iii)*

  - *determine that* ***significant decisions relating to the engagement,*** *use of professional judgement, resolution of significant matters have been properly documented.(ii)*

(CNO—PR.320) DIFFERENCE BETWEEN PEER REVIEW AND QUALITYREVIEW (QNO-653.035)



- Peer review is a review of the systems and procedures of an audit firm. Although sample audit files are inspected by the peer reviewer, it is done for the purpose of testing the effectiveness of the systems and procedures. The intention is to not to find faults but to help the firm develop effective systems. It is a kind of mentoring process. Peer review is apart of the activities of ICAI aimed at improving the quality of service.
- In contrast, a quality review is supposed to act as a deterrent. Quality Review Board (QRB)is constituted by the Central Government and is independent of ICAI. As per Section 28A o fthe Chartered Accountant's Act, the Central Government has the authority to constitute a Quality Review Board. QRB carries out supervisory and disciplinary functions. A quality review normally pertains to one particular audit conducted by an audit firm. The main objective quality review is to find errors or inadequacies, if any, committed by the auditor while conducting the audit. Serious errors detected in quality review lead to disciplinary action against the member.

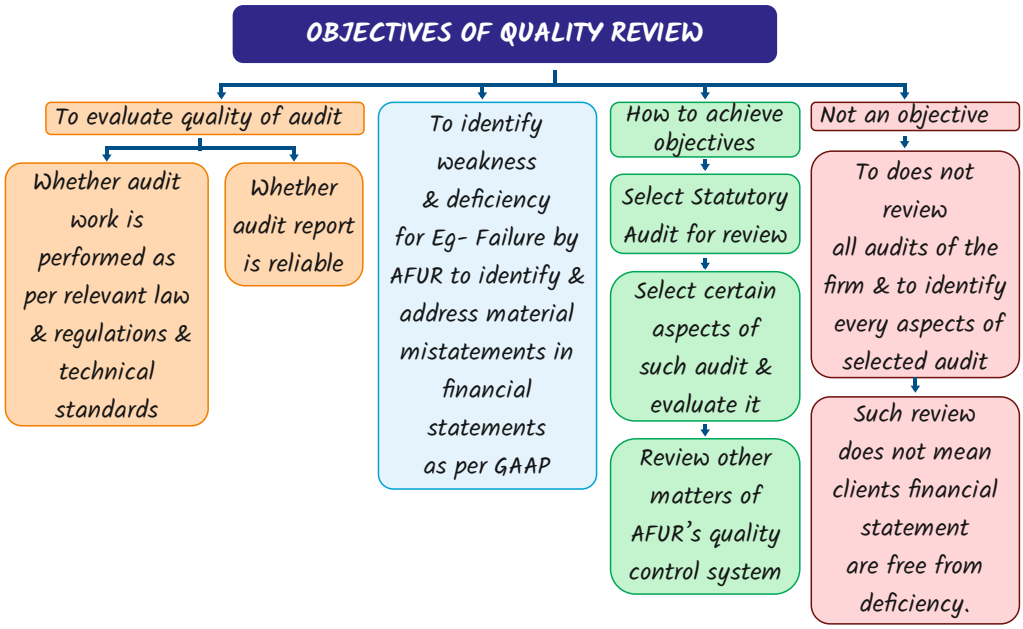
Unique Question	
QNO 650.000	Independence
QNO 653.030	Inherent Limitation of Peer Review

Students Notes

Part -2 QUALITY REVIEW

(CNO—QR.020) OBJECTIVES OF QUALITY REVIEW (QNO-653.040)

Chart



Evaluate Audit Quality

Quality review is directed towards evaluation of audit quality and adherence to various statutory and other regulatory requirements.

Identify & Address Weaknesses & Identify Deficiency & Failures

They are designed to identify, and address weaknesses and deficiencies related to how the audits were performed by the audit firms.

In the course of reviewing aspects of selected audits, a review may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, aspects in which an entity's financial statements do not present fairly the financial position or the results of operations in conformity with the applicable Generally Accepted Accounting Principles (GAAP) and other technical standards.

Review Aspects of Selected Statutory Audits & Firms Quality Control System

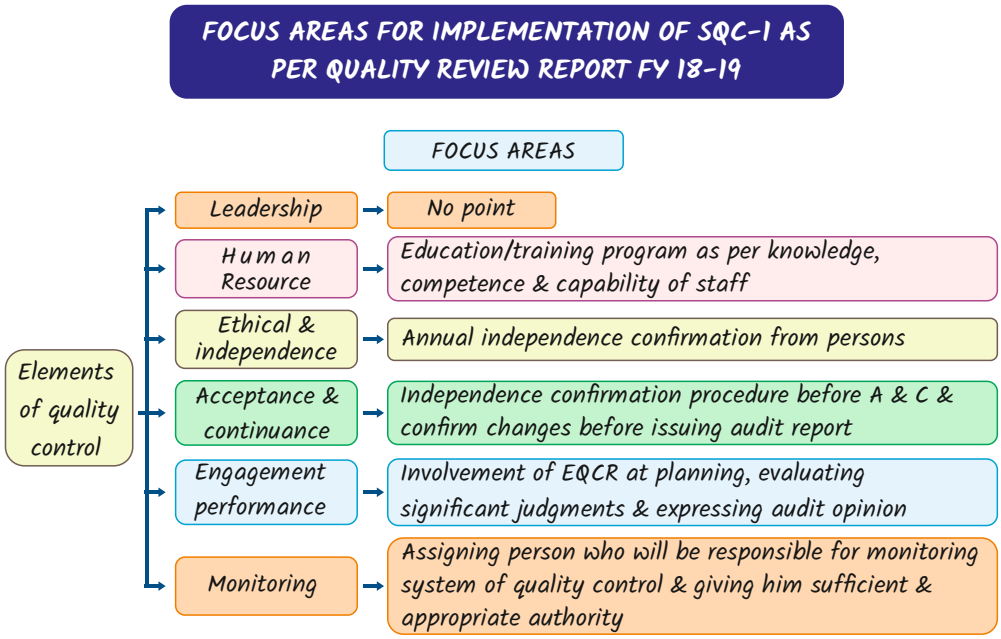
To achieve that goal, quality reviews included reviews of certain aspects of selected statutory audits performed by the firm and reviews of other matters related to the firm's quality control system.

Not the Purpose to Review all Audits

It is not the purpose of a review, however, to review all of a firm's audits or to identify every aspect in which a reviewed audit is deficient. Accordingly, a review should not be understood to provide any assurance that the firm's audits, or its clients' financial statements or reporting thereon, are free of any deficiencies.

(CNO—QR.040) EXAMPLE OF IMPORTANT AREAS AS PER QUALITY REVIEW REPORT (QNO- 653.095)

Chart



(1) Whether the audit firm establishes and implements policies and procedure on **all the element of system of quality control**

(2) Whether the **engagement quality control reviewer review** at an appropriate time for the planning of an audit, significant audit judgement, and expressions of an audit opinion.

(3) Whether the audit firm assigns as the **person responsible for the monitoring of the system of quality control** a person with appropriate experience for the role, vest the assigned person with sufficient and appropriate authority.

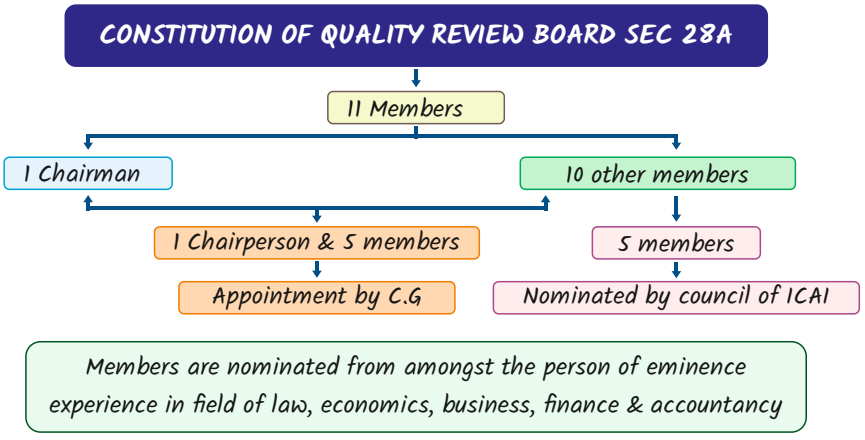
(4) Whether the audit firm obtain, at least **annually, a confirmation letter concerning compliance** with policies and procedure for the maintenance of independence from all person required to maintain independence.

(5) Whether the audit firm perform the **independence confirmation procedure** set forth in its internal rules before acceptance and continuance of an audit engagement, and when issuing the auditor's report appropriately confirms that there was no change in the status of independence.

(6) Whether the audit **firm develop and provides education/ training program** that fully take into account the knowledge, experience, competence and capabilities of the professional staff

(CNO—QR.060) CONSTITUTION AND COMPOSITION OF QUALITY REVIEW BOARD

Chart



CA Act

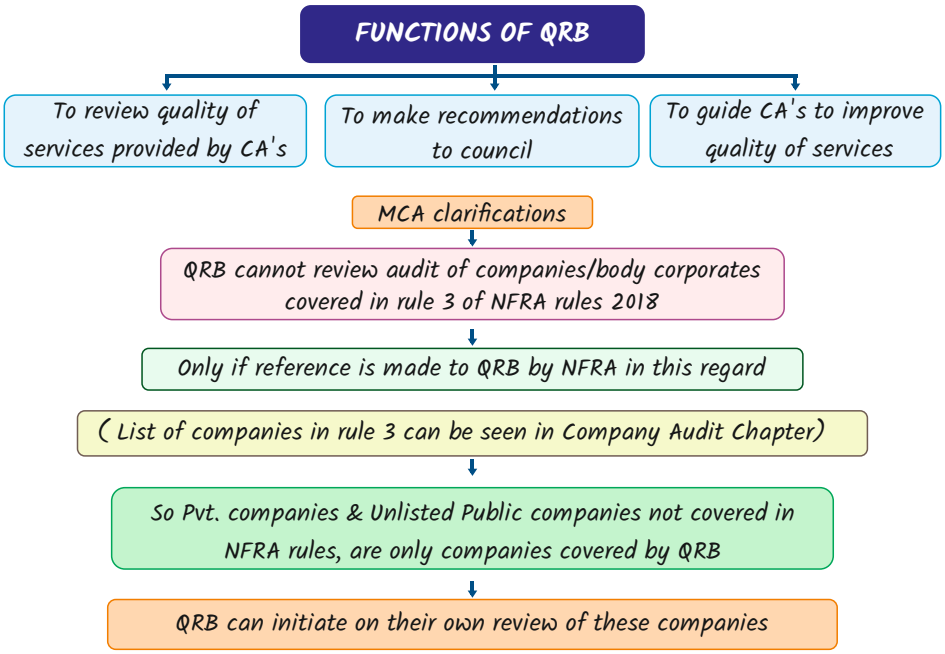
- The Quality Review Board (hereinafter "QRB"/ "the Board") has been set up by the Central Government under **section 28A of the Chartered Accountants Act, 1949** (hereinafter "the Act").
- The first Quality Review Board was constituted by the Central Government, in exercise of the powers conferred by section 28A of the Chartered Accountants Act, 1949, vide Notification GSR.448 (E) dated 28th June, 2007.

Constitution

- In terms of section 28A of the Chartered Accountants Act, 1949, the Board comprises of a Chairperson and ten other members. Central Government nominates the Chairperson and 5 members. Remaining 5 members are nominated by the Council of the ICAI. 6 out of 11 Members of the Board, including Chairperson, are nominated by the Central Government.
- Members are nominated from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy.

(CNO—QR.080) FUNCTIONS OF QUALITY REVIEW BOARD (QNO-653.045)

Chart



Assess Quality of work of practitioner

A quality review carried by the QRB is directed towards inspection/evaluation of audit quality and adherence to various statutory and other regulatory requirements. It involves inspection and assessment of the work of the practitioner while carrying out their audit function so as to enable QRB to assess:

- the quality of compliance with the accounting standards and disclosure requirements followed by the entity on which the audit report is issued;
- the quality of audit and reporting by the practitioner; and the quality control framework adopted by the practitioner/audit firms in conducting audit.

Section 28B

Section 28B of the Chartered Accountants Act, 1949 provides that: "The Board shall perform the following functions, namely:-

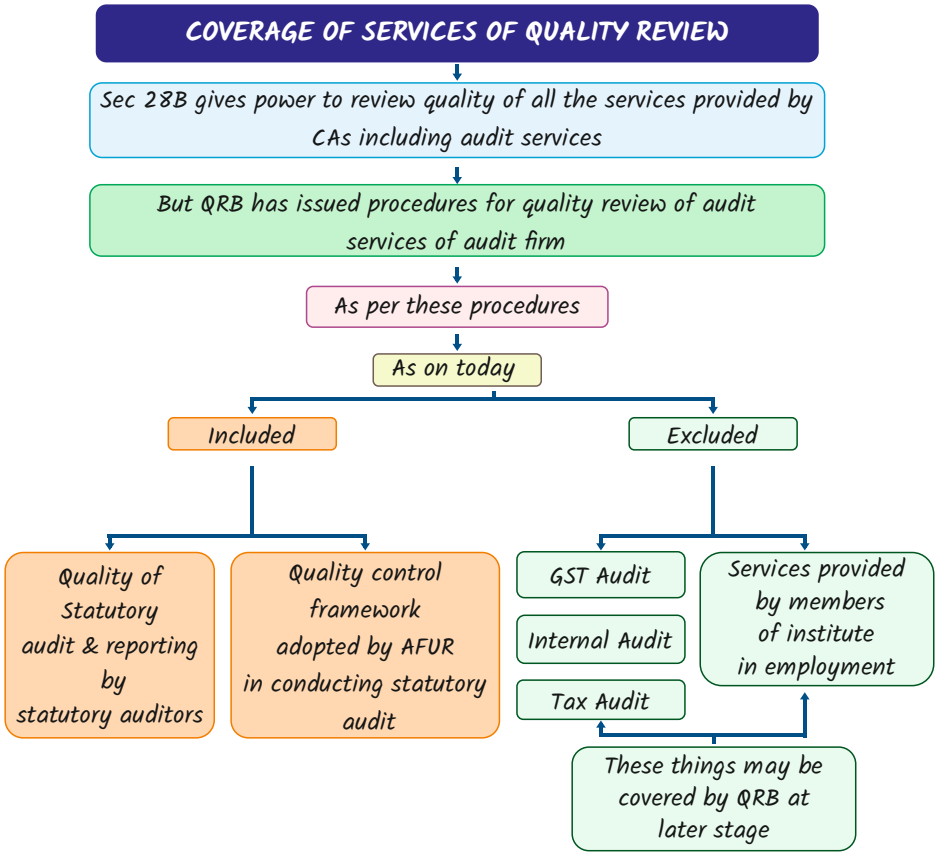
(a) to make **recommendations to the Council** with regard to the quality of services provided by the members of Institute;

(b) to **review the quality of services** provided by the members of the Institute including audit services; and

(c) to **guide the members of the Institute** to improve the quality of services and adherence to the various statutory and other regulatory requirements."

Companies / Body Corporates covered in Rule 3 of NFRA	However, the Ministry of Corporate Affairs, vide letter F.No.7/1/2019-CL-I dated 30th January, 2019, has clarified to the Quality Review Board that in view of Sec.132 (2) of theCompanies Act, 2013 r/w Rule 9(4) of NFRA Rules, 2018, the issue of QRB reviewing auditsof the companies/bodies corporate specified under Rule 3 of the NFRA Rules, 2018 will onlyarise in case a reference is so made to QRB by NFRA, and not otherwise.
Rule 3 of NFRA Rules	See NFRA notes
Rule 4 of NFRA Rules	Rule 9(4) of NFRA Rules, 2018 provides that the Authority (read NFRA) may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 (38 of 1949) or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.
Conclusion	Accordingly, QRB would now be able to initiate reviews of quality of audit services provided by members of the Institute only in respect of entities other than those specified under Rule 3(1) of NFRA Rules, 2018, namely, private limited companies, unlisted public companies below the thresholds specified under Rule 3(1) of NFRA Rules, 2018 and other entities not specified under Rule 3(1) of NFRA Rules, 2018; and those referred to QRB by NFRA under Rule 9(4) of NFRA Rules, 2018. However, in the meanwhile, QRB has also been completing its on-going reviews of top listed and other public interest entities which were in process.

(CNO—QR.100) COVERAGE OF SERVICES FOR QUALITY REVIEW



Procedure for Quality Review of Audit Services of Audit Firms	Pursuant to above discussed Rule 6, the Board issued the 'Procedure for Quality Review of Audit Services of Audit Firms' (the 'Procedure') providing for various matters, adopting best practices, in laying down the necessary system for conducting recurring quality reviews of audit firms in India. It is felt that the broad contours and requirements of review and the manner in which such review would be carried out, should not only be made known to users, stakeholders and service providers, in advance, but should also be transparent.

Covered by QRB

Quality Review in terms of the provisions under the Chartered Accountants Act, 1949 is directed towards review of audit quality and adherence to various statutory and other regulatory requirements. Accordingly, the Quality Review would involve assessment of the work of statutory auditors while carrying out statutory audit so that the Board is able to assess:-

(a) Quality of statutory audit and reporting by statutory auditors; and
(b) Quality control framework adopted by the AFUR in conducting statutory audit.

Not covered by QRB

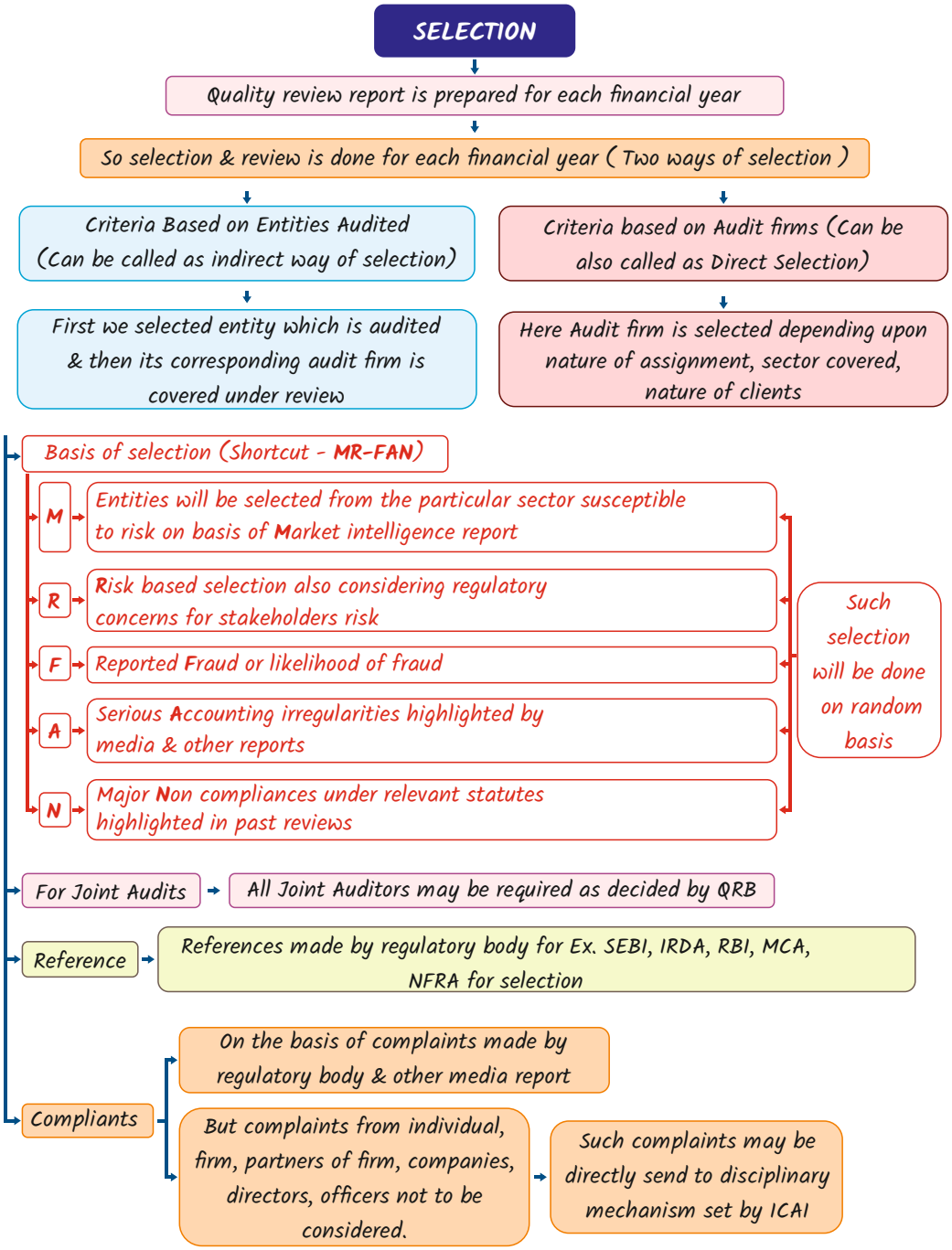
Exclusions: This Procedure would not extend to:

(I) Review of internal audit, tax audit, GST audit and other such special purpose audits conducted by the members of the Institute which may be covered by the Board at a later stage or unless otherwise specified; and

(ii) Review of services provided by the members of the Institute in employment

(CNO—QR.120) SELECTION OF AUDIT FIRMS

Chart



The quality review has been introduced in stages, with firms selected from different classes or types of audit firms being subjected to review at each stage. The Board may decide the audit firms to be included in the selection during each stage. Such selection of audit firms for review may be made on the basis of one or more of the following criteria:-

Criteria based on Entities Audited:

(i) The entities other than those specified under Rule 3(1) of NFRA Rules, 2018 may be selected on the basis of one or more of the following:-

- risk based selection including regulatory concerns pointing towards stakeholder risks.
- on account of being part of a sector otherwise identified as being susceptible to risk on the basis of market intelligence reports.
- reported fraud or likelihood of fraud.
- serious accounting irregularities in the financial statements highlighted by the media and other reports.
- major non-compliances under relevant statutes highlighted in past reviews.

(ii) In case of joint audits, if required, all joint auditors may be reviewed, as may be decided by the Board on case-to-case basis.

(iii) The Board may also review the quality of the statutory audit services of AFUR with a view to assessing the quality of statutory audit and reporting by the statutory auditors and their quality control framework on a reference made to it by any regulatory body like Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Ministry of Corporate Affairs, National Financial Reporting Authority (NFRA) under Rule 9(4) of NFRA Rules, 2018etc.

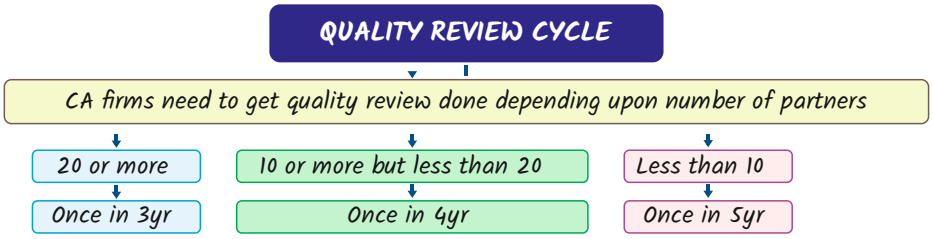
(iv) The Board shall not consider cases of complaints received from individuals, firms, companies, other entities and their partners, directors and other officers etc. which shall be continued to be dealt with in accordance with the mechanism available under the Chartered Accountants Act, 1949. Cases of complaints from only regulatory bodies and other media reports involving serious accounting irregularities shall be considered by the Board for the purpose of initiating the review.

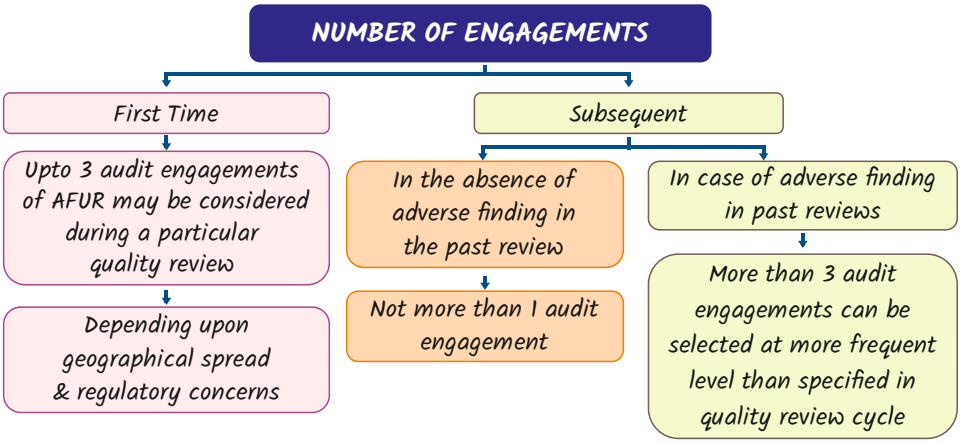
(v) The selection for suo moto quality reviews may, however, be done using methods such as random sampling, selection of particular class or classes of entities/audit firms, in the manner as specified at (i) above.

(vi) The QRB secretariat should place the details of the entities and audit firms, which may be selected for quality review before the Board for its consideration. The Board, at this stage, may consider whether the case warrants a quality review by a TR and may refer the cases selected for quality review to the relevant TRs. The Board will obtain the Annual Report of the entity concerned in terms of the 'Chartered Accountants Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006'

Criteria based on Audit Firms:

Selection of audit firms should also be made for quality review of their statutory audit work on random basis, the volume of work handled by them represented by the number and nature of clients, sectors that may be identified as facing high risk, or on account of fraud or likelihood of fraud.





Quality Review Cycle: (MCQ – Incs.34.5)

(i) The following quality review cycle of Audit firms may be followed generally or as may be decided by the Board:

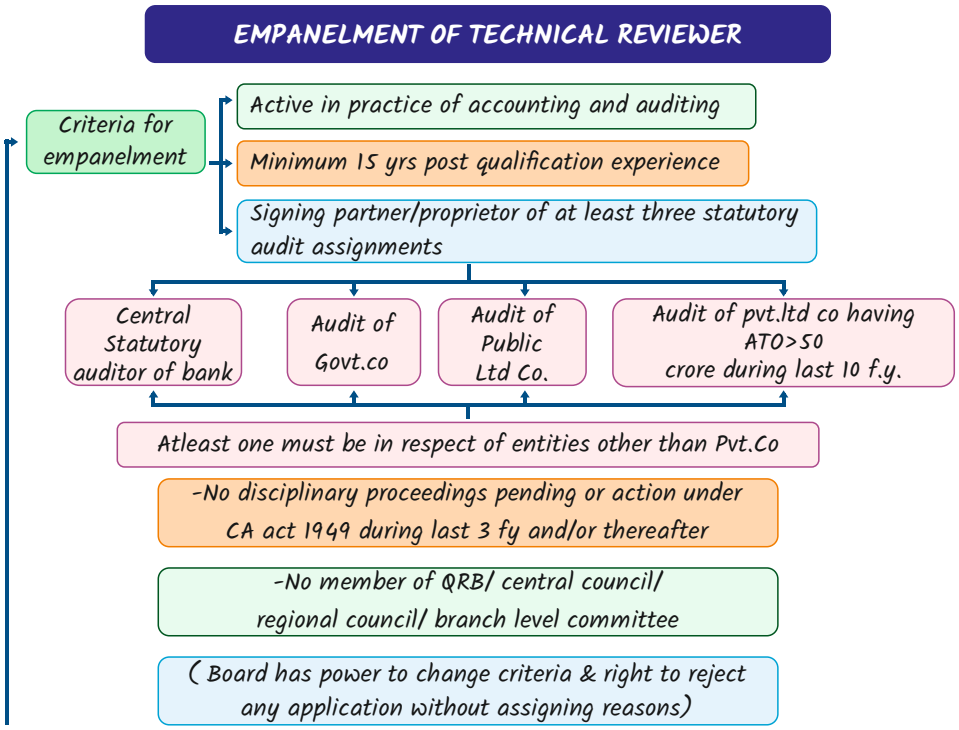
- Once in 3 years for Audit firms having 20 or more Partners
- Once in 4 years for Audit firms having 10 or more but less than 20 Partners
- Once in 5 years for Audit firms having less than 10 Partners.

(ii) Upto 3 audit engagements of an AFUR may be selected by the Board, as may be considered appropriate, during a particular quality review cycle covering entities of varied industries, size, geographical spread and regulatory concerns. However, in the absence of any adverse finding in a past review, not more than one audit engagement of the same engagement partner/ proprietor of an AFUR may be selected for quality review by the Board during a particular quality review cycle

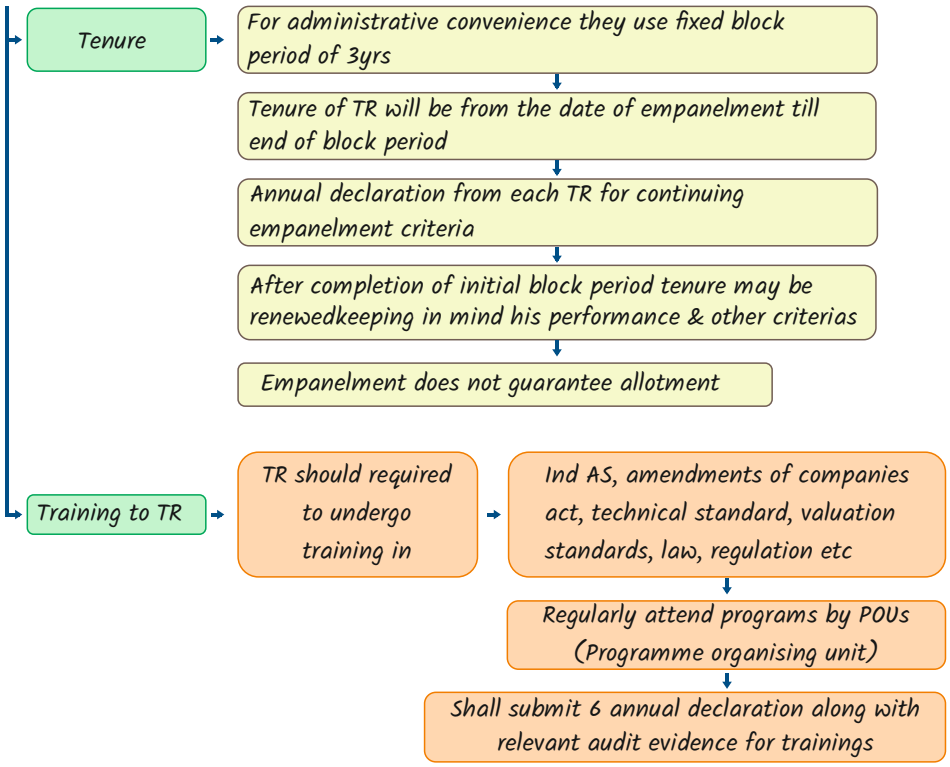
(iii) However, in case of any adverse findings in past review/s or in any other situation, QRB may conduct quality review of any particular audit firm or of a particular engagement partner at more frequent interval and/or select more than 3 audit engagements.

(CNO—QR.140) EMPANELMENT OF TECHNICAL REVIEWERS

Chart



Continue on next Page...



The Board has specified the following basic minimum criteria for empanelment of Technical Reviewers with the Board, applications in respect whereof are invited through an on-line empanelment process at the website of QRB :

Criteria for empanelment

- Reviewer should have minimum fifteen years of post qualification experience as a chartered accountant and be currently active in the practice of accounting and auditing.
- Reviewer should have handled as a signing partner/proprietor at least three statutory audit assignments as a Central Statutory Auditor of Banks/Public Limited Companies/Government Companies/Private Limited Companies having annual turnover of rupees fifty crores and above during the last ten financial years;
- Provided that out of the aforesaid three statutory audit assignments, at least one must be in respect of entities other than Private Limited Companies.
- Reviewer should not have any disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against you during last three financial years and/or thereafter.
- Reviewer should not currently be a Member of the QRB or ICAI's Central Council/Regional Council/Branch level Management Committee.

Power of QRB to change criteria

The Board may specify any other criteria, from time to time, apart from the aforesaid basic minimum criteria for empanelment of TRs with the Board. The Board reserves the right to reject any application for empanelment as TR without assigning any reason whatsoever.

Tenure of Empanelment

The empanelment of TRs, so made, shall be for the on-going block period of three years subject to obtaining annual declarations from each of the empanelled TR for continuing to meet the basic criteria of empanelment. However, it may be noted that empanelment as a TR with the Quality Review Board does not, in any way, guarantee allotment of quality review work to TR which shall be at the sole discretion of the Quality Review Board.

After completion of the initial block period of empanelment, the Board may decide to offer renewal of

empanelment to TR, subject to his consent, for another block period and so on based upon assessment of the quality of review work performed by the TR during the period, if any, his meeting the basic minimum criteria for empanelment, participation in training workshops and other such factors as may be considered appropriate by the Board.

Training to TR

TRs shall be required to undergo training on emerging areas such as Ind-AS, Amendments in Companies Act, other technical standards, Valuation Standards, other relevant laws and regulations etc. TRs shall regularly participate in training workshops/programmes organized by various POUs on the aforesaid areas and will update their knowledge. Further, they shall submit 6 annual declarations along with relevant evidences, to the QRB regarding their participation in such training workshops/programmes.

(CNO—QR.160) INDEPENDENCE AND QUALIFICATIONS OF TECHNICAL REVIEWERS (QNO - 653.065)

Chart

INDEPENDENCE & QUALIFICATION OF TR

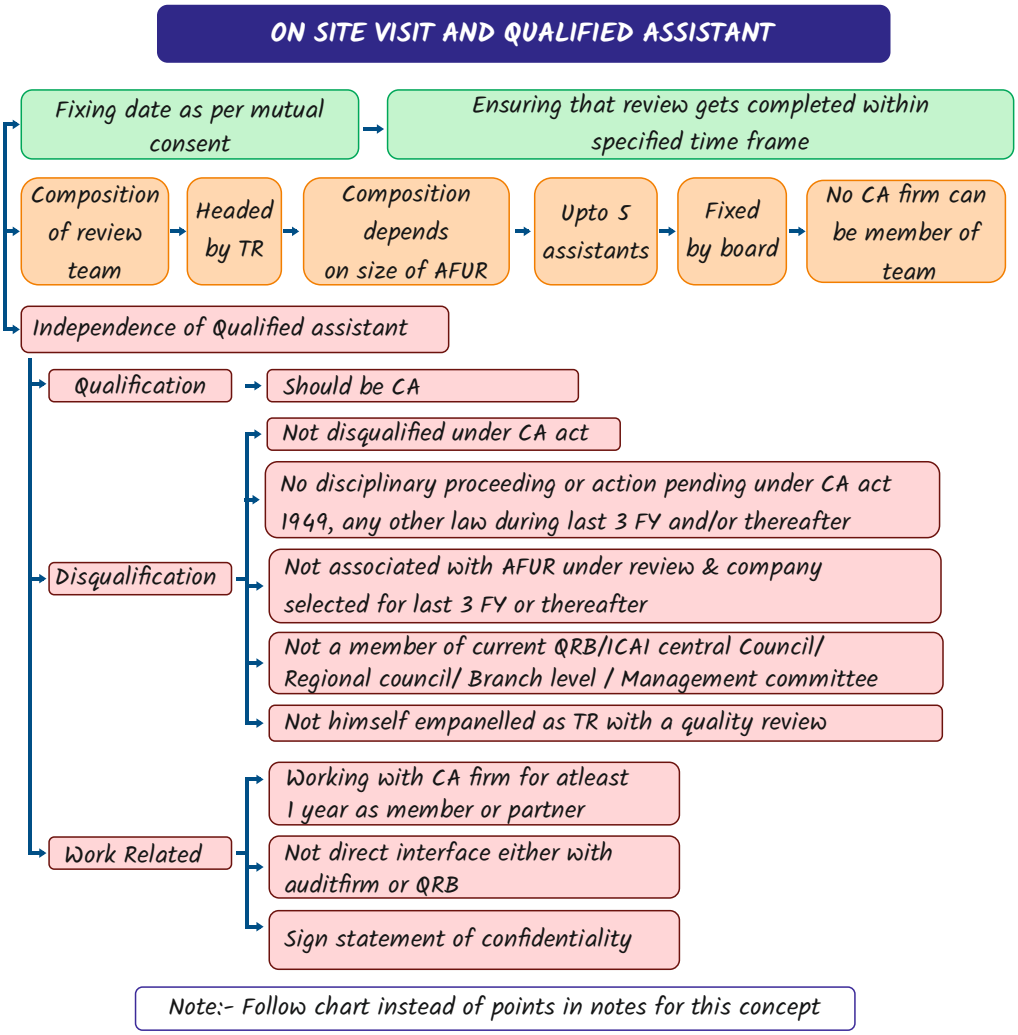
Shortcut - **DR DAS**

D	-	No pending **disciplinary proceedings** or action during last 3 FY & thereafter
R	-	Not belong to city, **region** of head office of AFUR
D	-	Not **disqualified** under companies act for the audit of concerned company
A	-	No **association** with specified AFUR of TR, TR firm or any of the network firm or partner of any other network firm during last 3 years or thereafter.
S	-	TR or his firm or partner of his firm or any network firm or partner of any network firm should not be **statutory auditor** of the concerned company during last 3 yrs or thereafter or have rendered any **other services**

While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence and avoid conflict of interest, the following eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment. For being a technical reviewer:

- A member to comply with all the eligibility conditions laid down for appointment as an auditor of a company **u/s 141(3) of the Companies Act, 2013 which apply mutatis mutandis** in respect of the review of the quality of statutory audit of the company/entity, as specified, so far as applicable.2
- A member **should not have disciplinary proceeding** under the Chartered Accountants Act, 1949 pending against him/her or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against you **during last three financial years and/or thereafter.**1
- A member or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms **should not have been the statutory auditor of the company,** as specified, or have rendered any other services to the said company/entity during last three financial years and /or thereafter.3
- A member or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms **should not have had any association with the specified AFUR, during the last three financial years and /or thereafter.**4
- He does not **belong to the city/region** of head office of the AFUR. 5

(CNO—QR.180) ON-SITE VISIT AND QUALIFIED ASSISTANT



Composition of the Review Team

The technical reviewers for carrying out the quality review assignment, could undertake a maximum of one **on-site visit** to the **Statutory Audit firm** which **shall not extend beyond seven days or, in exceptional circumstances, such other extended period, for specific reasons to be recorded in writing, with the prior approval of the Chairperson,** Quality Review Board, which shall not, in any case, **extend beyond fourteen days.**

Independence of Assistant (Qualified Assistance)

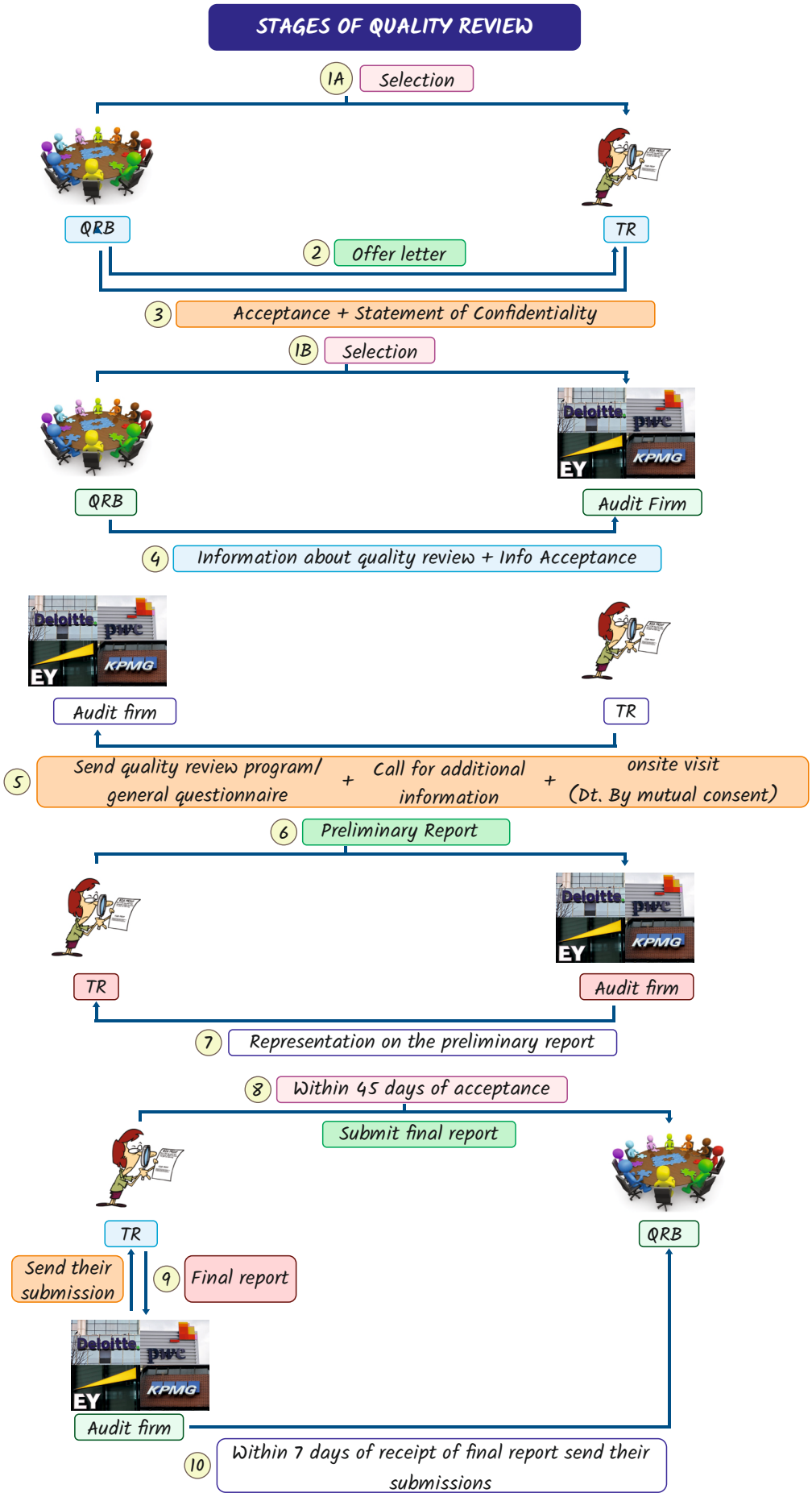
The QRB, from time to time, shall specify the requirements for engaging Assistants by the TR for ensuring their independence and avoiding conflict of interest including

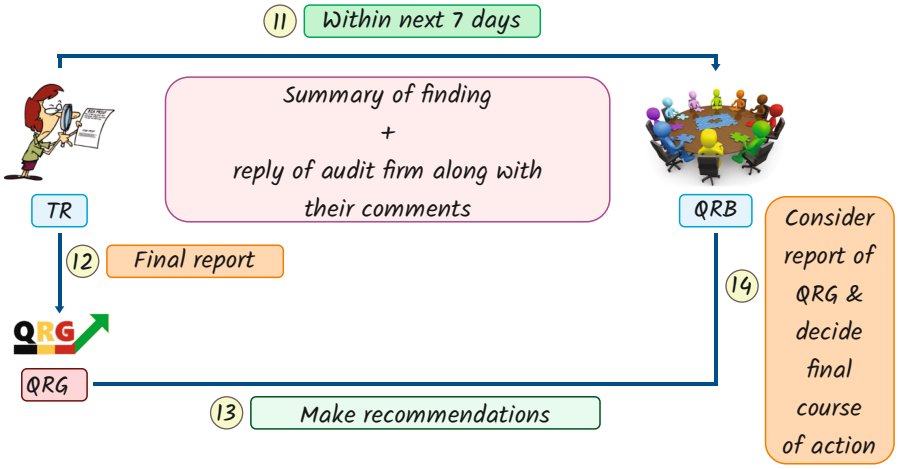
- He shall be chartered accountant;
- He does not attract any of the disqualifications prescribed under the Chartered Accountants Act, 1949;
- He shall also have to sign the statement of confidentiality in a prescribed format;
- He shall have no direct interface either with the audit firm under review (AFUR) or the Board;
- He should have been working with them for at least one year as a member/a partner in the CA firm with them;
- He should not have been associated with the AFUR and the concerned entity, whose audit is being reviewed, during last three financial years and/or thereafter.
- He should not have any disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against him during last three financial years and/or thereafter;

- He should not be a member of current QRB/ICAI's Central Council/Regional Council/Branch level Management Committee; and
- He should not himself be empaneled as a TR with the Quality Review Board.

(CNO—QR.200) THE QUALITY REVIEW PROCESS (TECHNICAL REVIEW)

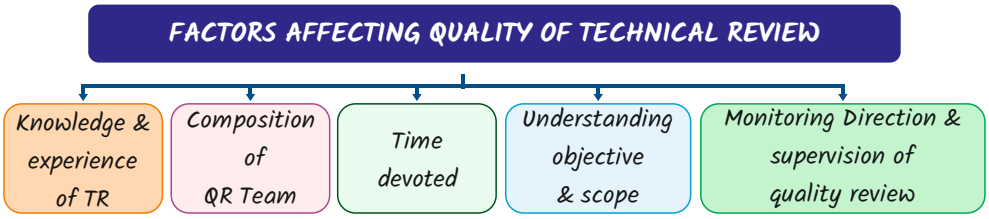
Chart





Maintain Quality of Technical Review (Quality Review)

A quality review is an engagement that needs to be carried out in a manner that ensures that the work performed by the Technical Reviewer appointed for the review and the review team meet the professional standards established by ICAI. Any shortcomings in the quality of the quality review would defeat the very purpose of the process of a quality review established by the Quality Review Board. It is, therefore, of utmost importance that ensuring quality in a quality review remains a priority for a technical reviewer.



Factors affecting quality of technical review – Ultimate Responsibility of Quality Reviewer

In so far as the technical reviewer is concerned, the quality of a quality review is directly affected by factors such as:

- **Knowledge and experience** of the technical reviewer
- Composition of the **quality review team**
- **Time devoted** by the technical reviewer
- **Understanding** of the objective and scope of work
- **Monitoring, direction and supervision** of the quality review team by the technical reviewer

In fact, maintaining the quality in a quality review as also the final report of the quality review is and remains the responsibility of the technical reviewer.

Stages of Quality Review (QNO-653,070)

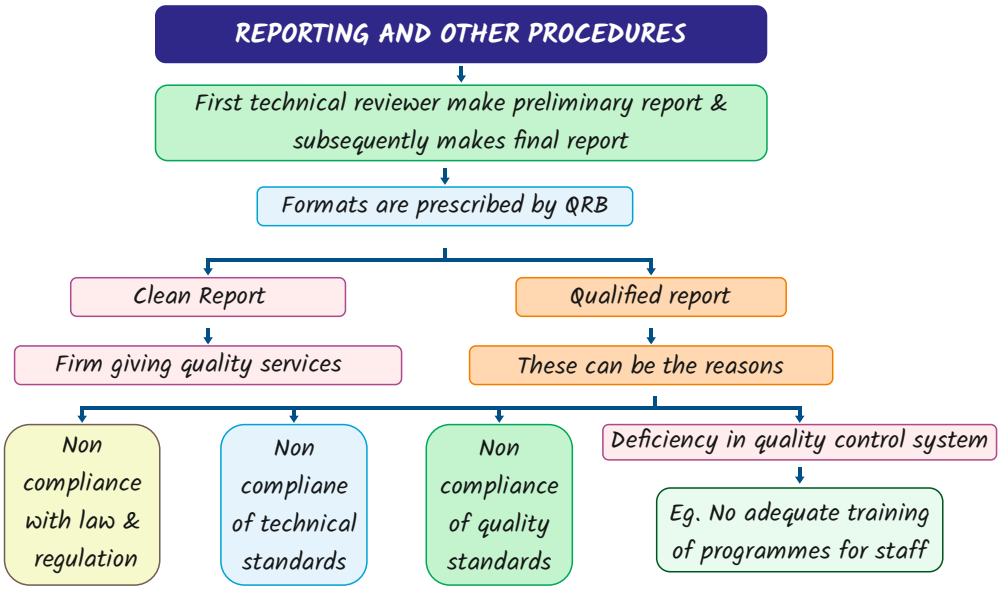
Various Stages involved in the Conduct of the Quality Review Assignments: The following table describes the various stages involved in the conduct of the quality review assignments:

- **Selection of Audit Firm and Technical Reviewer** to conduct Quality Review and
- Sending **Offer Letter of Engagement to the Technical Reviewer.**
- Technical Reviewer to convey his **acceptance** of Letter of Engagement by sending necessary declarations for meeting eligibility conditions and furnishing statement of **confidentiality by the Technical Reviewer** and his assistant/s, if any.
- **Intimation to the Audit Firm** about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. **Also marking a copy of the intimation to the Technical Reviewer.**

- *Technical Reviewer to send the specified Quality Review Questionnaire to the Audit firm for filling-up and call for additional information from the Audit Firm, if required.*
- *TR & his team carry out the Quality Review by starting their off-site review by making proper planning for the review and then* ***on-site visiting*** *the office of the AFUR by fixing the date as per mutual consent ensuring that review exercise gets completed within specified time frame*
- *Technical Reviewer to send the* ***preliminary report to Audit firm.***
- *Audit firm to submit* ***representation on the preliminary report*** *to the Technical Reviewer.*
- *TR to submit* ***final report*** *along with a copy of Annual report of the entity for the year under review, to the QRB in the specified format, on his (individual) letterhead, duly signed and dated within specified time frame or as extended by the QRB. In addition, he shall also send a copy of the final report to the AFUR, requesting them to send their final reply thereon to the QRB within 7 days of receipt of the final report. AFUR shall also send copy of their reply to Technical reviwer (TR)*
- *AFUR to submit to QRB their reply on the final report and feedback, in prescribed format, regarding their experience of the quality review.*
- ***Upon receipt of the final reply from the AFUR,*** *TR shall submit to QRB within next 7 days a summary of his findings, in the specified format, containing his findings, technical requirements, final reply of the AFUR and his final comments thereon.*
- *QRG to consider the report of the TR and responses of AFUR and make recommendations to QRB. QRG may also call for additional details/information/explanations, if required, from TR/AFUR or issue such directions to TR, as it may deem appropriate, enabling it to assess the quality of audit and reporting by the AFUR*
  QRB to consider report and recommendations of QRG and decide further course of action.

(CNO—QR.220) REPORTING AND OTHER PROCEDURES

Chart



Preliminary Report (QNO-653.050) (MCQ – PR.7)

The reviewer, after completion of his review, is required to submit a preliminary report to the audit firm on the review of the quality of audit and reporting by the auditors in the general-purpose financial statements within the specified period of time before submitting the final report to the Board. The Board may, however, extend the time limit for submission of preliminary review report. **The reviewer, based upon his satisfaction from the representation by the audit firm, may decide to issue either an interim report or a final report to the Board.** The purpose is to establish the guidelines on the form and contents of the reviewer's report issued pursuant to review of the quality of audit services of an audit firm.

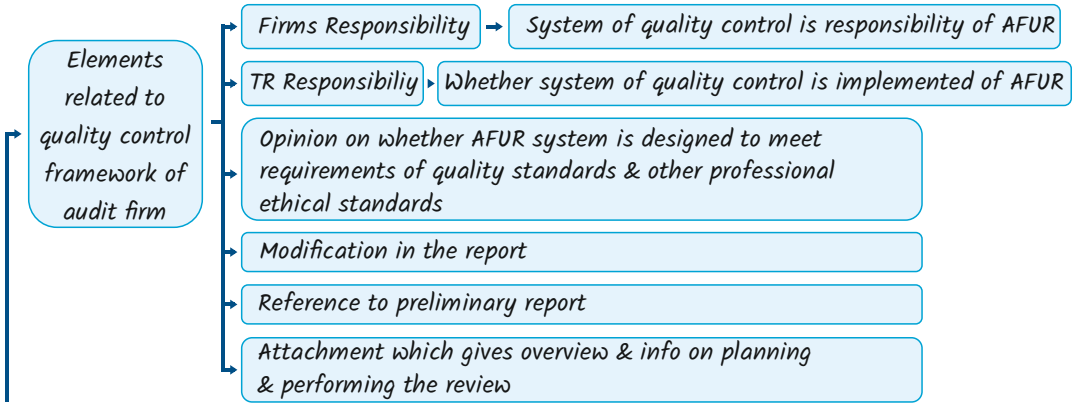
The reviewer should adhere to the principle requirements mentioned while preparing his report. It may be noted that the requirements mentioned apply to the interim as well as the final reports of the reviewer.

Reviewers, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered.

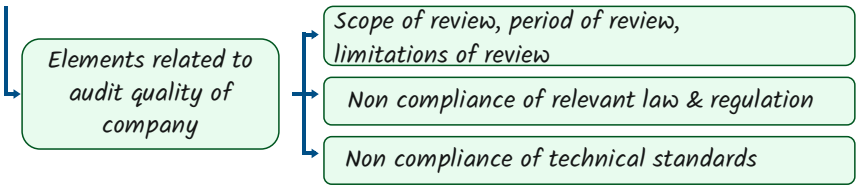
However, a reviewer may qualify the report due to one or more of the following:

- quality control system **design deficiency;**1
- **non-compliance with quality control policies** and procedures; or3
- **non-existence of adequate training programmes** for staff.2
- non-compliance with **relevant laws and regulations;**4
- non-compliance with **technical standards;**5

BASIC ELEMENTS OF REVIEWERS REPORT



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Basic Elements of the Reviewer's Report (QNO-653.090)

The report should contain:

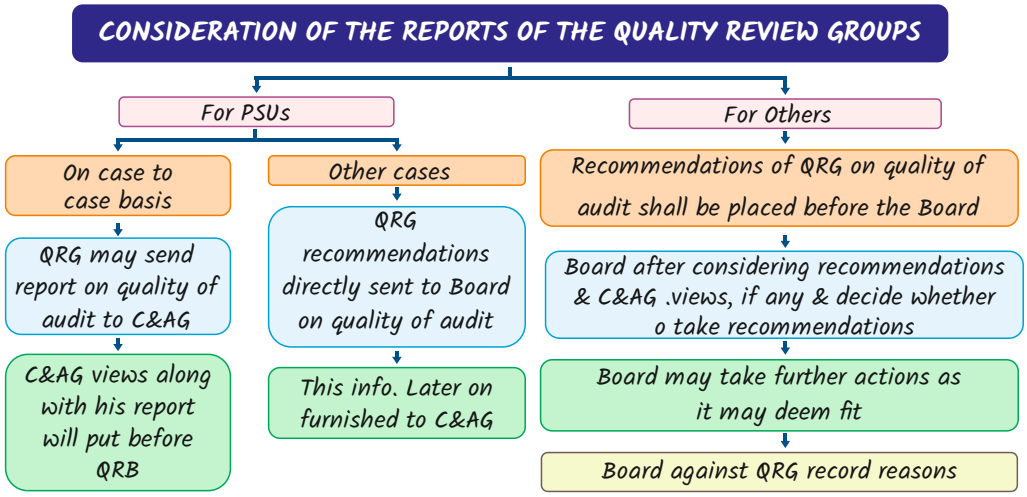
- **Elements relating to audit quality of companies:**
  - A reference to the description of the **scope of the review and the period of review of audit firm** conducted along with existence of limitation(s), if any, on the review conducted with reference to the scope as envisaged.
  - A statement indicating the **instances of lack of compliance with relevant laws and regulations.**
  - A statement indicating **the instances of lack of compliance with technical standards and other professional and ethical standards.**

- **Elements relating to quality control framework adopted by the audit firm in conducting audit:**
  - An indication of whether the AFUR has implemented a system of quality control with reference to the quality control standards.
  - A statement indicating that the system of quality control is the responsibility of the AFUR.
  - An opinion on whether the AFUR's system of quality control has been designed to meet the requirements of the quality control standards for attestation services and whether it was complied with during the period reviewed to provide the reviewer with reasonable assurance of complying with technical standards, other professional and ethical standards, other relevant guidance and relevant laws and regulations all material respects.
  - Where the reviewer concludes that a modification in the report is necessary, a description of the reasons for modification. The report of the reviewer should also contain the suggestions.
  - A reference to the preliminary report.
  - An attachment which describes the quality review conducted including an overview and information on planning and performing the review.

The Quality Review Report should be **issued on the reviewer's (individual) letterhead and signed by the reviewer.** The report should be addressed to the Board and should be dated as of the date of the conclusion of the review.

(CNO—QR.240) CONSIDERATION OF THE REPORTS OF THE QUALITY REVIEW GROUPS

Chart



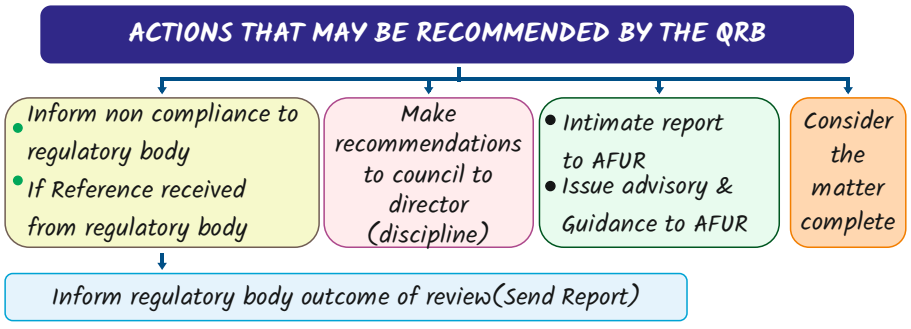
For PSUs

The Quality Review Group's Report on the quality of audit by the auditor of a Public Sector Undertaking (PSU) should be furnished to the Office of Comptroller and Auditor General of India (C&AG), on case to case basis, and the C&AG's views, if any, shall be put-up before the Board along with the recommendations of the QRG. In all other cases, the QRG's recommendations along with the decision of the Board on the quality of audit by the auditor of a PSU shall be furnished to the Office of the C&AG for information

For Others

The recommendations of the QRG on the quality of statutory audits by the auditors of entities (other than those covered above) shall be placed before the Board for its consideration directly.
The Board may, after due consideration of the recommendations and comments of Office of the C&AG, wherever applicable, decide whether the recommendation made by the QRG should be accepted or otherwise. The Board may, suo moto, take such further action, as it may deem appropriate. If the Board decides against the recommendations made by the QRG in its report, the Board shall record the reasons for doing so.

(CNO—QR.260) ACTIONS THAT MAY BE RECOMMENDED BY THE QUALITY REVIEW BOARD (QNO-653.080)



In Sequence of Severity of Action, Easy to Remember

The actions that may be recommended by the Board include one or more of the following:

- **Inform the details of the non-compliance to the regulatory bod (y)/ies** relevant to the entity as may be decided by the Board.
- **In case of review arising out of a reference received from a regulatory body,** inform the results of review and the details of action taken to the concerned regulatory body.
- **Make recommendations to the Council** of ICAI u/s 28B(a) of Chartered Accountants Act, 19referring the case to the Director (Discipline) of the Institute for consideration and necessary action under the Chartered Accountants Act, 1949.
- **Intimate the AFUR** as to the findings of the Report as well as action initiated as above.
- **Issue advisory and guidance to the AFUR** u/s 28B(c) of Chartered Accountants Act, 1949 for improvement in the quality of services and adherence to various statutory and other regulatory

requirements. A copy of such advisory may also be sent to the ICAI for information.

- **Consider the matter complete** and inform the AFUR accordingly

UNIQUE QNO's	
QNO-653.042	Scope of the Quality Review
QNO-653.060	General Reporting Responsibilities of QR
QNO-653.098	Professional judgment exercised by the auditor is one of the important aspects under Quality review
QNO-653.099	Power of Quality Review Board

Students Notes

18 Professional Ethics

Part I – Introduction & CA Act

Why Professional Ethics

Eye For Eye will make whole world





Fraud For Fraud will make whole world Bankrupt





Fraud For Fraud will become end of CA Profession





(CNO—PE.010) FUNDAMENTALS OF PROFESSIONAL ETHICS

Chart

FUNDAMENTALS OF PROFESSIONAL ETHICS

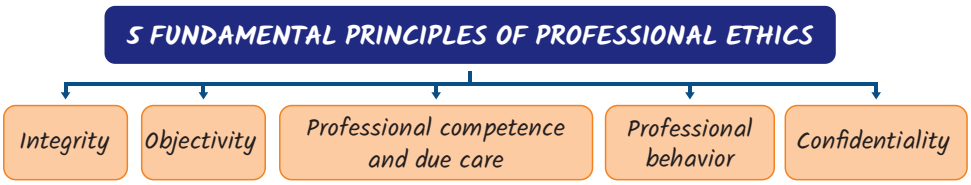
- **Ethics** → Are principles which tells us about what things will be considered as 'good' and what things will be considered as 'bad'.
- **Professional Ethics for CA** → These are principles which tell us what CAs should do (Good) and what CAs should not do (Bad)
- **Sources of Professional Ethics**
  - CA Act issued by Parliament
  - Rules made by Central govt. as per requirement of CA Act.
  - Regulations issued by Council of ICAI as per requirement of CA Act.
  - Guidelines, Directions, Clarifications issued by council of ICAI apart from requirement of CA Act.
  - International Code of Ethics
    - It is an important document / booklet prepared by ICAI to explain CAs about which activities they can do (Good) and which activities they cannot do (Bad)
      - Volume – i
        - It is adoption of international code of ethics for professional accountants which is issued by International ethical standard board of accountants. (IESBA)
        - It is a conceptual framework which explains 5 fundamental principles for ethical conduct. How to identify threats against these principles and how to apply safeguards to protect these principles.
        - Applicable from 01st July 2020.

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- Volume – ii
  - It explains important sections of CA Act and clauses of both the schedules along with guidelines issued by council of ICAI which helps in interpretations and implementation.
- Volume – iii
  - It is a collection of judgements passed by courts, appellate authority, council and its committee and board.

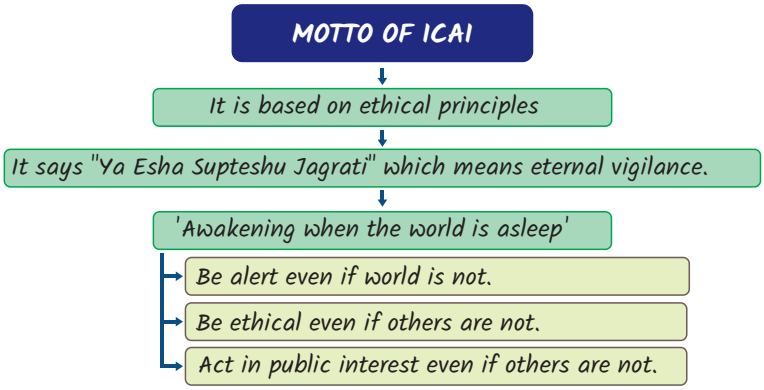
(CNO—PE.020) 5 FUNDAMENTAL PRINCILES OF PROFESSIONAL ETHICS

Chart



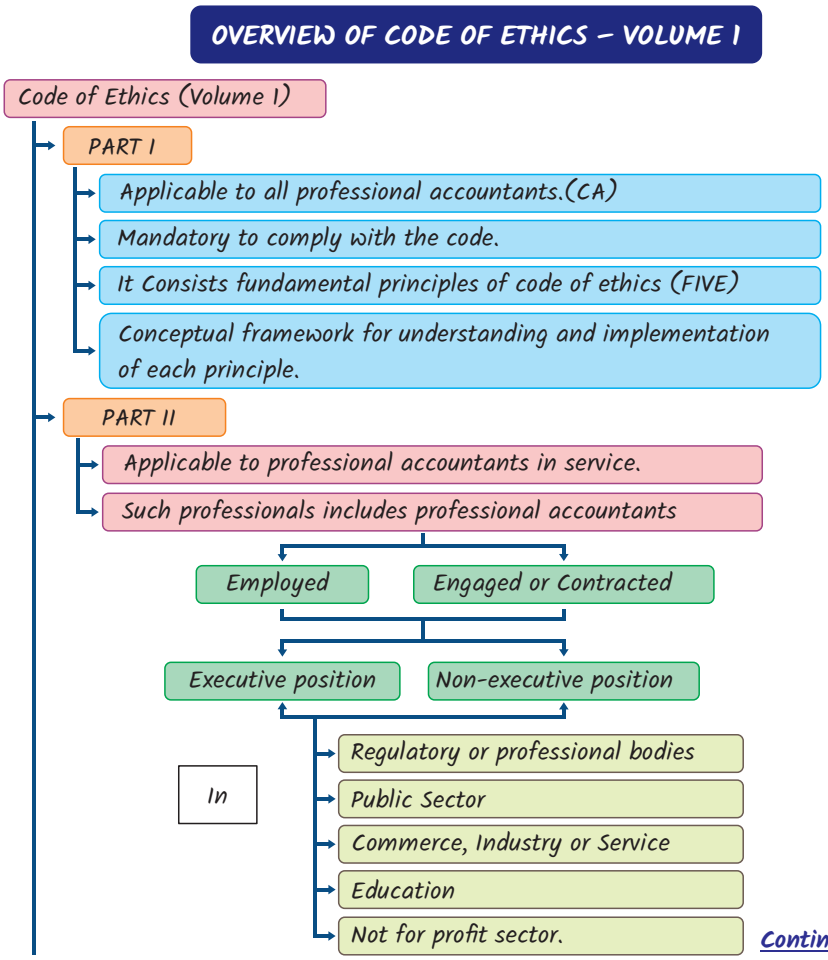
(CNO—PE.030) MOTO OF ICAI

Chart

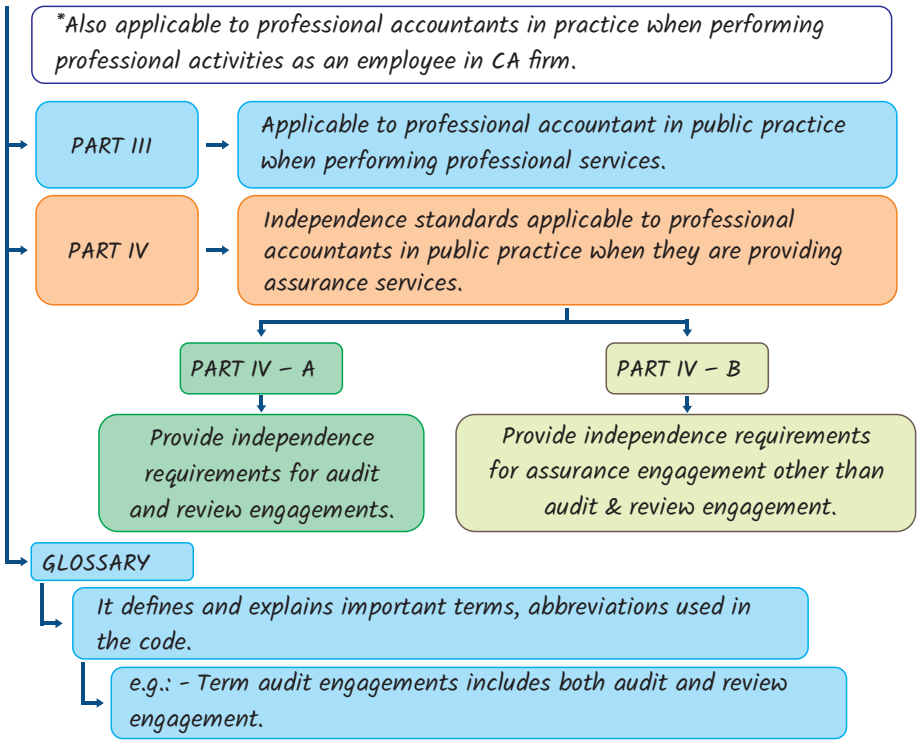


(CNO—PE.040) OVERVIEW OF CODE OF ETHICS – VOLUME I

Chart



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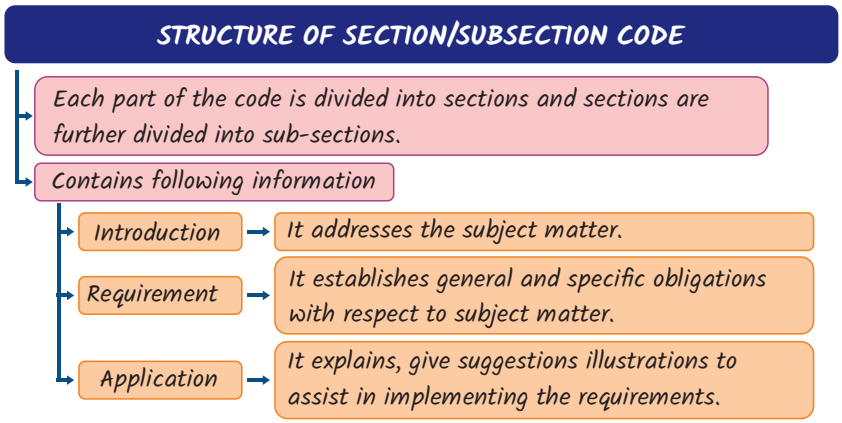


Discussion

- **Part 1** – Complying with the Code, Fundamental Principles and Conceptual Framework, which includes the fundamental principles and the conceptual framework and is applicable to all professional accountants.
- **Part 2** – Professional Accountants in Service, which sets out additional material that applies to professional accountants in service when performing professional activities. Professional accountants in service include professional accountants employed, engaged or contracted in an executive or non-executive capacity in, for example:
  - Commerce, industry or service.
  - The public sector.
  - Education.
  - The not-for-profit sector.
  - Regulatory or professional bodies.
- **Part 2** is also applicable to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm as an employee.
- **Part 3** – Professional Accountants in Public Practice, which sets out additional material that applies to professional accountants in public practice when providing professional services.
- **Part 4 – Independence Standards,** which sets out additional material that applies to professional accountants in public practice when providing assurance services, as follows:
  - **Part 4A** – Independence for Audit and Review Engagements, which applies when performing audit or review engagements.
  - **Part 4B** – Independence for Assurance Engagements Other than Audit and Review Engagements, which applies when performing assurance engagements that are not audit or review engagements.
- **Glossary,** which contains defined terms (together with additional explanations where appropriate) and described terms which have a specific meaning in certain parts of the Code. For example, as noted in the Glossary, in Part 4A, the term "audit engagement" applies equally to both audit and review engagements. The Glossary also includes lists of

(CNO—PE.050) STRUCTURE OF SECTION/SUB SECTION CODE

Chart



Discussion

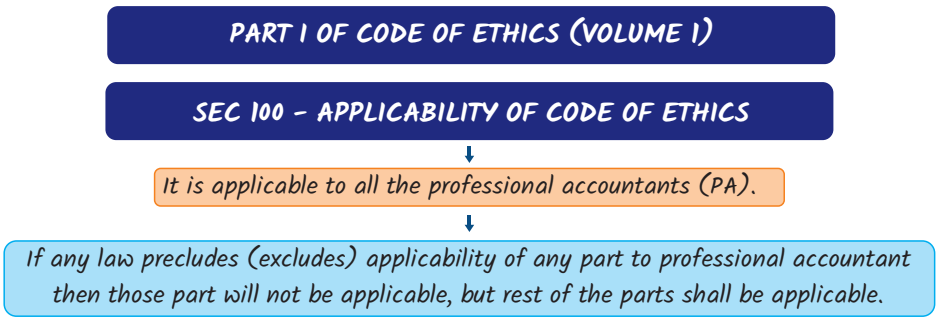
The Code contains sections which address specific topics. Some sections contain subsections dealing with specific aspects of those topics.

Each section of the Code is structured, where appropriate, as follows:

- ***Introduction*** *– sets out the subject matter addressed within the section, and introduces the requirements and application material in the context of the conceptual framework. Introductory material contains information, including an explanation of terms used, which is important to the understanding and application of each Part and its sections.*
- ***Requirements*** *– establish general and specific obligations with respect to the subject matter addressed.*
- ***Application material*** *– provides context, explanations, suggestions for actions or matters to*

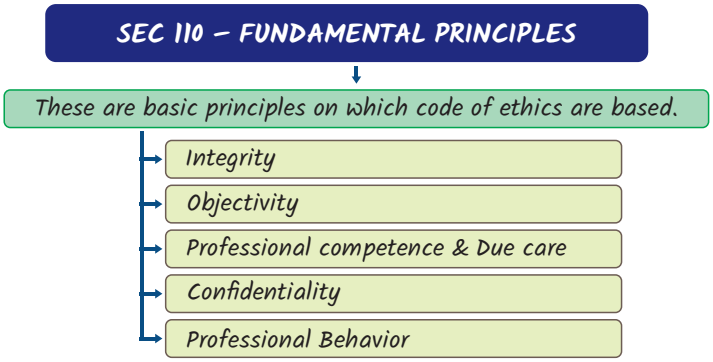
(CNO—PE.060) PART I OF CODE OF ETHICS (VOLUME I) - SEC 100 APPLICABILITY OF CODE OF ETHICS

Chart



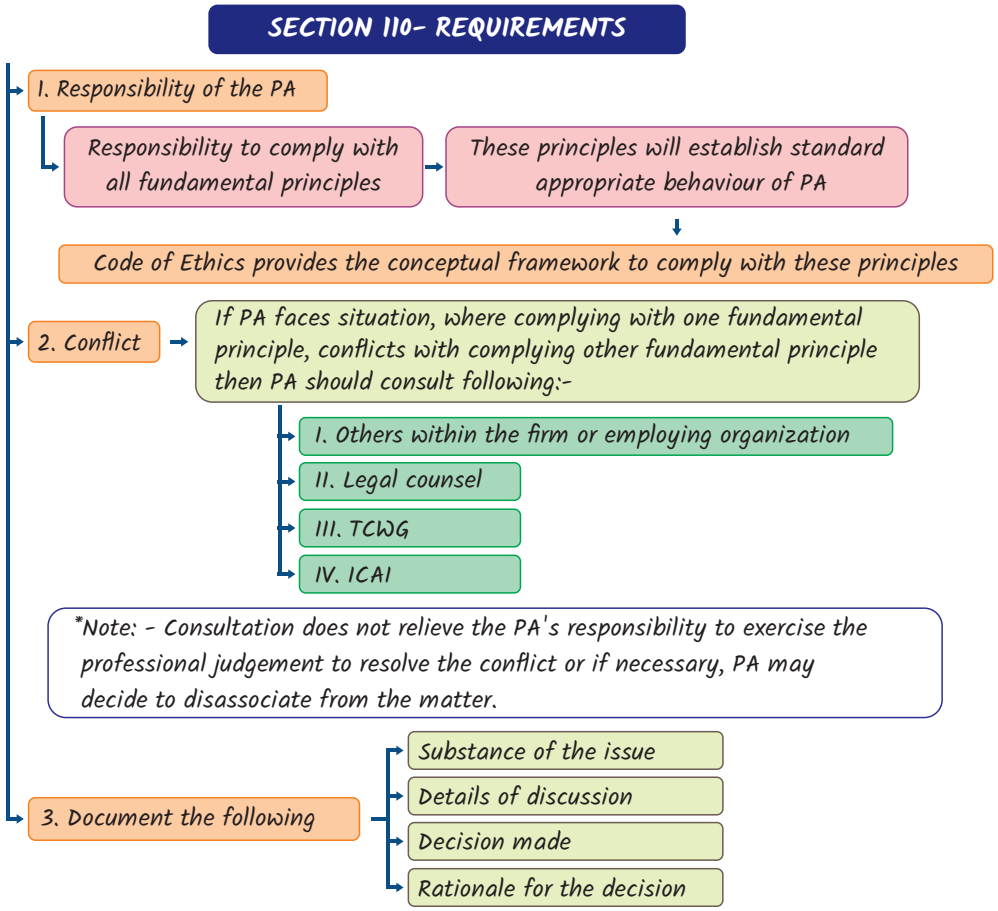
(CNO—PE.070) SECTION – 110 FUNDAMENTAL PRINCIPLE (QNO-780.000)

Chart



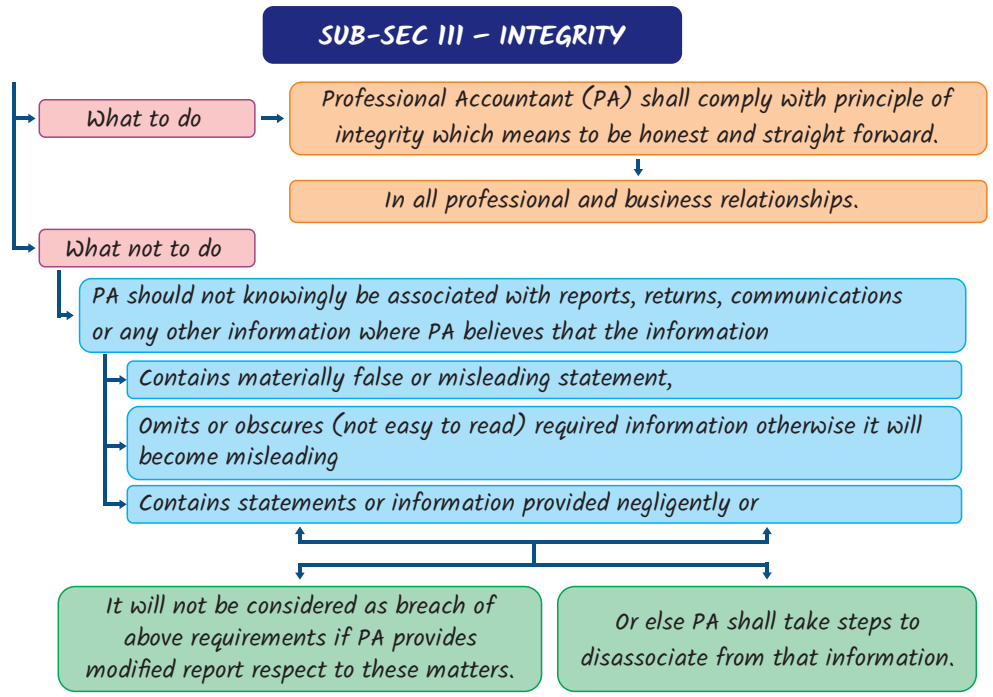
(CNO—PE.080) SECTION 110 REQUIREMENTS

Chart



(CNO—PE.090) SUB – SECTION – 111 INTEGRITY

Chart



Discussion

1. A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness.

2. A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:

(a) Contains a materially false or misleading statement;

(b) Contains statements or information provided negligently; or

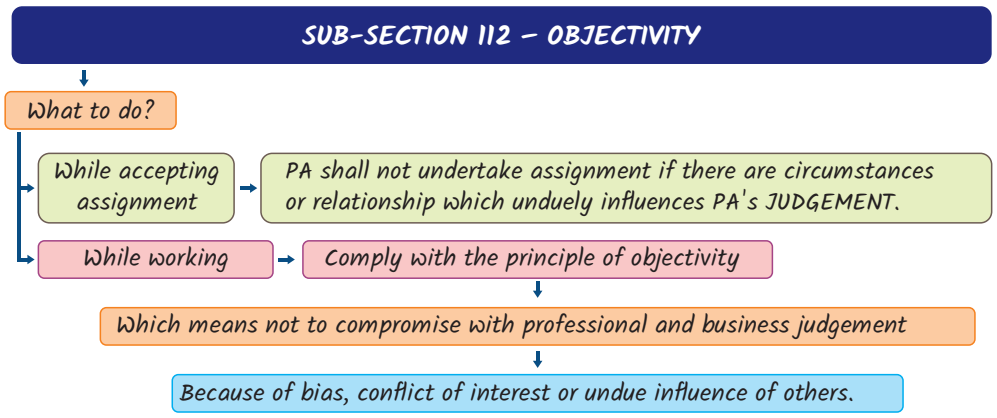
(c) Omits or obscures required information where such omission or obscurity would be misleading.

However, a professional accountant will not be considered to be in breach of matters mentioned above in paragraph 2 if the professional accountant provides a modified report in respect of such above mentioned matter.

3. When a professional accountant becomes aware of having been associated with information described in paragraph 2, the accountant shall take steps to be disassociated from that information.

(CNO—PE.100) SUB – SECTION – 112 OBJECTIVITY

Chart

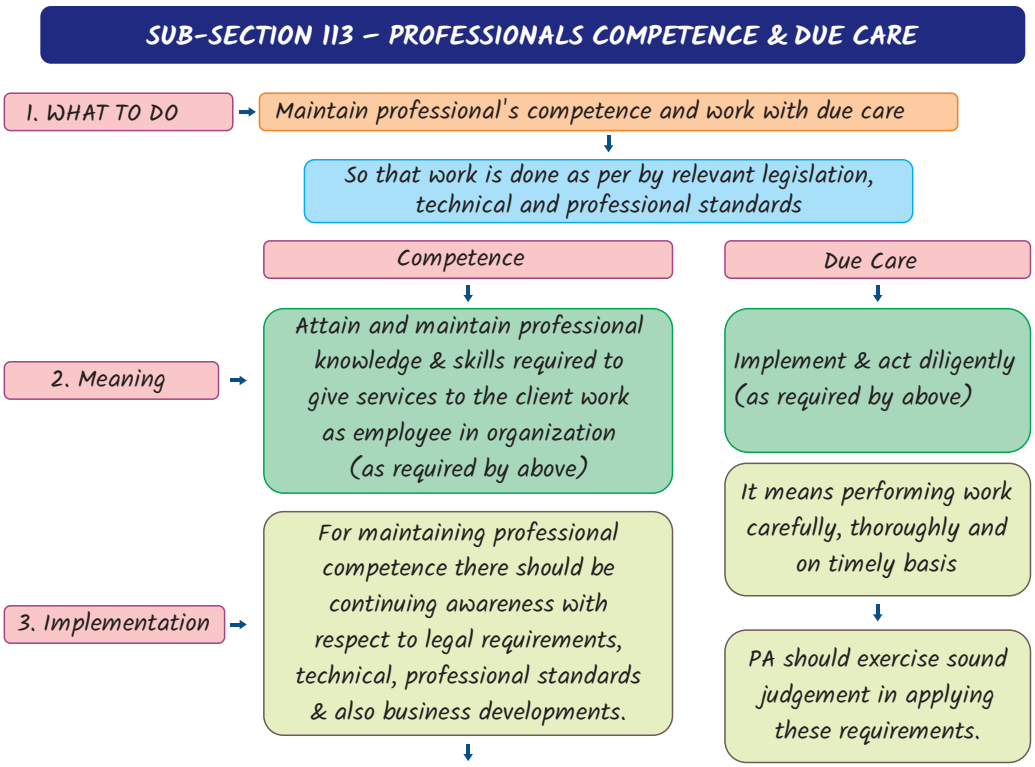


Discussion

- A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.
- A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

(CNO—PE.110) SUB – SECTION – 113 PROFESSIONAL COMPETENCE & DUE CARE

Chart



Continue on next Page...

For this PA should undergo continuous professional development (seminars, training, courses etc.)

Also take reasonable steps to ensure that people working under PA's authority having appropriate training & supervision.

4. Inherent limitations → Shall make clients and employing organization or other users aware of inherent limitations in services or activities.

Discussion

1.A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:

(a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and

(b) act diligently in accordance with applicable technical and professional standards.

2. **Serving** clients and employing organizations **with professional competence** requires **the exercise of sound judgment** in applying **professional knowledge** and **skill** when undertaking professional activities.

3. **Maintaining professional competence** requires a **continuing awareness** and an **understanding** of relevant technical, **professional and business developments.**

4. **Continuing professional development** enables a professional accountant to **develop** and **maintain** the **capabilities** to perform competently within the professional environment.

5. **Diligence** encompasses the **responsibility to act** in accordance **with the requirements** of an assignment, **carefully, thoroughly** and on a **timely** basis.

6. In **complying** with the **principle of professional competence and due care,** a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

Where appropriate, a professional accountant shall make clients, the employing organization, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities.

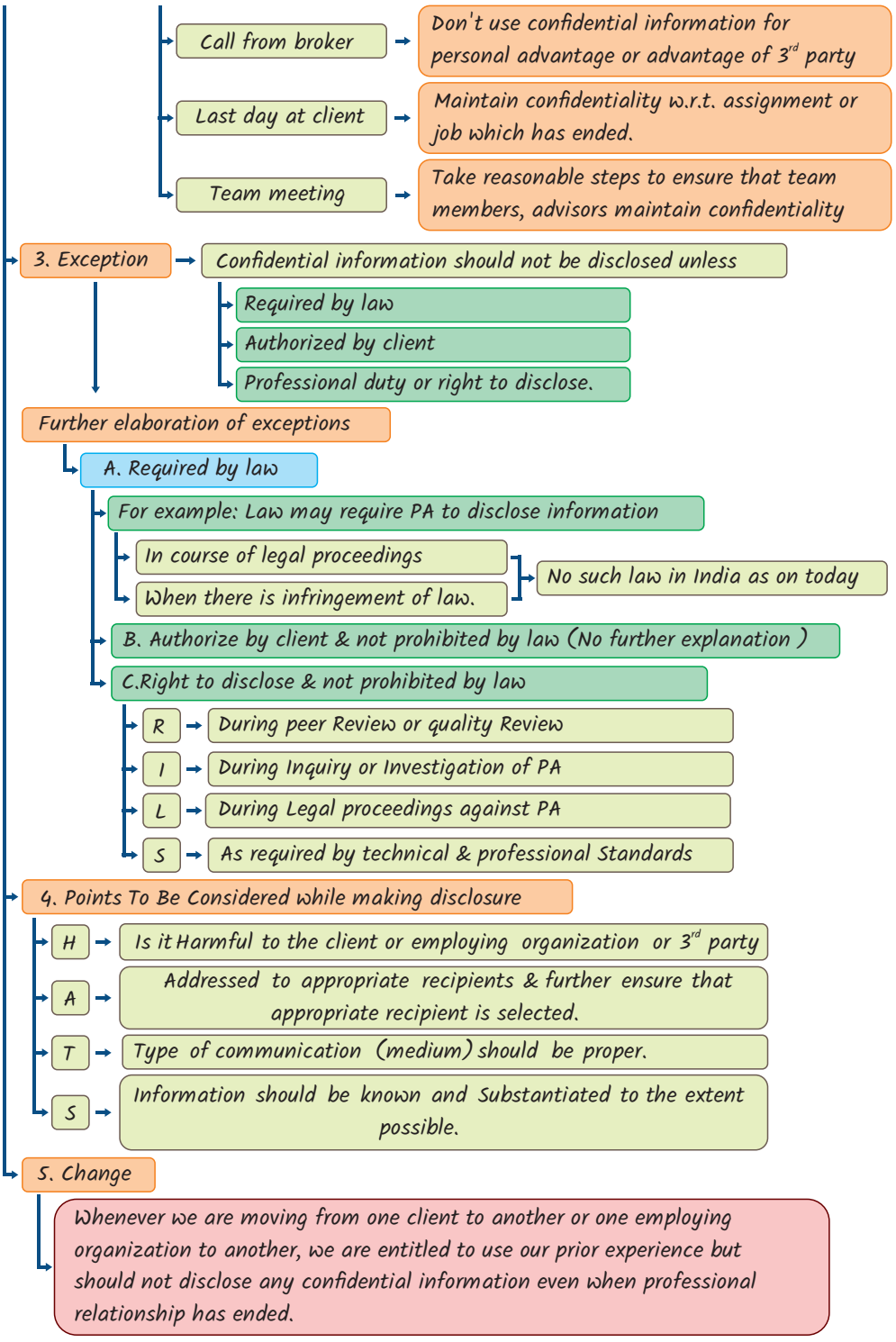
(CNO—PE.120) SUB – SECTION – 114 CONFIDENTIALITY

Chart

SUB-SECTION 114 – CONFIDENTIALITY

1. Basic principle
   - Comply with principle of confidentiality. That means keep information obtained as a result of professional /employment relationship confidential
2. Obligation of P.A. (Follow below given day wise story)
   - prospective client → Maintain confidentiality w.r.t. prospective client or employing organization
   - Office party → Maintain confidentiality within firm or employing organization
   - Home → Be alert to the possibility of inadvertent disclosure in social environment in particularly close associate and family members.

Continue on next Page...



Discussion

1. A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships. An accountant shall:

- Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;
- Maintain confidentiality of information within the firm or employing organization;
- Maintain confidentiality of information disclosed by a prospective client or employing organization;
- Not disclose confidential information acquired as a result of professional and employment relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;
- Not use confidential information acquired as a result of professional and employment relationships for the personal advantage of the accountant or for the advantage of a third party;

- Not use or disclose any confidential information, either acquired or received as a result of a professional or employment relationship, after that relationship has ended; and
- Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

2. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

(a) Disclosure is **required by law,**

- Production of documents or other provision of evidence in the course of legal proceedings.
- Disclosure to the appropriate public authorities of infringements of the law that come to light

(b) Disclosure is **permitted by law and is authorized by the client** or the employing organisation;

(c) There is a professional duty or right to disclose, when not prohibited by law:

(i) To comply with the requirements of Peer Review or Quality Review of the Institute;

(ii) To **respond** to an inquiry or investigation by a professional or regulatory body;

(iii) To **protect** the professional interests of a professional accountant in legal proceedings; **or**

(iv) To **comply** with **technical and professional standards,** including ethics requirements.

3. **In deciding whether to disclose confidential information, professional accountants should consider the following points:**

(a) Whether the interests of any party, including third parties whose interests might be affected, could be harmed if the client or employing organization consents to the disclosure of information by the professional accountant;

(b) Whether all the relevant information is known and substantiated, to the extent it is practicable; and

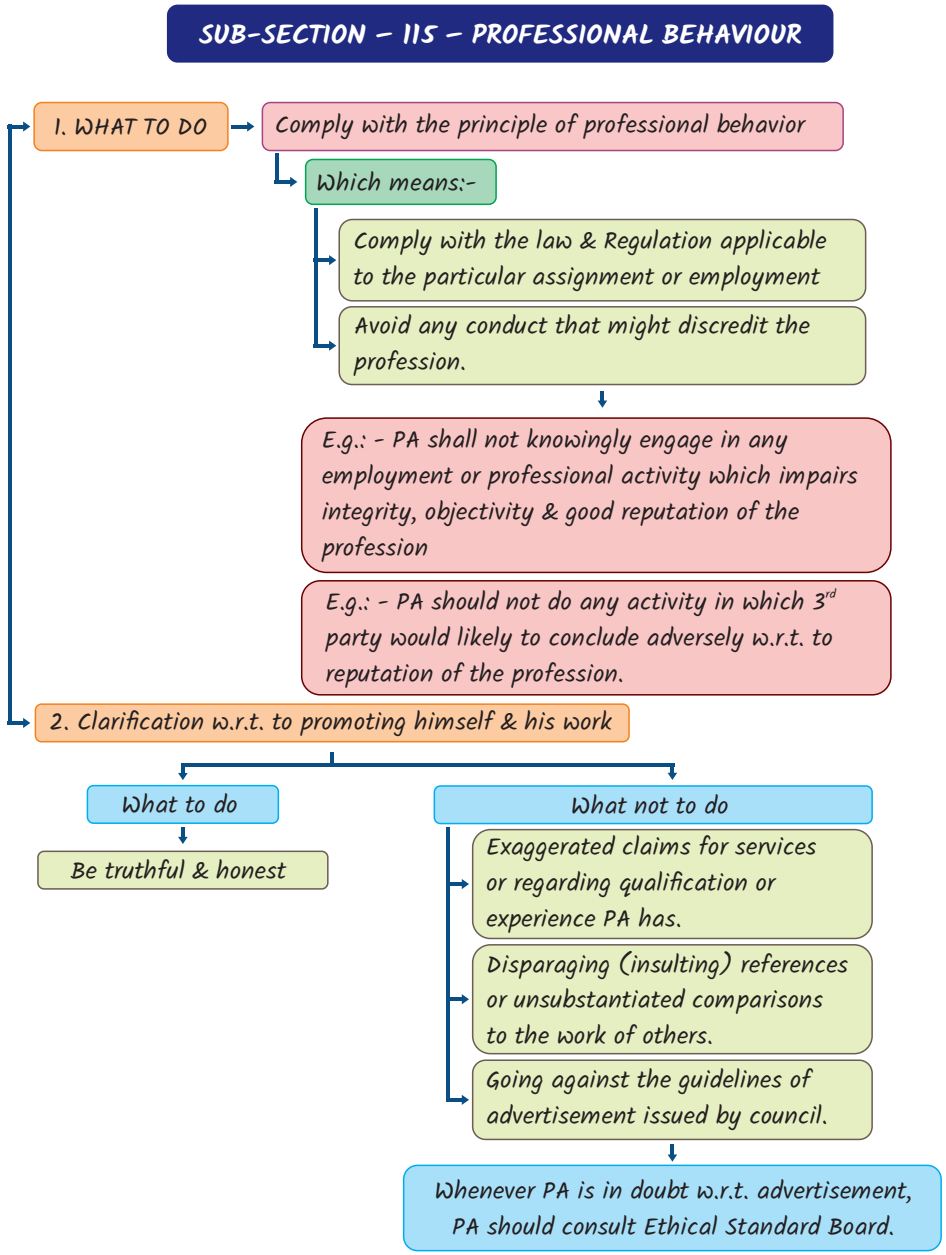
(c) The proposed type of communication, and to whom it is addressed;

(d) Whether the parties to whom the communication is addressed are appropriate recipients.

4. A professional accountant shall continue to comply with the principle of confidentiality even after the end of the relationship between the accountant and a client or employing organization. When changing employment or acquiring a new client, the accountant is entitled to use prior experience but shall not use or disclose any confidential information acquired or received as a result of a professional or

(CNO—PE.130) SUB – SECTION – 115 PROFESSIONAL BEHAVIOUR

Chart



Discussion

1. A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that accountant knows or should know might discredit the profession.

Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

2. When promoting himself and his work, a professional accountant shall not bring the profession into disrepute. A professional Accountant is required to conduct his affairs in a manner that he remains outside the boundaries of professional and other misconduct. A professional accountant shall be honest and truthful and should not make:

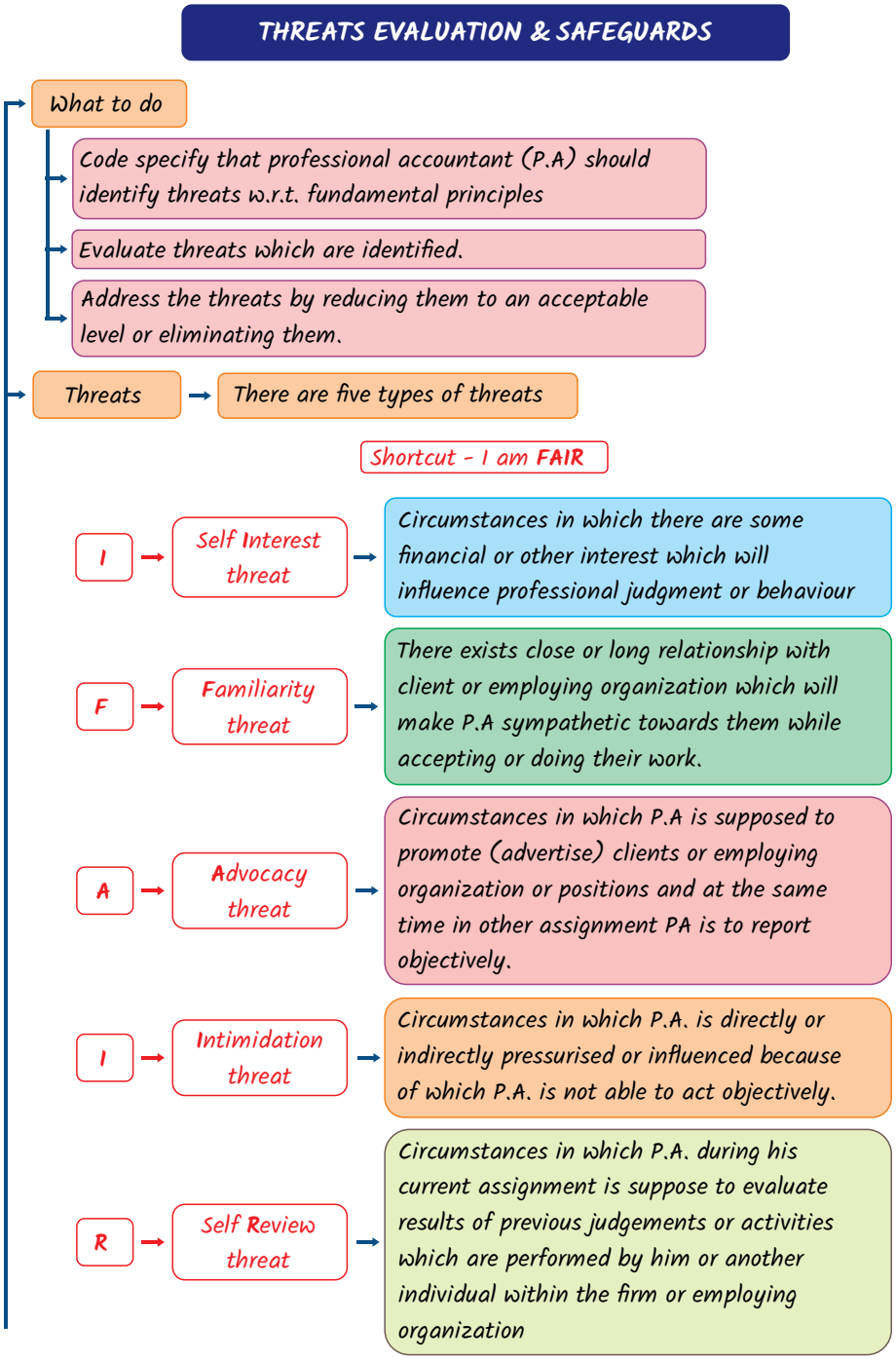
(a) Exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or

(b) Disparaging references or unsubstantiated comparisons to the work of others.
(c) Any direct or indirect measures to advertise any professional/other facts which are in violation of Advertisement Guidelines issued by the Council of the Institute from time to time.

The professional accountant should ensure that the contents of an advertisement are true to the best of his knowledge and belief, and are in conformity with the Advertisement Guidelines, and be aware that the Institute does not own any responsibility, whatsoever, for such contents or claims by him. However, if a professional accountant is in doubt about whether a form of proposed advertising is appropriate, the accountant is encouraged to consult with the Ethical Standards Board of ICAI.

(CNO—PE.140) THREATS EVALUATION & SAFE GUARD (QNO - 780.005 / 780.010) (MCQ – PE.13)

Chart



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- Examples
  - 1. Circumstances that may create self interest threat (BP² LTD)
    - Financial interest → Direct financial interest (equity, debt, loans etc)
      - Undue dependence on Total fees
      - Personal gain may arise because of access to confidential information of client
    - Other interest → Possibility of Losing client
      - Close Business relationship with client
      - Potential employment with client
    - *Note: Above bifurcation is only for ease to memorize examples
  - 2. Circumstances that may create familiarity threat
    - A. Member of engagement having close or immediate family relationship with
      - Director
      - Officer of the client
      - With an employee who is in position to exert direct and significant influence over subject matter
    - B. Former partner of the firm
      - Is a director
      - Is a officer
      - Is an employee who is in position to exert direct and significant influence over subject matter
    - C.Having long association with the client
  - 3. Circumstances that may create Advocacy threat
    - P.A is providing assurance services to the client and at the same time
      - Promoting shares of the client in market (IPO, FPO etc)
      - Acting as advocate on behalf of clients in litigation or disputes with 3rd parties
      - Lobbying in favour of legislation on behalf of client
  - 4. Circumstances that may create Intimidation threat
    - Threatened with dismissal or replacement if P.A disagrees on a professional matter
    - Informed that planned promotion will not occur till P.A agree's with inappropriate accounting treatment
    - Pressurized to agree with Judgement of client because client has more expertise on matter in question
    - P.A accepted a significant gift from client and now client is threatening that he will make this information public

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5. Circumstances that may create self Review threat

- P.A implemented financial systems and now he is supposed to evaluate & issue assurance report on the operations of same financial systems
- P.A prepared original data which is used to prepare statements and now he is supposed to check and issue report on the same

Note:- Unique threats

Specific circumstances may give rise to unique threats which cannot be categorized in this 5 types of threat. So P.A should always be alert for such circumstance and threats Eg. blackmailing (Personal info) Religion / Political / kidnaping parties to give wrong reports

Discussion

The conceptual framework specifies an approach for a professional accountant to:

(i) Identify threats to compliance with the fundamental principles;

(ii) Evaluate the threats identified; and

(iii) Address the threats by eliminating or reducing them to an acceptable level.

A. Threats

Threats to compliance with the fundamental principles fall into one or more of the following categories:

- Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgment or behaviour;
- Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made; or an activity performed by the accountant, or by another individual within the accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity;
- Advocacy threat – the threat that a professional accountant will promote a client's or employing organization's position to the point that the accountant's objectivity is compromised;
- Familiarity threat – the threat that due to a long or close relationship with a client, or employing organization, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.
- ***Circumstances that may create self-interest threats***
  - Having a direct financial interest in a client
  - Undue dependence on total fees from a client.
  - Having a close business relationship with a client.
  - Concern about the possibility of losing a client.
  - Potential employment with a client.
  - Having access to confidential information of the client that might be used for personal gain.
- ***Examples of Circumstances that may create Self Review Threat***
  - A loan to or from an assurance client or any of its directors or officers
  - A professional accountant holding a financial interest in, or receiving a loan or guarantee from, the employing organization.
  - A professional accountant participating in incentive compensation arrangements offered

- A professional accountant having access to corporate assets for personal use.
- A professional accountant being offered a gift or special treatment from a supplier of the employing organization.

➢ ***Examples of circumstances that may create advocacy threats:***

- Promoting shares in a entity when that entity is a financial statement audit client.
- Acting as an advocate on behalf of an assurance client in litigation or disputes with third parties.
- lobbying in favour of legislation on behalf of a client.

Examples of circumstances that may create familiarity threats

1. A member of the engagement team having a close or immediate family relationship with a director or officer of the client.
2. A member of the engagement team having a close or immediate family relationship with an employee of the client who is in a position to exert direct and significant influence over the subject matter of the engagement.
3. A former partner of the firm being a director or officer of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement.
4. Long association of an audit team member with the audit client.

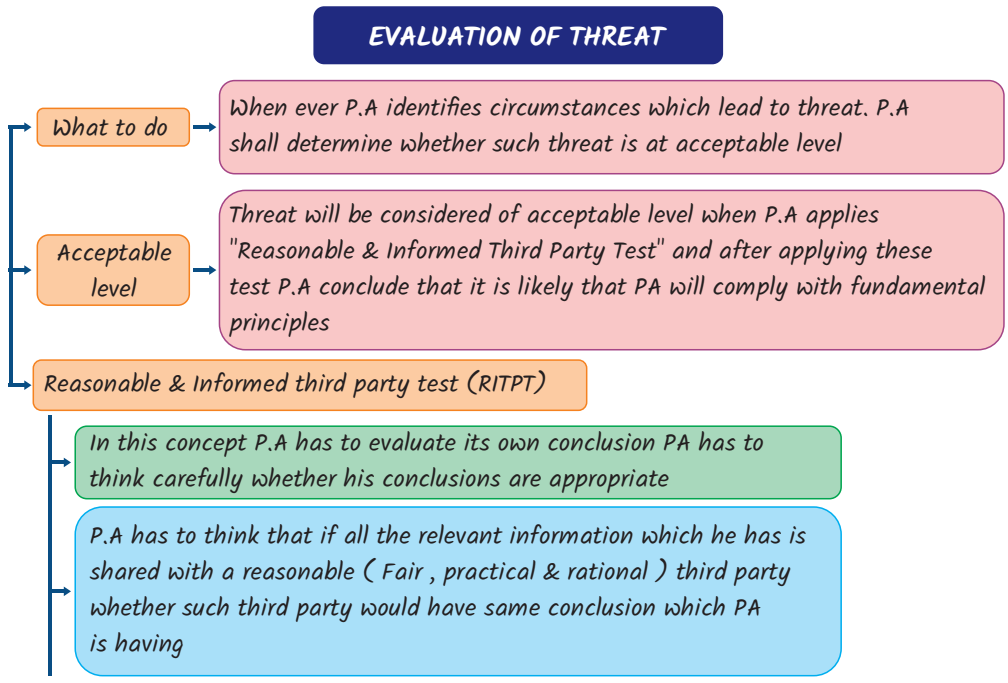
Examples of circumstances that may create intimidation threats

1. Being threatened with dismissal or replacement in relation to a client engagement because of a disagreement about a professional matter.
2. Being feeling pressured to agree with the judgment of a client because the client has more expertise on the matter in question.
3. Being informed that a planned promotion will not occur unless the accountant agrees with an inappropriate accounting treatment.

Specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats cannot be categorized. In either professional or business relationships, a professional accountant in public practice should always be on the alert for such circumstances and

(CNO—PE.150) EVALUATION OF THREATS

Chart



Continue on next Page...

- P.A can apply this test either by himself by careful thinking or P.A can go to such reasonable third party inform him, discuss with him and take his opinion
- Third party need not be an accountant, he can be a lawyer, company secretary etc who understand the circumstances and have relevant knowledge to draw conclusions

Discussion

B. Evaluation of Threats:

The conditions, policies and procedures described above might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level.

(i) Acceptable level: An acceptable level is a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.

(ii) Reasonable and Informed Third Party test : The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant but would possess the relevant knowledge and experience to understand and

(CNO—PE.160) ADDRESSING THREATS (MCQ – PE.5 / PE.8)

Chart

ADDRESSING THREATS

- What to do
  - If P.A identify threat which are not at acceptable level then P.A have to address threat in following manner
    - Option 1 → Eliminate the circumstances, including interest or relationship that are creating threat
    - Option 2 → Applying safeguards,to reduce the threat to an acceptable level.
    - Option 3 → Declining or ending specific professional activity
- How to apply above options
  - depending upon the circumstances and facts P.A should try to eliminate the threat , if that is not possible then P.A should apply safeguards to reduce threats to an acceptable level and even if that is not possible then P.A should think about declining or ending the specific professional activity

Discussion

C. Addressing Threats

If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating them or reducing them to an acceptable level. The accountant shall do so by:

(i) Eliminating the circumstances, including interests or relationships, that are creating the threats ;

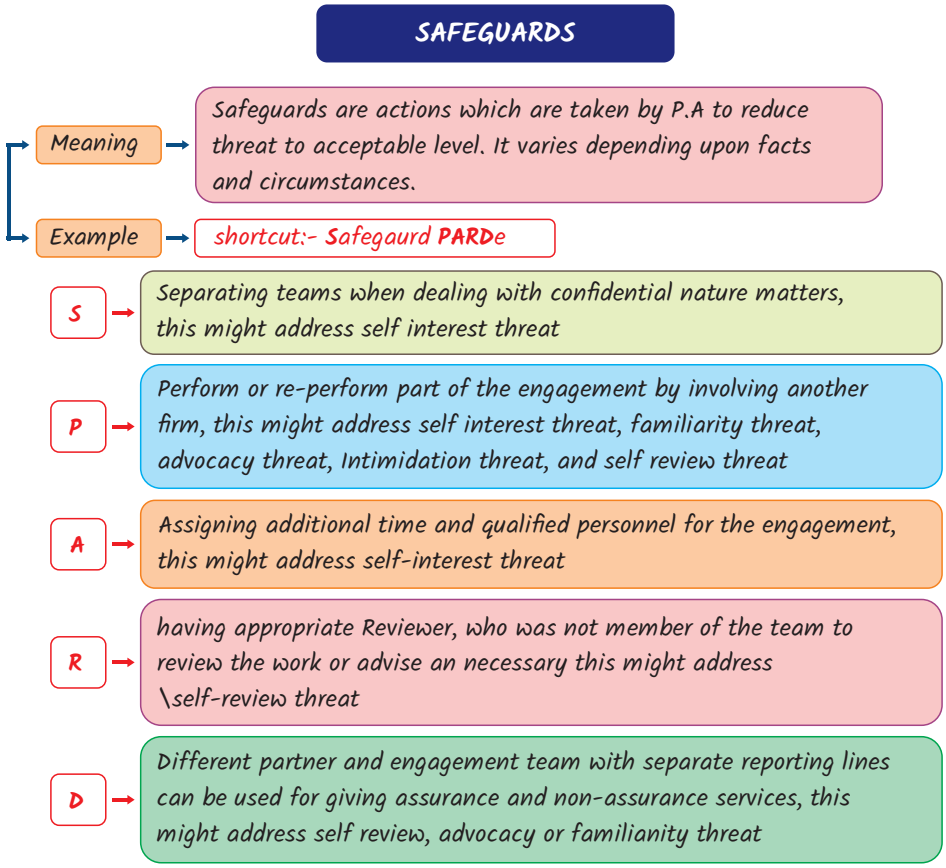
(ii) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or

(iii) Declining or ending the specific professional activity.

Actions to Eliminate Threats : *Depending on the facts and circumstances, a threat might be addressed by eliminating the circumstance creating the threat. However, there are some situations in which threats can only be addressed by declining or ending the specific professional activity. This is because the circumstances that created the threats cannot be eliminated and safeguards are not capable of being applied to reduce the threat to an acceptable level.*

(CNO—PE.170) SAFEGAURDS (QNO - 780.050)

Chart



Discussion

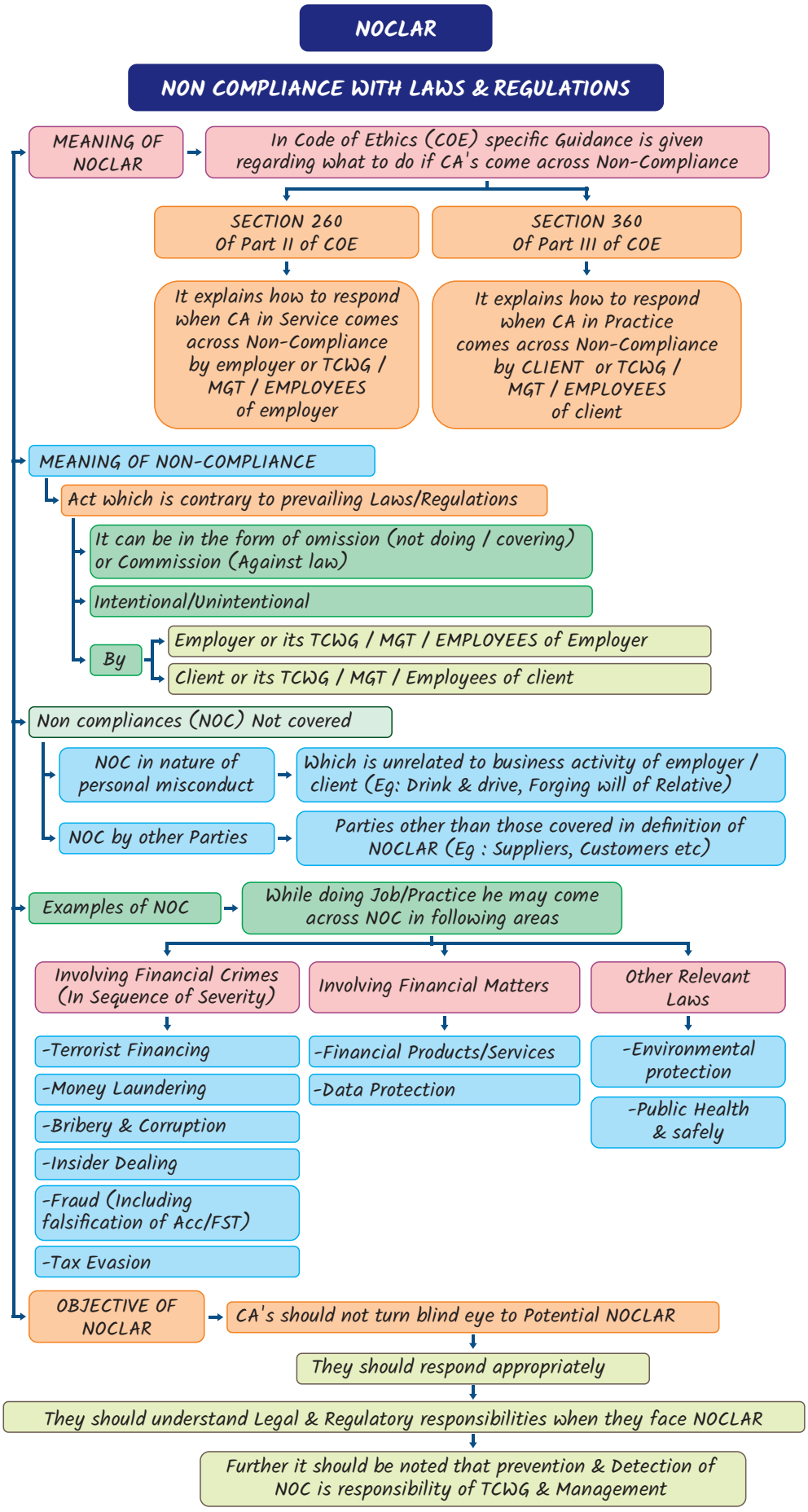
Safeguards are actions individually or in combination that the accountant takes that effectively reduce threats to an acceptable level. Safeguards vary depending on the facts and circumstances.

Examples of actions that in certain circumstances might be safeguards to address threats include:

- *Assigning additional time and qualified personnel to required tasks when an engagement has been accepted might address a self-interest threat.*
- *Having an appropriate reviewer, who was not a member of the team, review the work performed or advise as necessary might address a self-review threat.*
- *Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review, advocacy or familiarity threats.*
- *Involving another firm to perform or re-perform part of the engagement ight address self-interest, self-review, advocacy, familiarity or intimidation threats.*
- *Separating teams when dealing with matters of a confidential nature might address a self - interest threat.*

(CNO—PE.180) NON – COMPLIANCE WITH LAWS & REGULATION (NOCLAR)

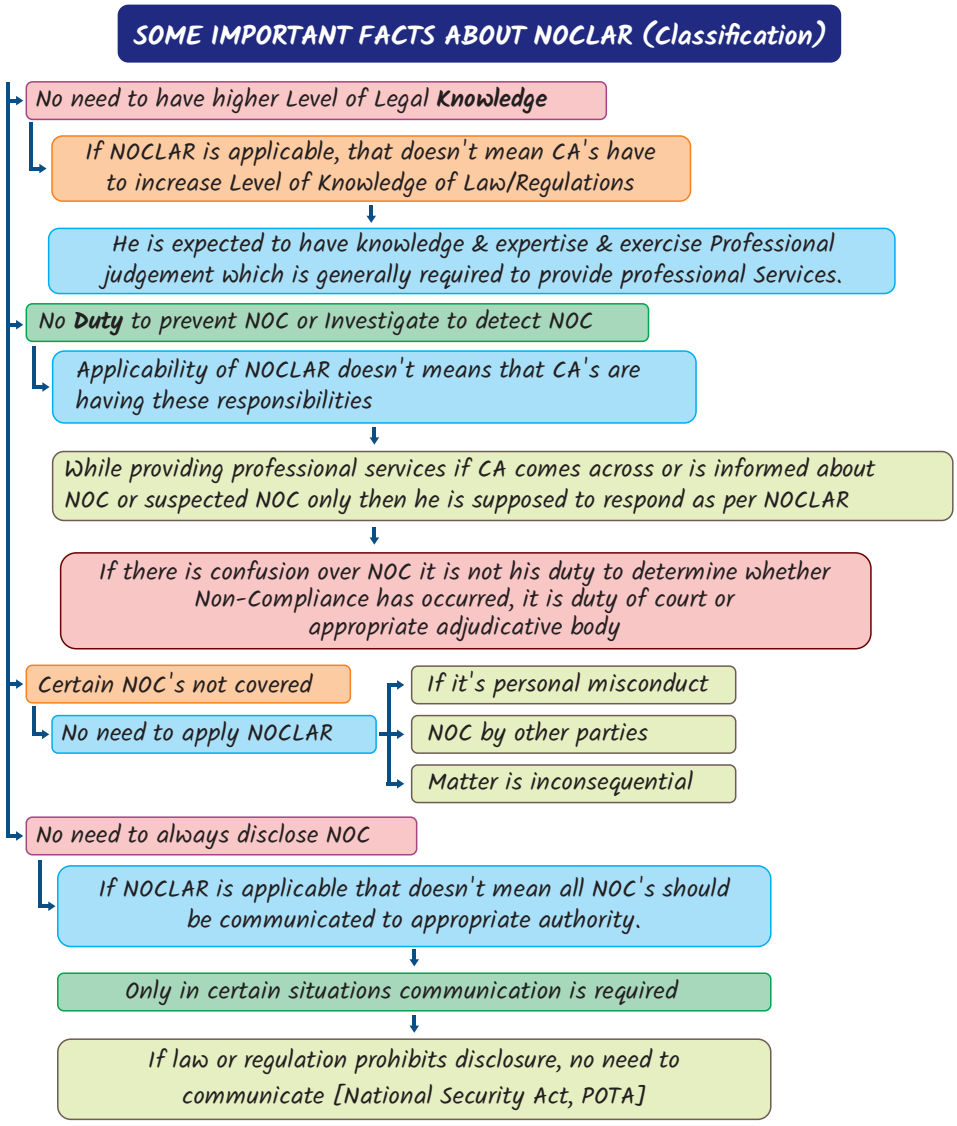
Chart



Meaning of NOCLAR	In the course of ➢ providing a professional service to a client or carrying out professional activities for an employer, a Professional accountant ➢ may come across an instance of non-compliance with laws and regulations (NOCLAR) or suspected NOCLAR committed or about to be committed ➢ by the client or the employer, or by those charged with governance, management or employees of the client or employer.
Meaning of Non Compliance	Non-compliance with laws and regulations ("non-compliance") comprises of ➢ acts of omission or commission, ➢ intentional or unintentional, ➢ which are contrary to the prevailing laws or regulations committed by: ▪ A client/professional accountant's employing organisation; ▪ Those charged with governance of a client or employing organisation; ▪ Management of a client/ employing organisation; or other individuals working for or under the direction of a client/ employing organisation.
Personal Misconduct not Covered	However, NOCLAR under Revised Code of Ethics does not address the personal misconduct unrelated to the business activities of the client/ employing organisation and non-compliance by parties other than listed out in the definition of NOCLAR
Examples of Laws	Examples of laws and regulations that would be covered are in the areas of: ➢ Financial Crimes Related Laws ▪ Money Laundering / Terrorist Financing; ▪ Bribery and corruption; ▪ Insider dealing; ▪ Fraud (including false accounting, falsification of accounting records); ▪ Tax evasion; ➢ Financial Matters Related Laws ▪ Financial products and services; ▪ Data Protection; ➢ Others Relevant Laws ▪ Environmental protection; ▪ Public health and safety.
Objective of NOCLAR	The objective of NOCLAR is that - turning a blind eye to potential NOCLAR is not an appropriate response (Don't hide behind principle of confidentiality) from professional accountants, while placing renewed emphasis on the roles of management and those charged with governance in addressing the matter. Further, it increases awareness and understanding among Professional accountant of their legal and regulatory responsibilities when they face NOCLAR

(CNO—PE.190) SOME IMPORTANT FACTS ABOUT NOCLAR (Classification)

Chart



During Course of Providing a Service (Duty)	NOCLAR will be applicable if a professional accountant encounters, or is made aware of, non-compliance or suspected non-compliance in the course of providing a professional service to a client. He is not required to investigate, nor responsible for ensuring complete compliance.
Expertise of Laws not Required (Knowledge)	A professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, he is not expected to have a level of knowledge of laws and regulations greater than that which is required to undertake the engagement. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.
Certain Matters Expressly Out of Purview (Converge)	Matters that are clearly inconsequential or relating to personal misconduct not pertaining to business activities of the client not covered.
Disclosure, which is Contrary to Law not Required	As per IESBA Code, disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. (If law restricts PA from communication of NOCLAR to authorities, then such communication should not be done)

(CNO—PE.200) NOCLAR V/S SA 250

Chart

NOCLAR V/S SA 250

	POINTS	NOCLAR	SA250
Coverage	Assignments covered	-Applicable to all the CA's in service as well as practice. -Further in practice it is applicable to Audits as well as other assignments. -But degree of responsibility (Response) differs as per role of CA.	It is applicable to CA in practice providing Audit Services
	Law Coverage	NOCLAR goes beyond SA250 It covers NOC of all the types of laws which may cause substantial harm in financial or Non-Financial terms. - License / membership cancellation - Prohibitions - Black Listing	-It focuses on two types of laws (Immediate impact on FST) 1 Having direct effect on material amounts & Disclosure in FST (Eg :tax & Labour Laws) 2 Other laws which are fundamental to operations of entity ,Hence NOC may lead to material effect.(Eg: CAR by RBI, solvency by IRDA)
	Effect of NOC (Impact)	NOCLAR asks to evaluate effect of NOC on investors/ creditors/Employees/Also General public (Stake Holders considered)	-SA 250 asks to consider effect on financial statement & its fundamental assumption going concern (stakeholders not considered)
	Disclosure to Authorities	-As per NOCLAR in exceptional circumstances, if there is imminent breach of Law/ Regulations plus substantial harm to Investors/Creditors/ Employees/Also General Public -Then apply judgement & decide whether to discuss with MGT/ TCWG or directly go to appropriate authority to prevent or mitigate consequences of imminent breach	-As per SA 250 we should disclose to authority only if it is required by Law or Regulation.

Discussion

- **Assignments Covered**
  - SA 250 is applicable only on Audit, and not on other Assurance engagements.
  - However, NOCLAR is applicable on professional accountants in service, and in practice. Among those in practice, it applies to Auditors, as well as professional services other than Audit. However, degree of responsibility of the professional accountant varies as per the role.

- **Laws Covered**
  - SA 250 talks of auditor's responsibilities for laws
  - having direct effect on the determination of material amounts and disclosures in the

financial statements (such as tax and labour laws); and

- other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business.
- NOCLAR, while being alike to SA 250 till this point, is further ahead of it in that it takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.

- Stakeholders Concerned
  - SA 250 does not define stakeholders.
  - NOCLAR is related to affect of non-compliance on investors, creditors, employees as also the general public.

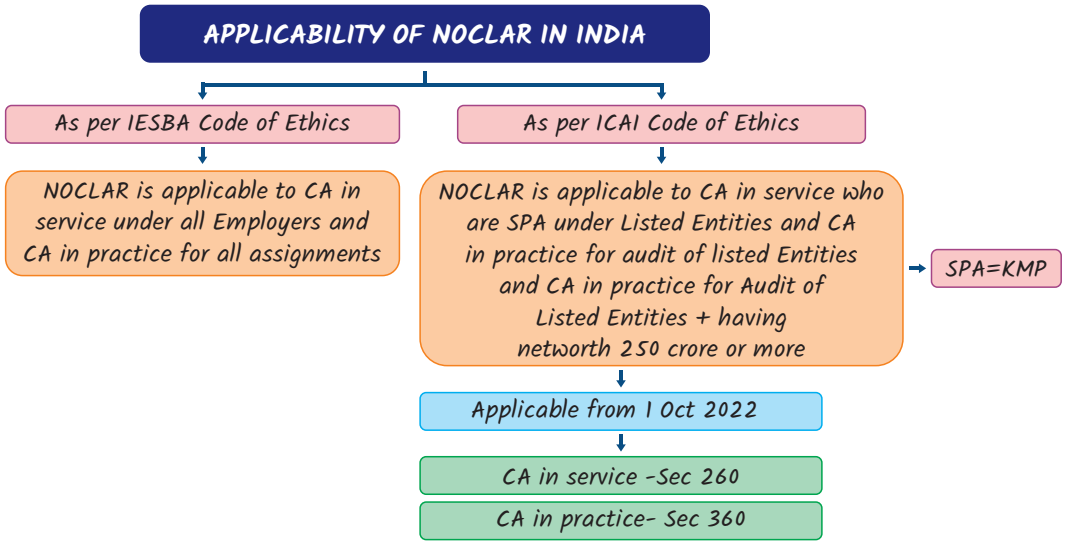
- Disclosure to Authorities
  - As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted.
  - This provision is not existent in SA 250.

It may also be noted that in a situation where disclosure ought to be made by the Auditor, the "Appropriate authority" for the purpose of disclosure will depend on the nature of the matter. For example, the appropriate authority would be SEBI in the case of fraudulent financial reporting. Appropriate alignment has been made in the Code with regard to requirements of Confidentiality, as required under Chartered Accountants Act, 1949.

(CNO—PE.210) APPLICABILITY OF NOCLAR IN INDIA

Chart

AMENDMENT



Discussion

The IESBA Code of Ethics makes NOCLAR applicable to all assignments (in case of members in practice), and to all employers (in case of members in service).

However, in the ICAI Code, as of now, Institute has restricted applicability of NOCLAR to Audit engagements of entities the shares of which are listed on recognized stock exchange(s) in India and have net worth of 250 crores of rupees or more (in case of Members in Practice) and for the members in service it is applicable to ***Senior Professional Accountants in service (SPA), being employees of listed entities.

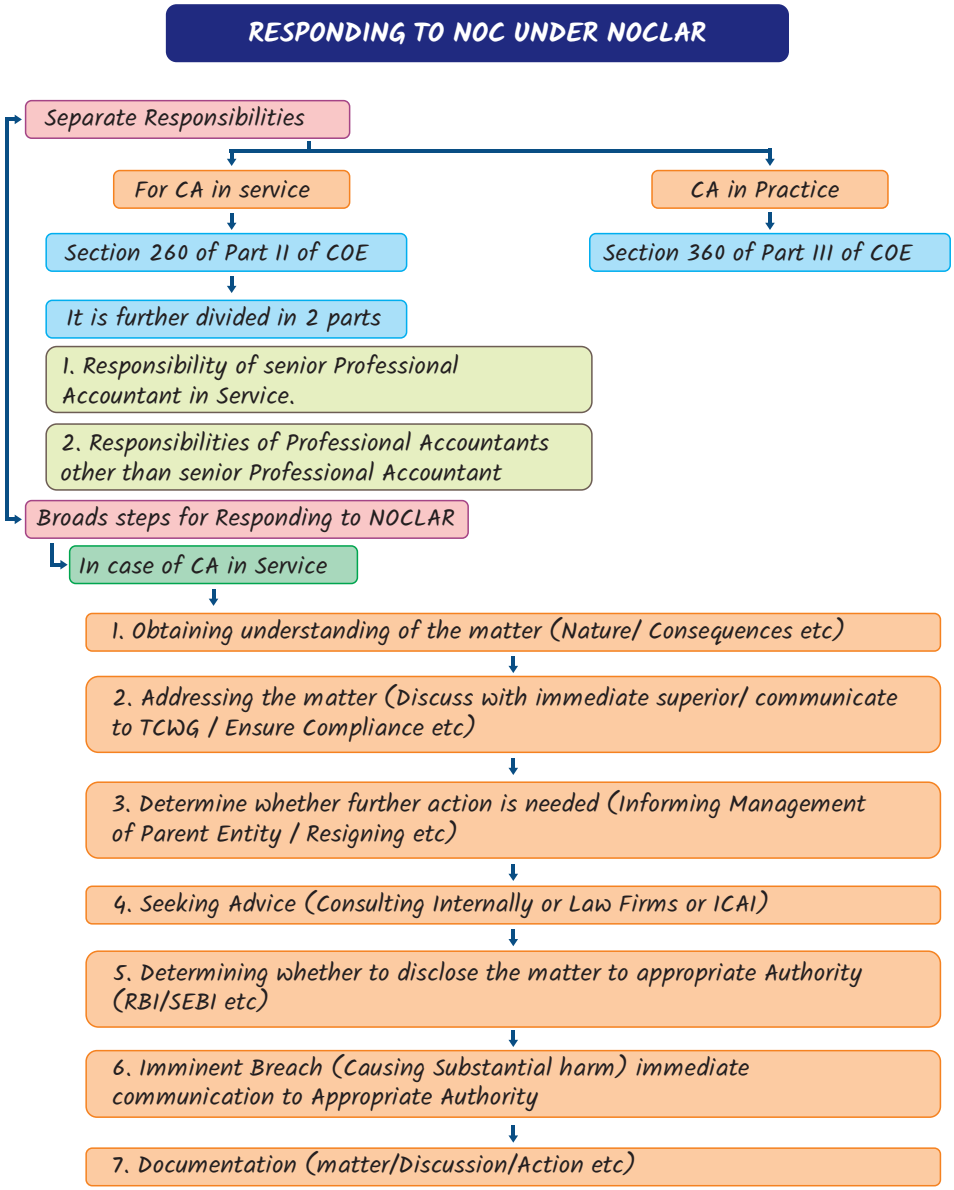
***senior professional accountants" are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources. It is further explained that the senior professional accountants SPA refer to key managerial personnel (KMP)

Further Sec 260 & Sec 360 of Code of Ethics issued by ICAI deals with NOCLAR is applicable from Ist April 2022

Note: The applicability of Section 360 will subsequently be extended to all listed entities, at the date to be notified later.

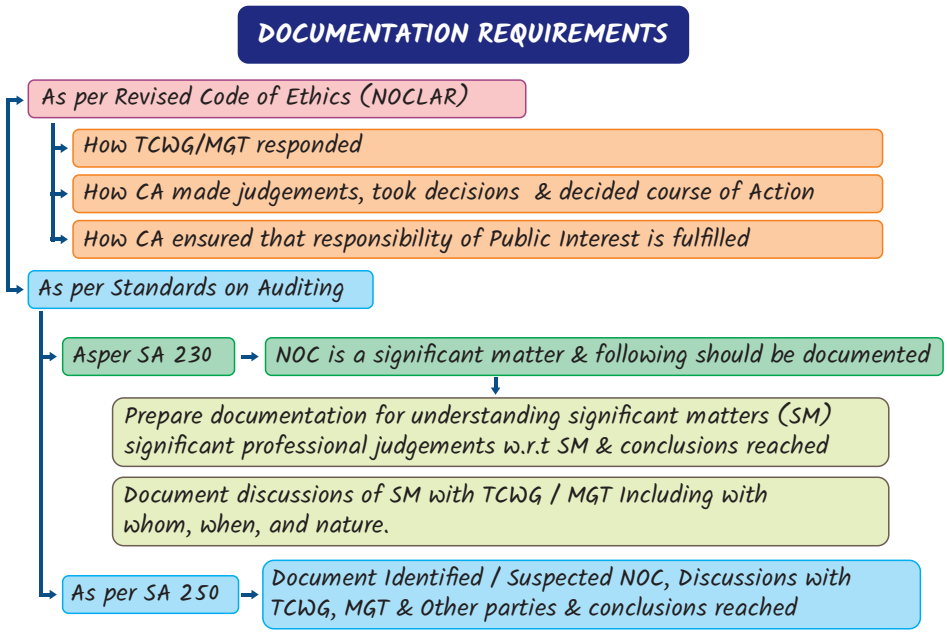
(CNO—PE.220) RESPONDING TO NOCLAR

Chart



(CNO—PE.230) DOCUMENTATION REQUIREMENTS

Chart



Discussion

- Revised Code over and above require the professional accountant to follow the additional documents requirements as under:
  - How management / those charged with governance have responded to the matter.
  - The course of action the accountant considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party test.
  - How the accountant is satisfied that the responsibility of public interest has been fulfilled.

- This documentation is in addition to complying with the documentation requirements under applicable auditing standards. SAs, for example, require a professional accountant performing an audit of financial statements to:
  - Prepare documentation sufficient to enable an understanding of significant matters arising during the audit, the conclusions reached, and significant professional judgments made in reaching those conclusions;
  - Document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place; and
  - Document identified or suspected non-compliance, and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity

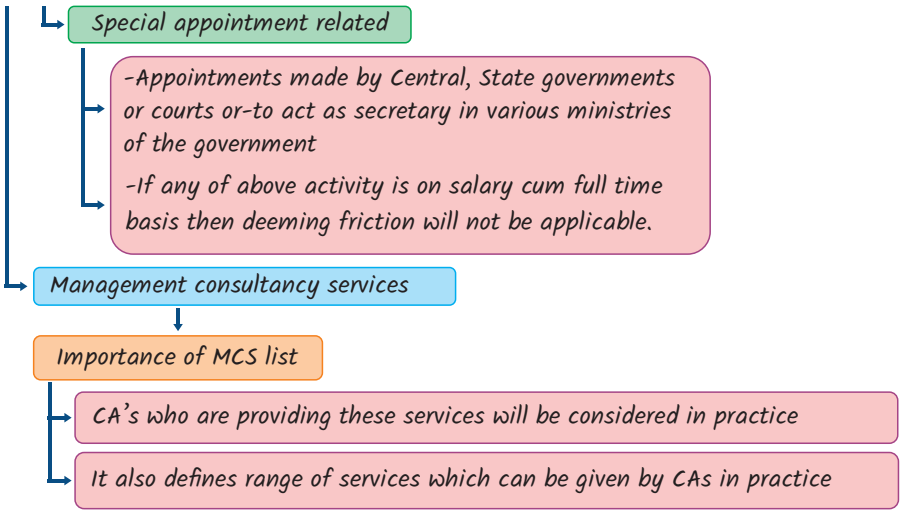
(CNO—PE.400) SECTION 2(2) DEEMED TO BE IN PRACTICE

Chart

CA ACT – SECTION 2(2) DEEMED TO BE IN PRACTICE

- Concept
  - Majority of the provision of CA Act, are for Charted Accountants in practice some CAs may do practice related work without taking COP so as to avoid provision of CA Act To ensure that all the CAs who are doing practice related work are governed by provision of CA Act concept of members deemed to be in practice is created.
  - It simply given list of activities, if CAs are involved in these activities they are deemed to be in practice
- Important Condition
  - CA whether individually or in partnership with CA/other prescribed professionals will be deemed to be in practice for performing these activities for remuneration (received or receivable) Further if CA is performing these activities as employee to any organization than this deeming fiction will not be applicable, that means it should be given in his professional capacity and not employee capacity or personal capacity nature help to friends and relatives, social work.
- Section 2(2) (i)/(ii)/(iii)
  - We have combined all the activities given in these individual clauses and arranged them logically for ease of understanding & memorization
  - Practice related activities
    - Describes himself as public accountant
    - Sets up office for practice
    - Offers to perform or performs any work related to accounting (including advisory) or auditing (including any verification or certification).
    - Services related activities
      - Working an a employee with CA /firm in practice (this is for limited purpose of giving right to train articles and not to put any other obligations under CA Act)
      - CA in service with armed forces
- Section 2(2) (iv)
  - This clause gives power to council of ICAI to increase list of activities
    - Regulation 191
      - Entities
        - Individual related → Executor
        - Trust related → Trustee
        - Company related → Receiver → Liquidator
      - Situation
        - Dispute related → Administrator → Arbitrator
        - Advisor related → Advisor or representative for costing, tax and financial matter.

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Section 2

(QNO-654.000/655.000/655.050)

Important Definition: - Sec 2(2) Members Deemed to be in Practice

CA will be deemed to be in practice if he is doing activities given in: -

- Section 2(2) (i) / (ii) / (iii)
- Clause (iv) gives power to ICAI to issue list of services
- Regulation 191 [Covered under clause (iv)]
- List of Management Consultancy Services [Covered under clause (iv)]

Combined Interpretation of Clauses of Sec 2(2)

(QNO-654.000/655.000/655.050)

CA will be deemed to be in practice, if for **remuneration (received or receivable)** and in **professional capacity** (Not personal capacity or capacity of employee) whether individually or in partnership with CA/Specified Professional

Practice Related

- Describes himself as PUBLIC ACCOUNTANT (Provider of Accountancy Services)
- Sets up OFFICE FOR PRACTICE
- OFFERS to perform or performs any work (including advisory) related to ACCOUNTING OR AUDITING (including any verification / certification)

Service Related

- Salaried CA employee of individual CA or Firm in practice (FOR LIMITED PURPOSE OF TRAINING

Discussion

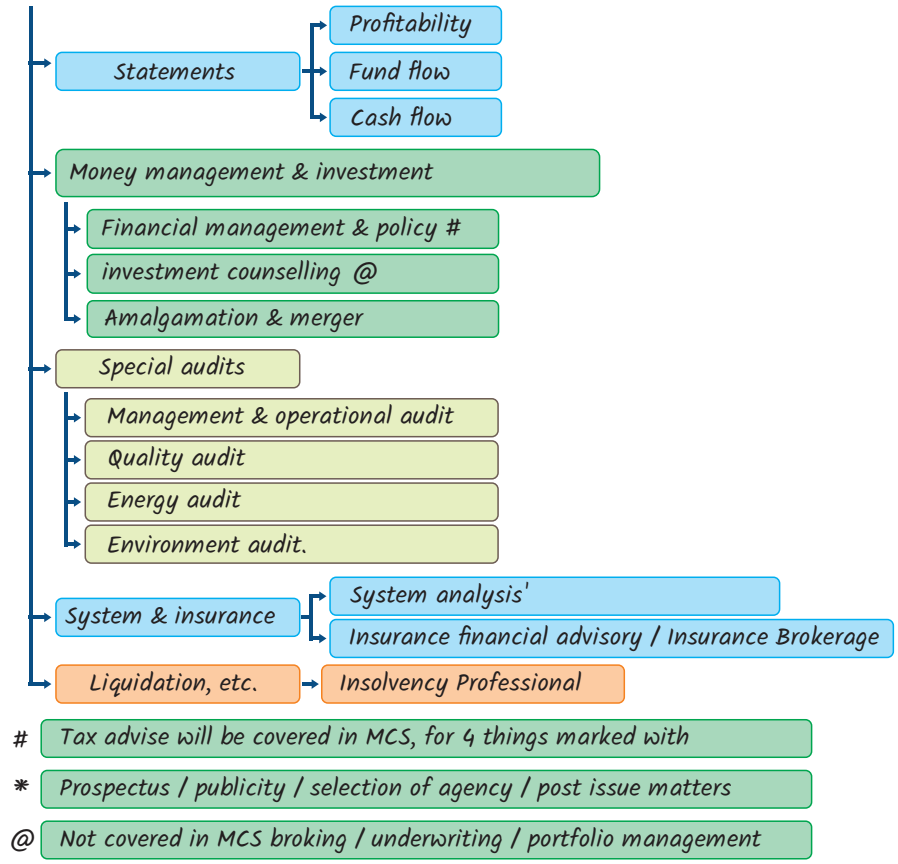
- CA in service with ARMED FORCES

List Extended by ICAI

- Regulation 191 –
  - Becomes ADMINISTRATOR, LIQUIDATOR, RECEIVER, TRUSTEE, ARBITRATOR, EXECUTOR, (Trust aur paise wale kaam)
  - Become adviser or representative for TAX, COSTING or FINANCIAL matters.
  - SECRETARY to central or state government / Court (Not covered if, SALARY CUM FULL TIME basis)
- Performing MANAGEMENT CONSULTANCY SERVICES (See next point)

MANAGEMENT CONSULTANCY SERVICES

- **Origin** → ICAI issued list of MCS as per power given in section 2(2)(iv)
- **Corporate form** → MCS can be provided in traditional form of practice (proprietorship / partnership) or it can be giving by forming management consultancy company (MCC)
- **Exclusions**
  - 1. Statutory / Corporate form Periodic audits
  - 2. Tax advisory or representation (direct on indirect tax)
  - 3. List of activities given in regulation 191 above
    - That means these services connot be provided by MCC
  - 4. Also MCC cannot provide accounting services as it is prohibited u/s 25 of CA Act.
- **List of MCS** → We have arranged all the services in sequence of life cycle of company for ease of understanding and memorization
  - **Prior to incorporation** → Project reports & feasibility studies #
  - **Post incorporation fund raising**
    - Capital structure planning & raising finance #
    - Valuation of shares (Registered valuer)
    - Acting as advisor to public issue *
    - Acting as Registrar to issue and share transfer
  - **Planning**
    - Business policy
    - Corporate planning
    - Organization development
    - Budgets (capital & revenue)
    - Cash budgets
  - **Staffing**
    - Personnel recruitment, training
    - Organizational structure & development of human Resource
    - Incentive plan
  - **Administration service**
    - Assisting clients with their routine or mechanical tasks and such services includes
    - Word processing services,
    - Preparing administrative or statutory forms for client approval
    - Monitoring statutory filing dates and advising client
    - Submitting such forms as instructed by client. (Example functions of GST practitioner under rule 83(8) of CGST Rules 2017
  - **Working capital & cost**
    - Working capital management #
    - Inventory management (Handling / storage)
    - Management accounting (Cost accounts) and MIS
    - Cost control & methods & MIS
    - Value analysis
  - **Pricing**
    - Market research & demand studies
    - Price fixations & other decisions
  - **Recovery** → Acting as recovery consultant in banking sector.



Management Consultancy Services

Pursuant to Section 2(2)(iv) above, the Council has passed a resolution permitting a Chartered Accountant in practice to render entire range of "Management Consultancy and other Services".

The expression "Management Consultancy and other Services" shall not include the function of statutory or periodical audit, tax (both direct taxes and indirect taxes) representation or advice concerning tax matters or acting as liquidator, trustee, executor, administrator, arbitrator or receiver, but shall include the following-

*(i) Financial management planning and financial policy determination.**

*(ii) Capital structure planning and advice regarding raising finance.**

*(iii) Working capital management.**

*(iv) Preparing project reports and feasibility studies.**

(v) Preparing cash budget, cash flow statements, profitability statements, statements of sources and application of funds etc.

(vi) Budgeting including capital budgets and revenue budgets.

(vii) Inventory management, material handling and storage.

(viii) Market research and demand studies.

(ix) Price-fixation and other management decision making.

(x) Management accounting systems, cost control and value analysis.

(xi) Control methods and management information and reporting.

(xii) Personnel recruitment and selection.

(xiii) Setting up executive incentive plans, wage incentive plans etc.

(xiv) Management and operational audits.

(xv) Valuation of shares and business and advice regarding amalgamation, merger and acquisition.

Acting as Registered Valuer under the Companies Act, 2013 read with The Companies (Registered Valuers and Valuation) Rules, 2017.(incorporated pursuant to decision of Council at its 388th Meeting)

(xvi) Business Policy, corporate planning, organisation development, growth and diversification.

(xvii) Organisation structure and behaviour, development of human resources including design and conduct of training programmes, work study, job-description, job evaluation and evaluation of workloads.

* Consideration of "tax implications" while rendering the services at (i), (ii), (iii) and (iv) above will be considered as part of "Management Consultancy and other services"

(xviii) Systems analysis and design, and computer related services including selection of hardware and development of software in all areas of services which can otherwise be rendered by a Chartered Accountant in practice and also to carry out any other professional services relating to Electronic Data Processing (EDP).

(xix) Acting as advisor or consultant to an issue, including such matters as:

(a) Drafting of prospectus and memorandum containing salient features of prospectus. Drafting and filing of listing agreement and completing formalities with Stock Exchanges, Registrar of Companies and SEBI.

(b) Preparation of publicity budget, advice regarding arrangements for selection of (i) ad - media, (ii) centres for holding conferences of brokers, investors, etc., (iii) bankers to issue, (iv) collection centres, (v) brokers to issue, (vi) underwriters and the underwriting arrangement, distribution of publicity and issue material including application form, prospectus and brochure and deciding on the quantum of issue material (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).

(c) Advice regarding selection of various agencies connected with issue, namely Registrars to Issue, printers and advertising agencies.

(d) Advice on the post issue activities, e.g., follow up steps which include listing of instruments and dispatch of certificates and refunds, with the various agencies connected with the work.

Explanation - For removal of doubts, it is hereby clarified that the activities of broking, underwriting and portfolio management are not permitted.

(xx) Investment counselling in respect of securities [as defined in the Securities Contracts (Regulation) Act, 1956 and other financial instruments.] (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).

(xxi) Acting as registrar to an issue and for transfer of shares/other securities. (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).

(xxii) Quality Audit.

(xxiii) Environment Audit.

(xxiv) Energy Audit.

(xxv) Acting as Recovery Consultant in the Banking Sector.

(xxvi) Insurance Financial Advisory Services under the Insurance Regulatory & Development Authority Act, 1999, including Insurance Brokerage.

(xxvii) Acting as Insolvency Professional in terms of Insolvency and Bankruptcy Code, 2016 (incorporated pursuant to decision of Council at its 362nd Meeting).

(xxviii) Administrative Services. (Incorporated pursuant to decision of Council at its 388th Meeting)

Administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Such services require little to no professional judgment and are clerical in nature.

Examples of administrative services include:

- *Word processing services.*
- *Preparing administrative or statutory forms for client approval.*
- *Submitting such forms as instructed by the client.*
- *Monitoring statutory filing dates, and advising an audit client of those dates.*

For example, the functions of a GST practitioner as specified under Rule 83(8) of Central Goods and Services Tax Rules, 2017:-

(a) furnish the details of outward and inward supplies;
(b) furnish monthly, quarterly, annual or final return;
(c) make deposit for credit into the electronic cash ledger;
(d) file a claim for refund;
(e) file an application for amendment or cancellation of registration;
(f) furnish information for generation of e-way bill;
(g) furnish details of challan in form GST ITC-04;
(h) file an application for amendment or cancellation of enrolment under rule 58; and
(I) file an intimation to pay tax under the composition scheme or withdraw from the said

(CNO—PE.420) Section 4 to 8

Chart

SECTION 4 — **WHO CAN BECOME MEMBER**

- Regular route → As per section 4(1)(ii) pass such examination & pass such training
- Foreign route → As per section 4(1)(v) pass such examination & pass such training without India (outside India) as recognized by CG or council as equivalent (concept of direct membership & MOU based membership)
- Fees → Should not exceed 3000 if approved by CG it may go up to 6000

Section 4 Who can become member

- As per Sec 4(1) Cl (ii) passed such examination & passed such training
- As per Sec 4(1) Cl (V) passed such examination & passed such training without India as recognized by Central Government or Council being equivalent

(Concept Direct of Membership & MOU based Memberships)

- Membership registration fees should not exceed 3000, if prior approval from CG it may go up to 6000.

SECTION 5 — **ASSOCIATE V/S FELLOW**

- Associate member → As soon as name of person is included in membership register maintained by ICAI, person become associate member
- Fellow member
  - Associate member has to apply to become fellow member
  - Fees should not exceed 5000 if prior approved by CG it may go upto 10000
  - Who can apply:
    - Associate member (+) continuous practice In India for 5 years (foreign practice will not be counted)

Associate member for at least 5 years plus qualification as prescribed by council to ensure that experience and knowledge is equivalent to CA's in practice for 5 year

ICAI requirement W.R.T. qualification required to become FCA;

CA should be in job in government entities for 5 years continious, commercial entities, statutory authority, local bodies in areas of accounts, tax, cost, Company law, Info-Tech secretarial position etc.

Or

Pursuing job under practicing CA or CA Firm (Break of one year can be condoned/ experience can be partly in practice and partly in job as specified above.)(Foreign job will be considered)

Section 5 Associate V/s Fellow

- **Associate Member**

  As soon as name is entered in register, person become associate member.

- **Fellow Member**

  Associate member has to apply become fellow member. Fees should not exceed 5000, if prior approval from CG it may go up to 10,000.

- **Who can apply?**

  The name of following types of members shall be entered into the Register as a Fellow of the Institute, on payment of such fees along with the application made and granted in the prescribed manner-

  - An associate member who has been in continuous practice in India for at least 5 years, (foreign practice will not be counted)
  - A member who has been an associate for a continuous period of not less than 5 years and who **possess such qualifications as may be prescribed by the Council with a view to ensuring that he has experience equivalent to the experience normally acquired as a result of continuous practice for a period of 5 years as a Chartered Accountant.**

  The abovementioned members shall be entitled to use the letters F.C.A. after his name to indicate that he is a Fellow Member of the Institute.

- **As per ICAI announcement in Dec 2014:** – If CA is in job with govt entities, commercial entities, statutory authorities or local bodies with continuous work in accounts, cost, tax, company law or secretarial employment for 5 year or full-time paid assistant of CA for 5 years. He can apply for FCA. (Break of one year can be condoned / experience can be partly in practice and partly in job

SECTION 6 SIGNIFICANCE OF COP

1. Mandatory → It is mandatory to take COP to practice in India or elsewhere
2. Practicing outside India → COP is mandatory even if you are practicing outside India. In this case CA will be governed by ICAI professional ethics as well as law applicable in foreign countries, if there is conflict then CA should get clarity from ICAI
3. Temporary suspension of COP or Membership
   - Once person become member of ICAI, he is bound by provision of CA Act even if there is temporary suspension of COP or membership
   - That means even during suspension period he cannot perform CA related activities (as discussed in Member deemed to be in Practice) in any other capacity such as Lawyer, CS, GST practitioner. It is mandatory to have COP to provide CA related activities.

- 4. Working as employee
  - If CA is doing CA related work for employer such as appearing as representative before tax authorities then CA will not need COP because CA is working as employee
  - Services given to other
    - If CA employee is giving services to others then CA is working in professional capacity & CA will need COP before giving services to others.
- 5. Dual COP
  - To have dual COP of professional bodies, permission is required from both the professional bodies
  - ICAI has given permission to have dual COP with BAR council of India but BAR council has not given such permission so practically it is not possible Further if dual COP is allowed by both the professional bodies then in such case we should not use both the designations together
- 6. Cancellation of COP for following reasons under Regulation 10
  - Name of the holder removed from register
  - Certificate issued on the basis of incorrect, mis leading or false information
  - Annual fees not paid till 30th sept of financial year
  - Member surrendered COP or COP is cancelled
- 7. Restoration of COP
  - If application is made in prescribed form along with fees, COP will be restored
  - If fees is paid before end of the financial year then COP will be restored from the same date on which COP got cancelled.

Section 6 Certificate of Practice (QNO-655.100/ 655.200/ 655.300)

- A member who is not in practice is precluded from accepting engagement to render services of any of the types normally prescribed for a Chartered Accountant, even though for doing so, he does not require special qualifications. The Council of the institute is of view that –
  - Once the person concerned **becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act and its Regulations.** If and when he appears before the Income-tax Tribunal as an Income-tax representative after having become a member of the Institute, he could so appear only in his capacity as a Chartered Accountant and a member of the Institute. Having, as it were, brought himself within the jurisdiction of the Chartered Accountants Act and its Regulations, **he could not set them at naught by contending that even though he continues to be a member of the Institute and has been punished by suspension from practice as a member, he would be entitled, in substance, to practice in some other capacity.**
  - A member of the Institute can **have no other capacity in which he can take up such practice, separable from his capacity to practice as a member of the Institute."**

  Therefore, in nutshell, a Chartered Accountant whose name has been removed from the membership for professional and/or other misconduct, during such period of removal, will not appear before the various tax authorities or other bodies before whom he could have appeared in his capacity as a member of this Institute.

- **Case**

  A Chartered accountant in service may appear as tax representative before tax authorities on behalf of his employer, but not on behalf of other employees of the employer.

- **Dual COP**

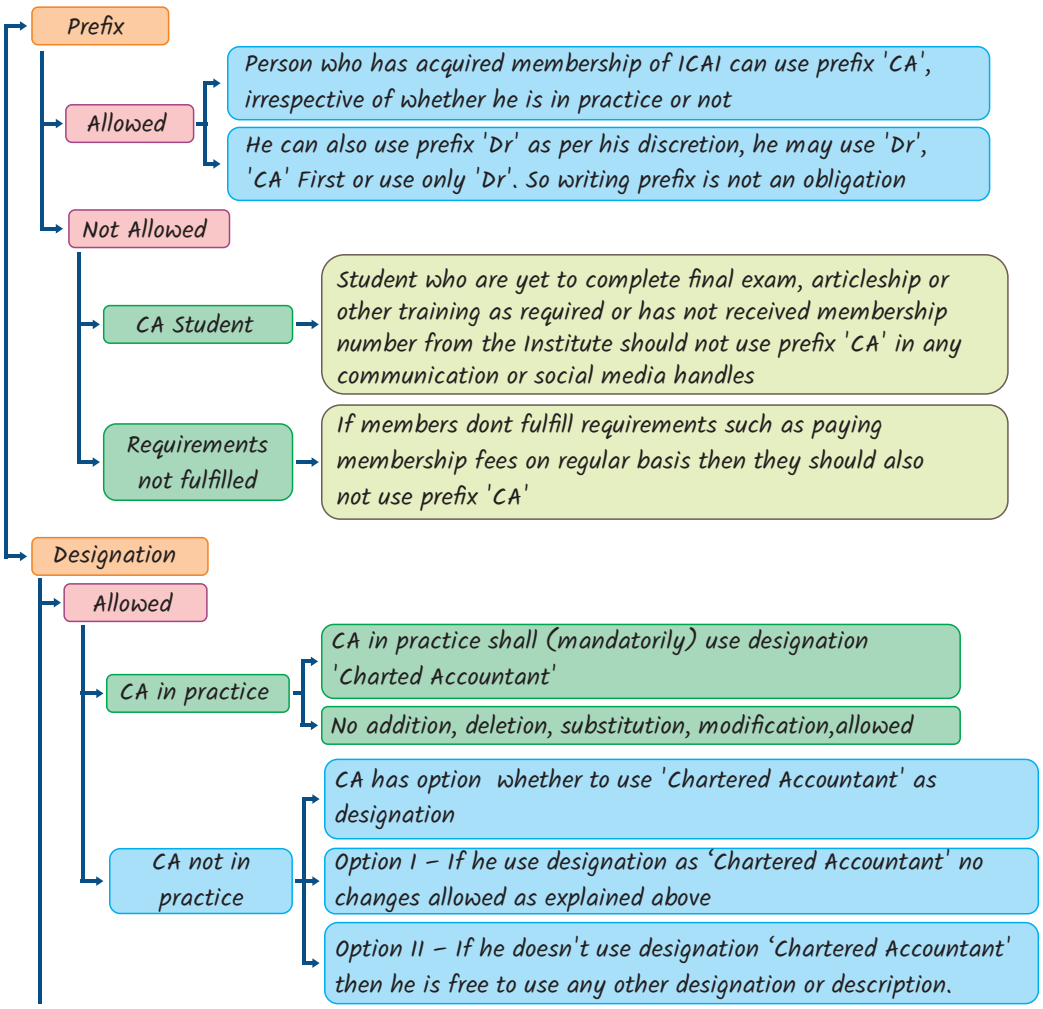
  Concept of dual COP is allowed by ICAI only for having COP of ICAI & BAR council of India at same time, but both designations should not be used together.

Regulation 10 & Regulation 11 Cancellation and Restoration of Certificate of Practice

- **Regulation 10** provides that a Certificate of Practice (COP) shall be liable for cancellation, if:
  - the **name of the holder** of the certificate is **removed** from the Register; or
  - the Council is satisfied, after giving an opportunity of being heard to the person concerned, that such **certificate was issued on the basis of incorrect, misleading or false information, or by mistake or inadvertence;** or
  - a member **has not paid annual fee** for certificate of practice till 30th day of September of the relevant year.
  - a member **has ceased to practise;** or Where a COP is cancelled, the holder shall surrender the same to the Secretary.
- Further, **Regulation 11 on restoration of COP** states that, on an application made in the approved Form and on payment of such fee, the Council may restore the COP with effect from the date on which it was cancelled, to a member whose certificate has been cancelled due to non-payment of the annual fee for the COP and whose application, complete in all respects, together with the fee, is received by

SECTION 7

RELATED TO PREFIX, DESIGNATION AND OTHER DESCRIPTION



Continue on next Page...

- Not allowed
  - Modification → Industrial accountant, cost accountant, CA(1st attempt), Income Tax consultant, Management consultant
  - Merchant banker → CA or CA firm can get themself registered as merchant banker with SEBI in such case, in prospectus they can write 'advisor / consultant to issue' below their name but on letter head, visiting cards they should use Chartered Accountant as designation
- Other descriptions or letters, qualifications & membership
  - Indicating membership / qualifications of "Other Accountancy Bodies" whether in India or outside India allowed only if recognized by council on this behalf
    - Allowed
      - CMA → CA member cannot designated themself as Cost accountant they can use letter ACMA (associate) or FCMA (fellow) after their name to indicate qualification.
      - MOU/MRA → CA's can mention membership or qualification of foreign accountancy bodies with whom ICAI has signed memorandum of understanding (MOU) /Mutual recognition agreement (MRA)
      - Dual COP → If CA is allowed to keep dual COP by both respective institutes as the case may be. Other institutes like ICSI, Bar Council, Cost Institute then such members can use designations such as Company Secretary, Cost Accountant or Advocate but these designation should not be use along with designation Chartered Accountant. Either that designation should be used or Chartered accountant should be use at a time
    - Not allowed
      - CPA → ICAI has not yet allowed to use designation CPA in description
      - CFA → ICFAI is also considered as accountancy body by court and no membership or qualification can be mentioned because it is not allowed by ICAI.
      - Directorship/Position
        - Members in practice should not mention their directorship in companies or position in political parties or position in any club or other organization
  - Qualification/Membership other than from accountancy bodies
    - Allowed
      - Qualification such as LLB, B.com, MBA and such other qualifications are allowed
      - Insolvency Professional
        - Member in practice who are empanelled as Insolvency professional can write Insolvency professional in other descriptions.
        - He should not use any other nomenclature or designation and he should not mention other Insolvency professional agencies like CS, CMA
      - Registered valuer
        - Member who is registered with insolvency and bankruptcy board of India as registered valuer can use other description as registered valuer
- Designation of CA firm
  - CA firm can use designations Chartered Accountant below their name if all the PARTNERS OF FIRM are Chartered Accountants in practice

Section 7 Designation That Can Be Used by Chartered-Accountants

(i) Members of the Institute are now permitted to use the word 'CA' as prefix before their name irrespective of the fact that they are in practice or not.

(ii) Under Section 7 of the Chartered Accountants Act, 1949 a member in practice cannot use any designation other than that of a Chartered Accountant, nor he can use any other description, whether in addition thereto or in substitution therefor, but a member who is not in practice and does not use the designation of a Chartered Accountant may use any other description. Nevertheless a member in practice may use any other letters or description indicating membership of such other Institute of accountancy, whether in India or elsewhere, as may be recognized in this behalf by the Council, or any other qualification that he may possess, or to allow a firm, all the partners of which are members of the Institute and in practice, from being known by its firm name as Chartered Accountants.

Merchant Banker / Advisor to an issue: The members may apply for and obtain registration as category IV Merchant Banker under the SEBI's rules and regulations and act as Advisor or Consultant to an issue. In client Companies' offer documents and advertisements regarding capital issue, name and address of the Chartered Accountant or firm of Chartered Accountants acting as Advisor or Consultant to the Issue could be indicated under the caption "Advisor/Consultant to the Issue". However, the name and address of such Chartered Accountant/firm of Chartered Accountants should not appear prominently.

Directors of Companies, Members of political parties, position in clubs, etc.: The members of the Institute who are also Directors in Companies, members of Political parties or Chartered Accountants Cells in the political parties, holding different positions in clubs or other organizations are not permitted to mention **these positions as these would be violative of the provisions of Section 7 of the Act.**

Members who are also Cost Accountants: Though a member cannot designate himself as a Cost Accountant, he can use the letters A.C.M.A (Associate) or F.C.M.A (Fellow) after his name, when he is a member of that Institute.

Permission to mention qualifications of certain Institutions: The members are permitted to mention membership of a foreign Institute of Accountancy, which has been recognized by the Council through a Memorandum of Understanding (MoU) / Mutual Recognition Agreement (MRA) with the said Institute. With regard to the other qualifications of a member, which he is permitted to mention, the following observations of the Supreme Court in Institute of Chartered Financial Analyst of India (ICFAI) vs Council of the Institute of Chartered Accountants of India (ICAI) dated 16th May, 2007 are relevant:

"The expression 'any other qualification that he may possess', therefore, must be read as qualification other than conferred upon the member by other Institutes of Accountancy. Such qualification of accountancy may be conferred even by other Institutes. But as noticed hereinbefore, an exemption had been granted by reason of a resolution of the Institute in relation to the Institute of Cost and Works Accountants. Furthermore, a degree conferred by any university also is subject to an exemption from the rigour of the provisions of Section 7 of the Act. There cannot, therefore, be any doubt whatsoever that 'the other qualification' would mean a qualification other than granted by an Institute of Accountancy, subject of course to recognition thereof by the Institute."

For example, though a member cannot designate himself as a Cost Accountant, he can use the letters A.C.M.A.(Associate) or F.C.M.A. (fellow) after his name, when he is a member of that Institute.

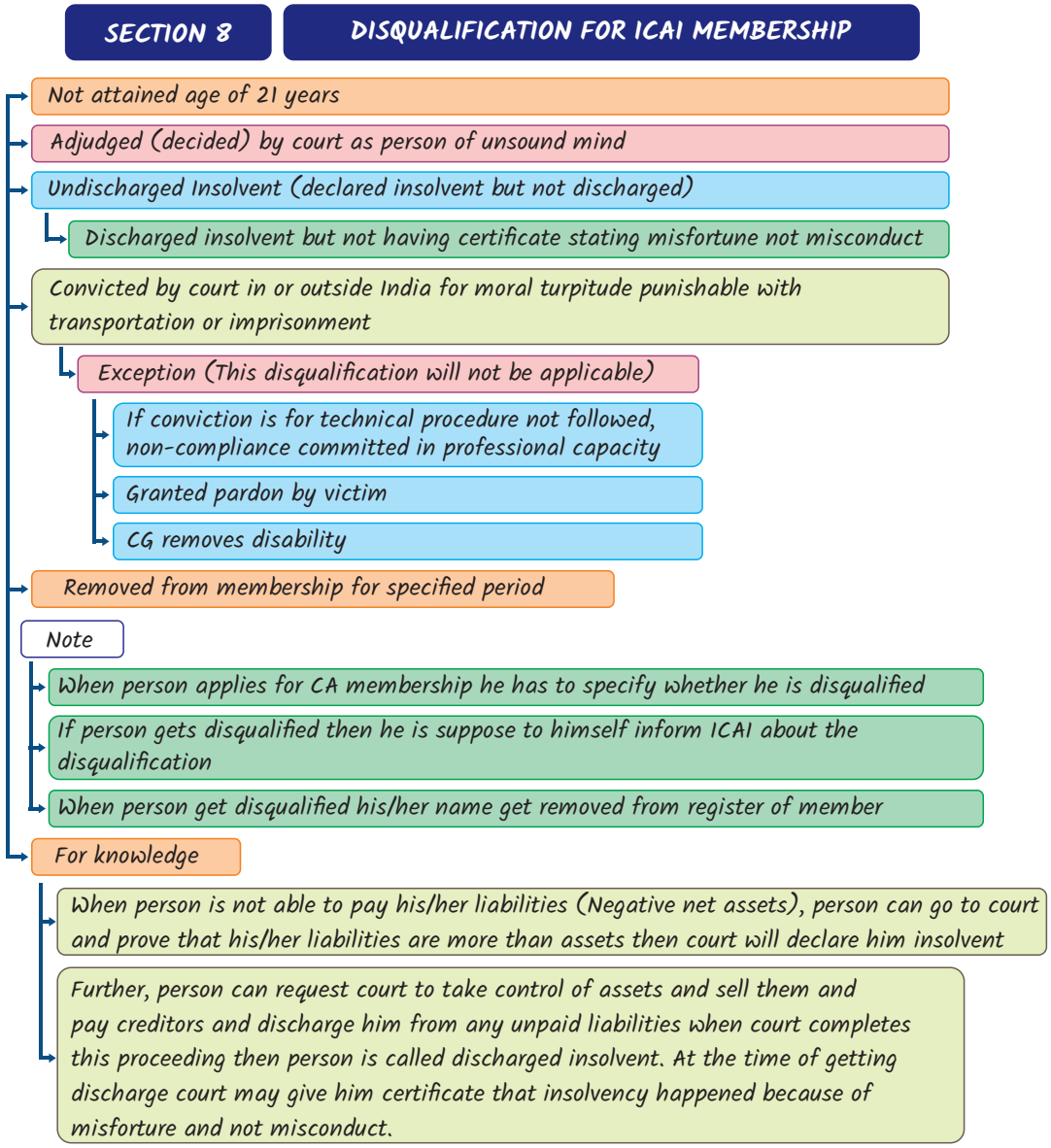
It is improper for a Chartered Accountant to state on his professional documents that he is an Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant.

Member are allowed to appear before the various authorities including Company Law Board, Income Tax Appellate Tribunal, Sales Tax Tribunal where the law has permitted the same, so far as the designation "Corporate Lawyer" is concerned, the Council was of the view that as per the existing provisions of law, a

Chartered Accountant in practice is not entitled to use the designation "Corporate Lawyer".

Further, the members are not permitted to use the initials 'CPA' (standing for Certified Public Accountant) on their visiting cards.

Members of the Institute in practice who are otherwise eligible may also practice as Company Secretaries and/or Cost Accountants. Such members shall, however, not use designation/s of the aforesaid Institute/s simultaneously with the designation "Chartered Accountant".



Section 8 Disqualification for ICAI Membership (QNO.655.400)

- Not attained age of 21
- Adjudged by court "unsound mind"
- Undischarged Insolvent
- Discharged Insolvent but not having "certificate stating misfortune and not misconduct"
- Convicted + by Court + in or outside INDIA + for moral turpitude + punishable with transportation or imprisonment + not of technical nature + committed in professional capacity unless granted pardon or Central Government removed disability.

(E.g. Assisting in Drug Smuggling or Terrorism)

If CA fails to inform ICAI about disqualifications he will be guilty of professional misconduct.

It may be noted that a person who has been removed from membership for a specified period, shall not be entitled to have his name entered in the Register until the expiry of such period

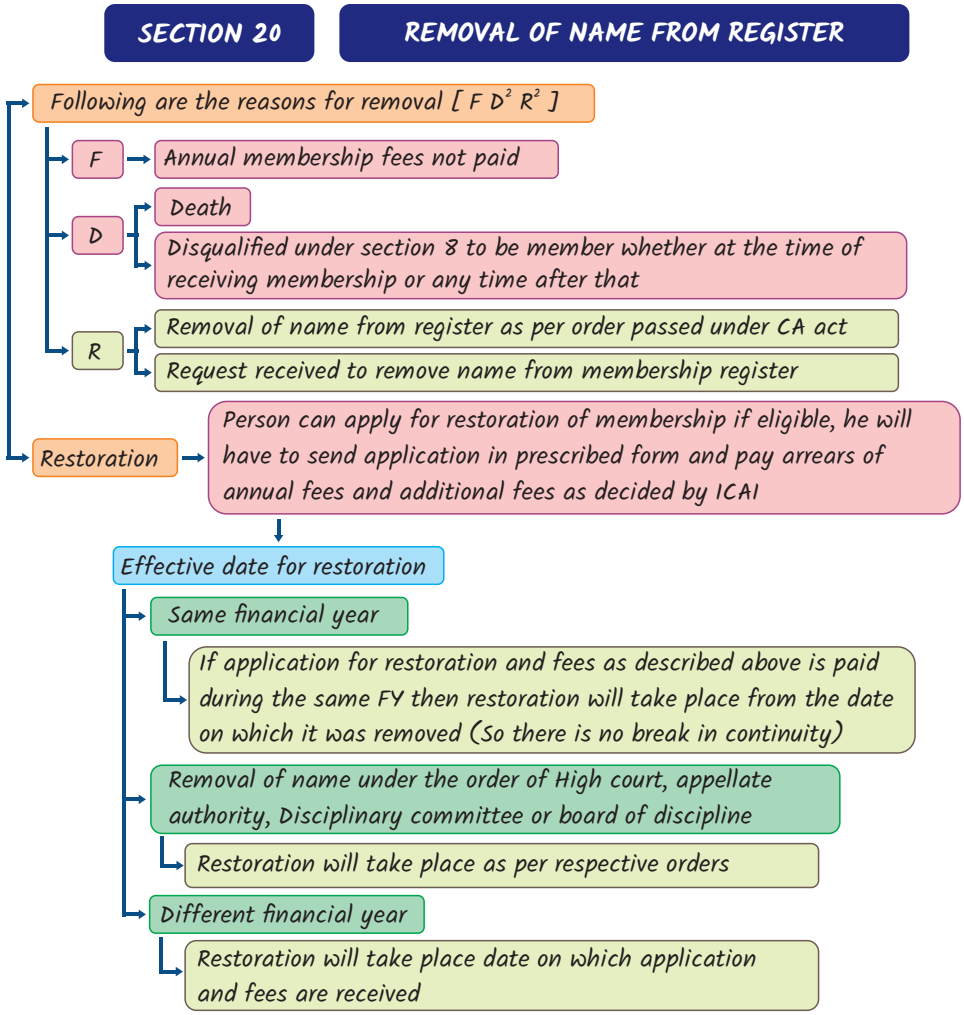
Form 2 is for membership registration

First Line of Form 2

"I [beg to] apply that my name be entered in the Register. I hereby declare that I am not subject to any of the disabilities stated in Section 8 of the Chartered Accountants Act, 1949"

(CNO—PE.460) Section 20

Chart



Removal of name from Register (Section 20) (MCQ- Incs. 44.5)

Council may remove name of member from register if

- Disqualified under Sec 8. 2
- Not paid prescribed fees. 3
- Request to remove name. 4
- Person is Dead. 5
- If order is passed for removal, its compulsory for council to remove name. 1

Restoration of Membership

(Section 20 & Regulation 19)

Restoration of Membership

In addition to the provisions of the section 20 of the Chartered Accountants Act, 1949 (as discussed in above Para), Regulation 19 of the Chartered Accountants Regulations, 1988, as well states that the name of the member may be restored by the Council in the Register on an application, in the appropriate Form, received in this behalf whose name has been removed from the Register for non-payment of prescribed fee as required to be paid by him, **if he is otherwise eligible to such membership, on his paying the arrears of annual membership fee, entrance fee and additional fee determined by the Council under the Act.**

However, **the effective date in case of restoration** of cancelled membership, in different situations, shall be in the following manner:

- Application for restoration and **requisite fees are made within the same year of Removal:-** Restoration shall be with effect from the date on which it was removed from the Register

- Removal of name under the **orders of the Board of Discipline or the Disciplinary Committee or the Appellate Authority or the High Court:-** Restoration shall be in accordance with such orders.
  In other cases:-Restoration shall be with effect from the date on which the application and fee are received.

(CNO—PE.480) CHAPTER V SECTION 21-22G (QNO- 656.000 / 656.500) (MCQ- Incs.51.3)

Chart

TYPES OF UNETHICAL ACTIVITY

In 1st and 2nd schedule of CA Act, list of activities is given which are considered misconduct (wrang doing/unethical)

Irrespective of what was the intention and whether or not any person is harmed, if CA has done any of these activities then CA will be deemed to have conducted mis-conduct

- Professional misconduct
  - Acts which will be deemed as professional misconduct are given in
    - 1st Schedule
      - Part I
      - Part II
      - Part III
    - 2nd Schedule
      - Part I
      - Part II
- Other misconduct
  - List of activities considered other misconduct are given in
    - 1st Schedule
      - Part IV
    - 2nd Schedule
      - Part III
- Other misconduct (as per past cases)
  - Section 22 explains that list of professional and other misconduct is given in schedules.
    - It further says that disciplinary directorate can exercise his power to collect information and do investigation as given in section 21(1)
    - **In any other circumstances** and if appropriate proceed ahead with the case for other misconduct
    - Earlier this power was exercised by court and council of ICAI
  - List of instances which were declared other misconduct is given below

(Other Misconduct as per past decided cases)

	Anger	Objectionable/Derogatory/Abusive/Insane Comments
A	Anger	Publishing advertisements with malafied intention to malign any person
	Article	Used service of article for running other occupation or business (Eg Agriculture/ Election work)
B	Bank	Submission of bogus bills & receipts to claim expenses during bank audit
C	Client	Coercion for payment of fees
	Client	Where a chartered accountant had adopted coercive methods on a bank for having a loan sanctioned to him.
	Client	Retained books & failed to return without reasonable cause. Further as per ESB announcement:- A Chartered accountant cannot exercise lien over the client documents/records for non-payment of his fees

Continue on next Page...

D	Deceive	Manipulating minute book of Company
	Deceive	Giving fake documents to client, claiming that they are issued by ROC
	Deceive	Issue of fake experience certificate to other person
	Deceive	Forged will of relative
E	Employer	Gross negligent as employee
	Employer	Fake experience certificate while applying for job
F	Fraud	Misappropriation of ICAI funds for personal purpose
	Fraud	Cheques given by NBFC bounced because of lack of fund, where CA was managing director, negotiable instrument act 1881
G	Govt	Not replying to authorities (Export Authorities)
	Govt	Unauthorised possession of government records
	Govt	Authored book on tax for secret income (black money)
	Govt	CA filed 2 return of income to evade tax
	Govt	Fabricated challan of advance tax of client, encashed it by opening fake account of client

Types of Miscounduct

According to section 22 of the Act, for the purposes of this Act, the expression "professional or other misconduct" shall be deemed to include any act or omission provided in any of the Schedules, but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under sub-section (1) of section 21 to inquire into the conduct of any member of the Institute under any other circumstances.

A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any Professional or Other Misconduct.

Professional Misconduct

Professional misconduct has been defined in part I, II and III of the First Schedule; and part I and II of the Second Schedule. A member who is engaged in the profession of accountancy whether in practice or in service should conduct/restrict his actions in accordance with the provisions contained in the respective parts of the schedules. If the member is found guilty of any of the acts or omissions stated in any of the respective parts of the Schedule, he/she shall be deemed to be guilty of professional misconduct.

Other Misconduct

Other misconduct has been defined in part IV of the First Schedule and part III of the Second Schedule. These provisions empower the Council to inquire into any misconduct of a member even it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

For example, a member who is found to have forged the will of a relative, would be liable to disciplinary action even though the forgery may not have been done in the course of his professional duty.

Other misconduct would also relate to conviction by a competent court for an offence involving moral turpitude punishable with transportation or imprisonment to an offence not of a technical nature committed by the member in his professional capacity. [See section 8(v) of the Act].

Some illustrative examples, where a member may be found guilty of "Other Misconduct", under the aforesaid provisions, rendering himself unfit to be member are:

(i) Where a chartered accountant retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.

(ii) Where a chartered accountant makes a material misrepresentation.

(iii) Where a chartered accountant uses the services of his articled or audit assistant for purposes other than professional practice.

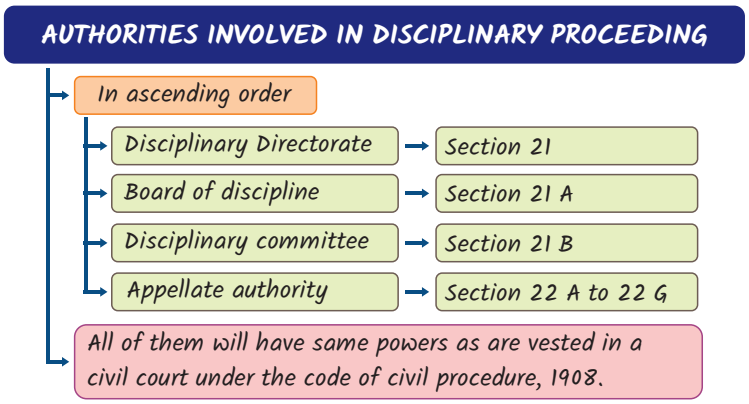
(iv) Conviction by a competent court of law for any offence under Section 8 (v) of the Chartered Accountants Act 1949.

(v) Misappropriation of money by office-bearer of a Regional Council of the Institute and utilisation thereof for his personal use.

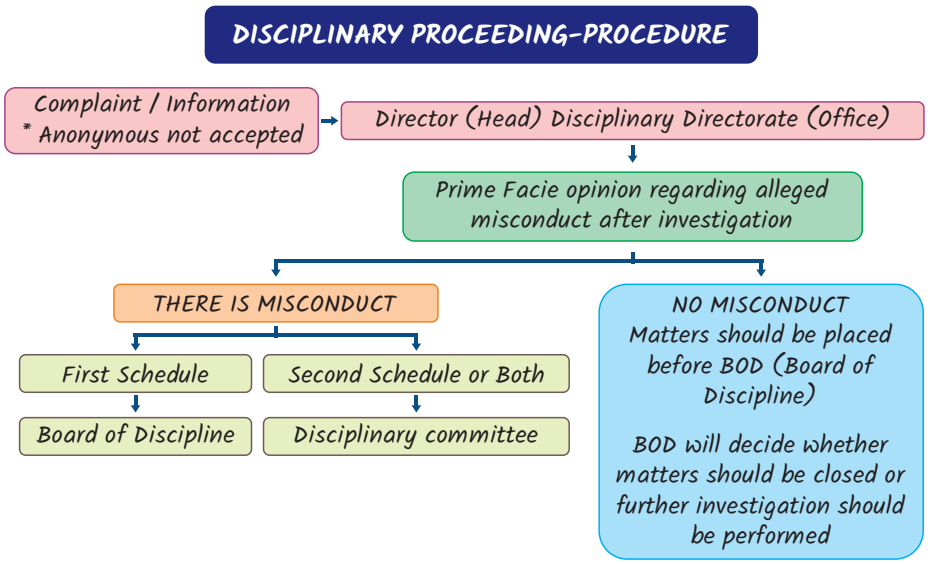
(vi) Not replying within a reasonable time and without a good cause to the letter of the public authorities.

(vii) Where certain assessment records of income tax department belonging to a client of a Chartered Accountant were found in the almirah of the bed-room of the chartered accountant.

(viii) Where a chartered accountant had adopted coercive methods on a bank for having a loan sanctioned to him.



Disciplinary Proceedings (QNO-732.000/733.000)



BOD V/S Disciplinary Committee

BOD V/S DISCIPLINARY COMMITTEE

	BOD	DC
Misconduct covered	First Schedule	Second schedule or Both
Number of Members	Members → Council; Chairman by council; CG Nominee	Members → 2-council member; Chairman (President or Vice president); 2-CG Nominee
Multiple	No	Yes
Process	Summary disposal procedure	Specified Disposal procedure
Punishment	-Reprimand -Membership (removal) ->3M -Fine upto 1,00,000	-Reprimand -Membership (removal) -> Permanent -Fine upto 5,00,000

APPELLATE AUTHORITY

Order passed by Board of Discipline or Disciplinary committee

Within 90 Days Aggrieved person CA

Or

Director (Discipline) if permitted by ICAI

→ APPELLATE AUTHORITY ←

Chairman (Past High Court Judge)

2 Past Council Member
2 Government Nominee
*All are part time members
Term of Chairman
3 years (Max age 65 years)
Term of Member
3 years (Max age 62 years)

↓

Confirm / penalty / Modify / Set Aside order Or Remit the case to BOD / DC Or Pass such order as deems fit

- Authority should give opportunity of being heard to concerned parties.
- Chairman or Member can resign, it will be effective from 3 months or new appointment or expiry of term whichever earlier.
- Chairman or Member can be removed - Proven misbehavior or incapacity + Inquiry by CG + Opportunity of being heard.

(CNO—PE.520) Section 24-28D (QNO—660.500)

Chart

Penalties → **SECTION 24**

Non-CA	Claims be CA or uses Designation CA	First time fine of Rs 1000
CA BUT NO-COP	Claims to have COP or Does CA practice	
Any institute other than ICAI	Claims to give CA Equivalent Degree etc	Second time fine of Rs 5000 or imprisonment of 6 months Or both
	Uses similar seal / name	
	Claims to regulate profession	

Section 24

Section 24 of the Chartered Accountants Act, 1949 provides that any person who-

(i) not being a member of the Institute;

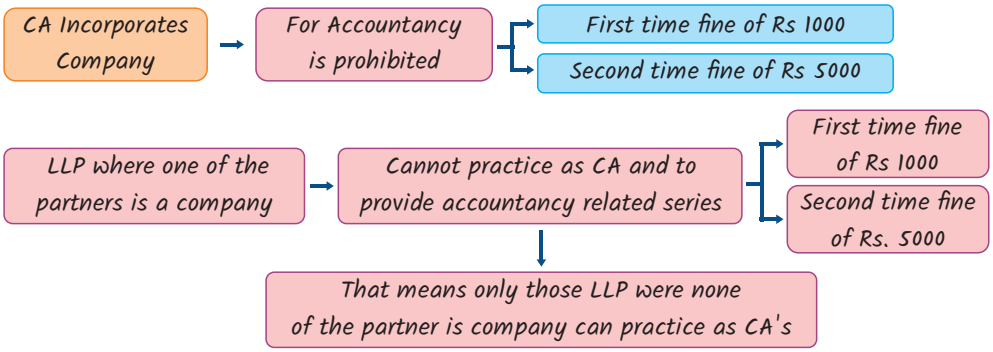
(a) represents that he is a member of the Institute; or

(b) uses the designation Chartered Accountant;

(ii) being a member of the Institute, but not having a certificate of practice, represents that he is in practice or practices as a Chartered Accountant,

shall be punishable on first conviction with fine which may extend to ` 1000, and on any subsequent conviction with imprisonment which may extend to 6 months or with fine which may extend to ` 5,000, or with both.

SECTION 25



Section 25 (MCQ- Incs. 44.4)

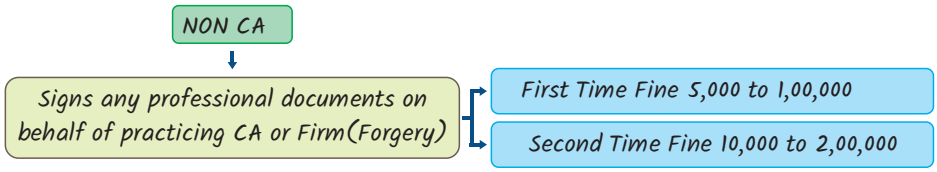
Section 25 of the Chartered Accountants Act, 1949 provides that:

(1) No company, whether incorporated in India or elsewhere, shall practise as chartered ccountants. Here, the term "company" shall include any limited liability partnership which has company as its partner for the purpose of this section.

(2) If any company contravenes this provision then, without prejudice to any other proceedings which may be taken against the company, every director, manager, secretary and any other officer thereof who is knowingly a party to such contravention shall be punishable with fine which may extend on first conviction to` 1,000 and on any subsequent conviction to` 5,000.

In addition, as per section 141(2) of the Companies Act, 2013, where a firm (includin g a limited liability partnership) is appointed as an auditor of a company, then, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

SECTION 26



SECTION 27 MAINTENANCE OF BRANCH OFFICE

- Requirements
  - CA/CA firm can open any number of branches in India
  - But one important condition:- That there should be separate incharge for each office
  - Separate incharge should be
    - CA may be in practice or may not be in practice
    - Associated as partner or full time employee of the firm
    - Actively associated with such office
      - Active association is deemed
      - If member resides in same place where office is situated for a period not less than 182 days in a year or
      - CA should attend such office for not less than 182 days a year or
      - active association can be proved in other manner also eg. Giving regular instructions, discussions, review and exchange of documents etc but in this case executive committee of ICAI should accept it as active association
- Exemptions
  - 2nd office
    - CA in practice can have 2nd office without separate incharge provided such office is located in
      - Same premises
      - Located in same city
      - Located within 50kms from municipal limits of city in which 1st office is located
  - CA practicing in hilly areas subject to certain condition:-
    - Temporary office can be opened in plain areas near hilly region for period not exceeding 3 months
    - Before commencement of every winter CA in practice should inform of opening temporary office from a particular date and also inform ICAI after office is closed. Such communication should be sent by registered post to ICAI

      *It means office can be opened in winter season but ICAI in one of the answer assumed that office can be opend in any season only communication should be before winter. We think view taken by BOS is not correct but if question comes in exam present both the views.
    - Regular office need not be closed, name board of the firm need not be displayed at temporary office, name of temporary office should not come in visiting cards or any other documents
- Same member can be incharge of two offices if they are located in same accommodation
- Clarification w.r.t name board
  - CA can put name board at his residence with name and designation but CA cannot put name of CA firm.

Note:- Sometimes in question distance is given from the main office and not from the municipal limits of city in which main office is situated in such case students should assume that this distance is from municipal limits not from main office as if, is of no use

Member In Charge (Section 27)
(QNO- 657.000/ 658.000/ 659.000/ 660.000 / 660.500

In terms of Section 27 of the Act, if a Chartered Accountant in practice or a Firm of Chartered Accountants has more than one office in India, each one of such offices should be in the separate charge of a member of the Institute. Failure on the part of a member or a firm to have a member in charge of its branch and a separate member in case of each of the branches, where there is more than one, would constitute professional misconduct.

However, exemption has been given to members practicing in hill areas subject to certain conditions. The conditions are:

(1) Such members/firm be allowed to open temporary offices in a city in the plains for a limited period not exceeding 3 months in a year.

(2) The regular office need not be closed during this period and all correspondence can continue to be made at the regular office.

(3) The name board of the firm in the temporary office should not be displayed at times other than the period such office is permitted to function as above.

(4) The temporary office should not be mentioned in the letterheads, visiting cards or any other documents as a place of business of the member/firm.

(5) Before commencement of every winter it shall be obligatory on the member/firm to inform the Institute that he/it is opening the temporary office from a particular date and after the office is closed at the expiry of the period of permission, an intimation to that effect should also be sent to the office of the Institute by registered post.

Above conditions apply to any additional office situated at a place beyond 50 kms from the municipal limits in which any office is situated.

It is necessary to mention that the Chartered Accountant in-charge of the branch of another firm should be associated with him or with the firm either as a partner or as a paid assistant. If he is a paid assistant, he must be in whole time employment with him.

The requirement of Section 27 in regard to a member being in charge of an office of a Chartered Accountant in practice or a firm of such Chartered Accountants shall be satisfied only if the member is actively associated with such office. Such association shall be deemed to exist if the member resides in the place where the office is situated for a period of not less than 182 days in a year or if he attends the said office for a period of not less than 182 days in a year or in such other circumstances as, in the opinion of the Executive Committee, establish such active association.

However, a member can be in-charge of two offices if they are located in one and the same Accommodation. In this context some of the Council's decisions are as follows:

(1) With regard to the use of the name-board, there will be no bar to the putting up of a nameboard in the place of residence of a member with the designation of Chartered Accountant, provided it is a name-plate or a name-board of an individual member and not of the firm.

(2) The exemption may be granted to a member or a firm of Chartered Accountants in practice to have a second office without such second office being under the separate charge of a member of the Institute, provided-

(a) the second office is located in the same premises, in which the first office is located or,

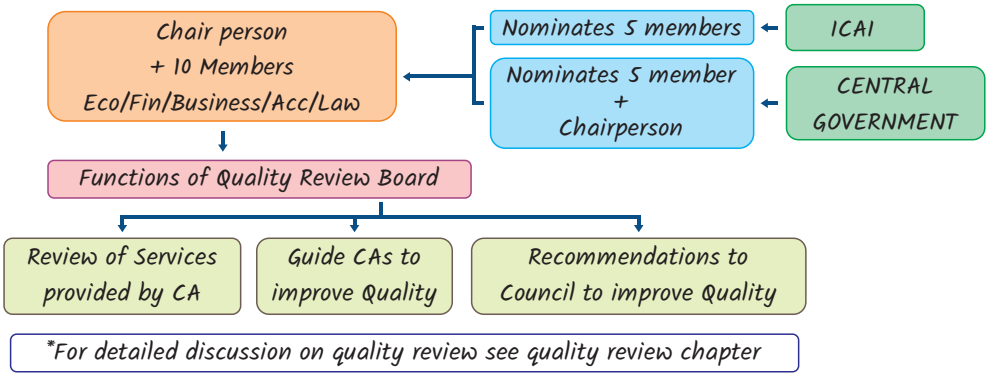
(b) the second office is located in the same city, in which the first office is located or,

(c) the second office is located within a distance of 50 km. from the municipal limits of a city, in which the first office is located.

A member having two offices of the type referred to above shall have to declare, which of the two offices is his main office, which would constitute his professional address.

Quality Review Board

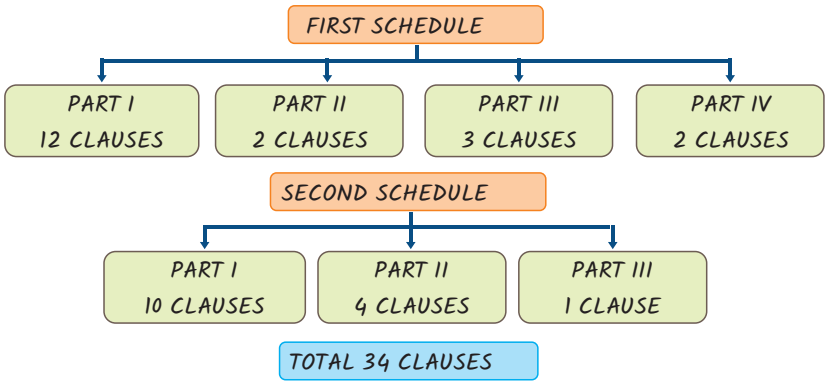
SECTION 28A TO 28D QUALITY REVIEW BOARD



(CNO—PE.560) STRUCTURAL OVERVIEW – FIRST SCHEDULE & SECOND SCHEDULE

Chart

STRUCTURAL OVERVIEW OF FIRST & SECOND SCHEDULE



UNIQUE MCQS

MCQ No. PE.9 / PE.10 (Covered in Bank Audit)

Part 2 – First Schedule

IMAGE RECOGNITION MEMORY TECHNIQUE OF FIRST SCHEDULE

Chart

IMAGE RECOGNITION MEMORY TECHNIQUE OF FIRST SCHEDULE

FIRST SCHEDULE PART – I



NARGIS FAKHRI
NAME CA in
practice
Clause 1



PARESH RAWAL
PAYING
Share
Clause 2



ALIA BHATT
ACCEPTING
SHARE
Clause 3



PRABHUDEWA
PARTNERSHIP
Clause 4



SCORPIO
SECURE
WORK
Clause 5



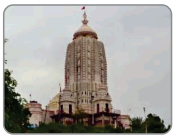
AUDI
ADVERTISES
Clause 6



DUSTER
DESIGNATION
Clause 7



TOYOTA CAMRY
COMMUNICATION
WITH PREVIEOUS
AUDITOR
Clause 8



RANCHI
REQUIREMENT
OF CO ACT
Clause 9



FIROZABAD
FEES
Clause 10



BOMBAY
BUSINESS
Clause 11



SHIRDI
SIGN
Clause 12

FIRST SCHEDULE PART II



EK THA TIGHER
EMOLUMENTS
Clause 1



ASHIQUE
ACCEPTS
Clause 2

FIRST SCHEDULE
PART III



FAFDA
FELLOW
Clause 1



RASGULLA
REPLY
Clause 2



TEA
TENDER
Clause 3

FIRST SCHEDULE
PART IV
(Other Misconduct)



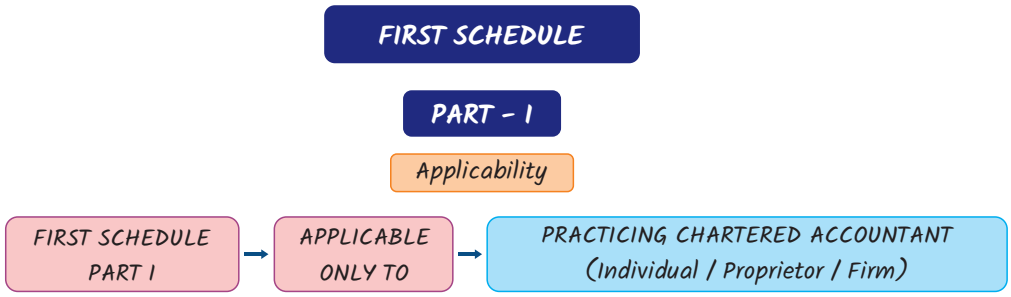
Imprisonment
Clause 1



Disrepute
Clause 2

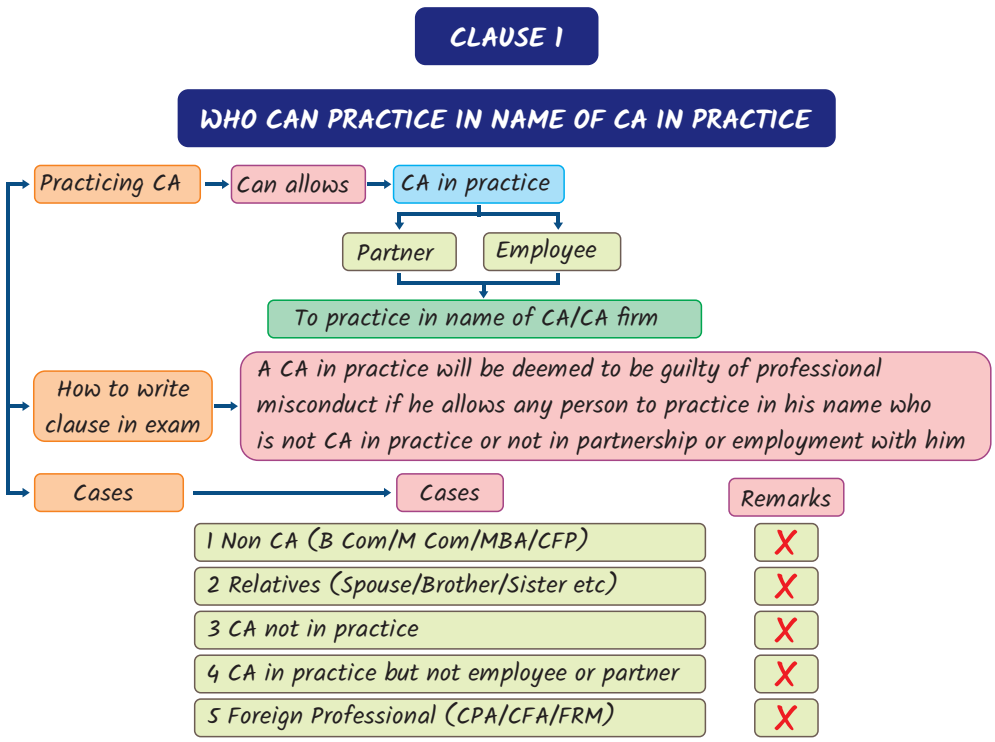
(CNO—PE.570) FIRST SCHEDULE PART I

Chart



(CNO—PE.580) CLAUSE 1 -WHO CAN PRACTICE IN NAME OF CA IN PRACTICE? (QNO-660,100)

Chart



Clause 1 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

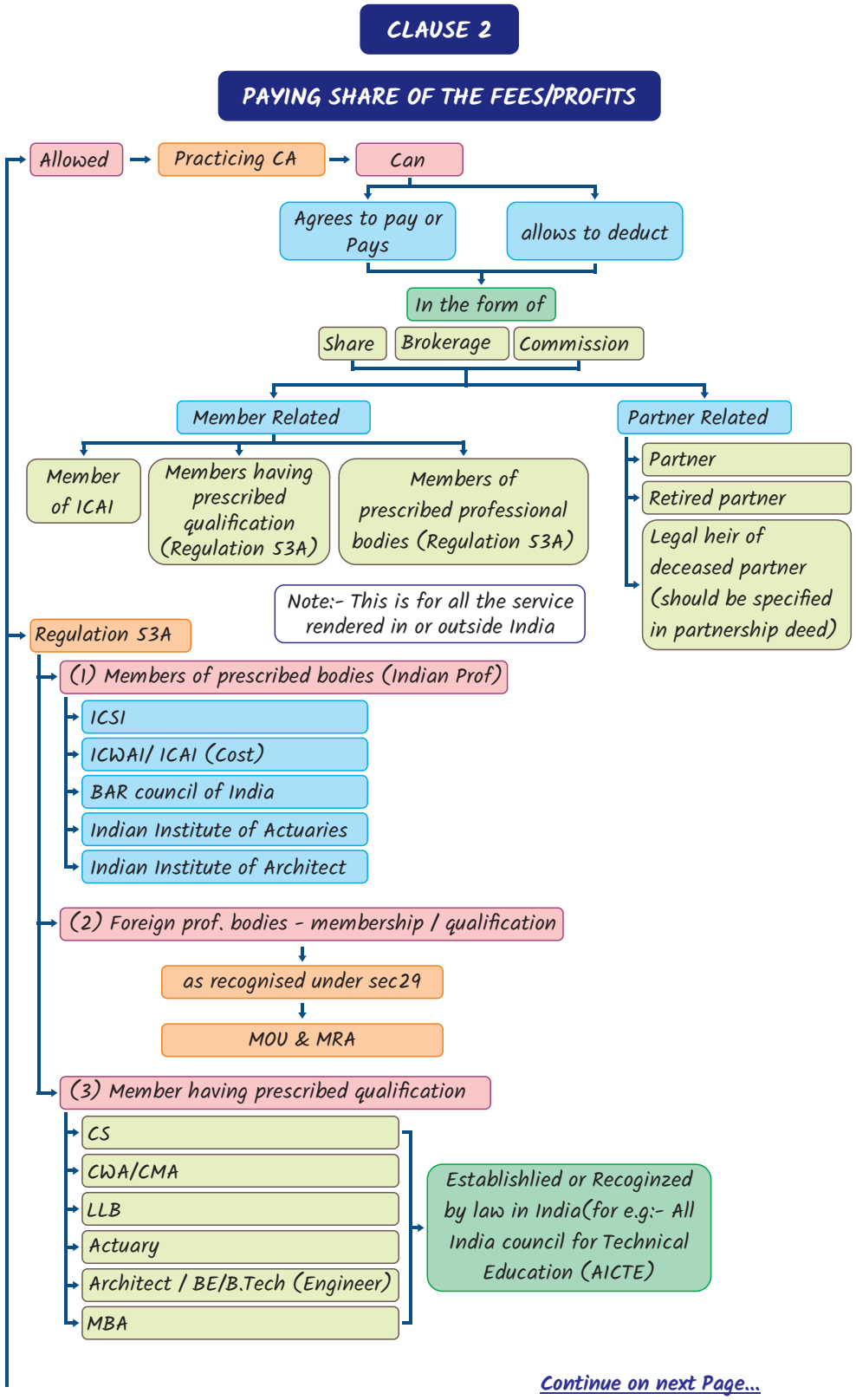
A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- allows any person to practice in his name as a chartered accountant unless such person is also
  - a chartered accountant in practice and
  - is in partnership with or employed by him.

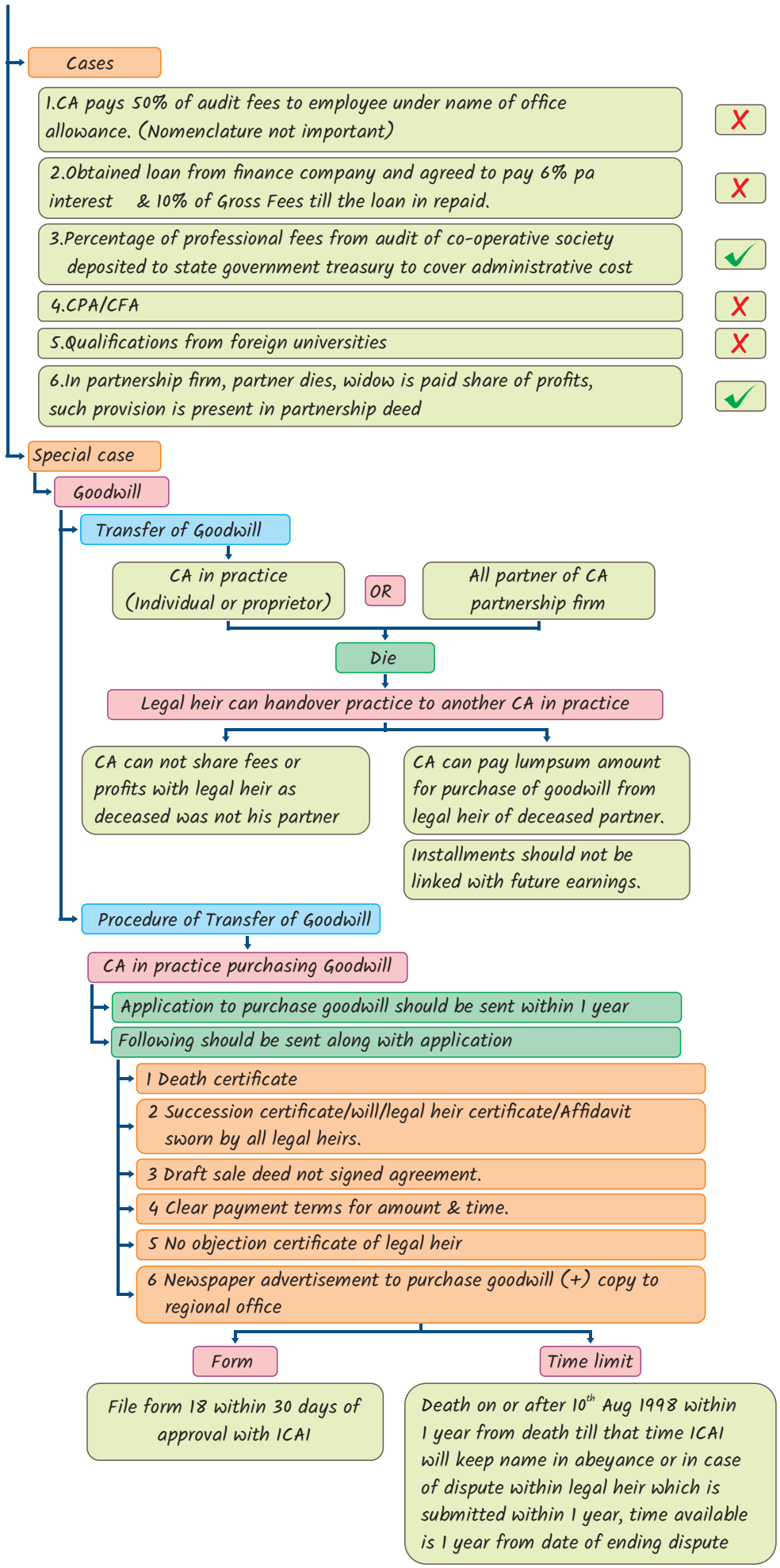
(CNO—PE.600) CLAUSE 2 - (PAYING SHARE OF FEES / PROFITS)

(QNO-660.000/662.000/662.005/662.010) (MCQ - Incs.29.3)

Chart



Continue on next Page...


Cases
1.CA pays 50% of audit fees to employee under name of office allowance. (Nomenclature not important)
X
2.Obtained loan from finance company and agreed to pay 6% pa interest & 10% of Gross Fees till the loan in repaid.
X
3.Percentage of professional fees from audit of co-operative society deposited to state government treasury to cover administrative cost
✓
4.CPA/CFA
X
5.Qualifications from foreign universities
X
6.In partnership firm, partner dies, widow is paid share of profits, such provision is present in partnership deed
✓
Special case
Goodwill
Transfer of Goodwill
CA in practice (Individual or proprietor)
OR
All partner of CA partnership firm
Die
Legal heir can handover practice to another CA in practice
CA can not share fees or profits with legal heir as deceased was not his partner
CA can pay lumpsum amount for purchase of goodwill from legal heir of deceased partner.
Installments should not be linked with future earnings.
Procedure of Transfer of Goodwill
CA in practice purchasing Goodwill
Application to purchase goodwill should be sent within 1 year
Following should be sent along with application
1 Death certificate
2 Succession certificate/will/legal heir certificate/Affidavit sworn by all legal heirs.
3 Draft sale deed not signed agreement.
4 Clear payment terms for amount & time.
5 No objection certificate of legal heir
6 Newspaper advertisement to purchase goodwill (+) copy to regional office
Form
File form 18 within 30 days of approval with ICAI
Time limit
Death on or after 10th Aug 1998 within 1 year from death till that time ICAI will keep name in abeyance or in case of dispute within legal heir which is submitted within 1 year, time available is 1 year from date of ending dispute

Clause 2 from BARE ACT

(Try to write all the contents as given in below clause, to cram language is difficult for few, it's not necessary to write each word as it is but content and its meaning should be same with all points covered)

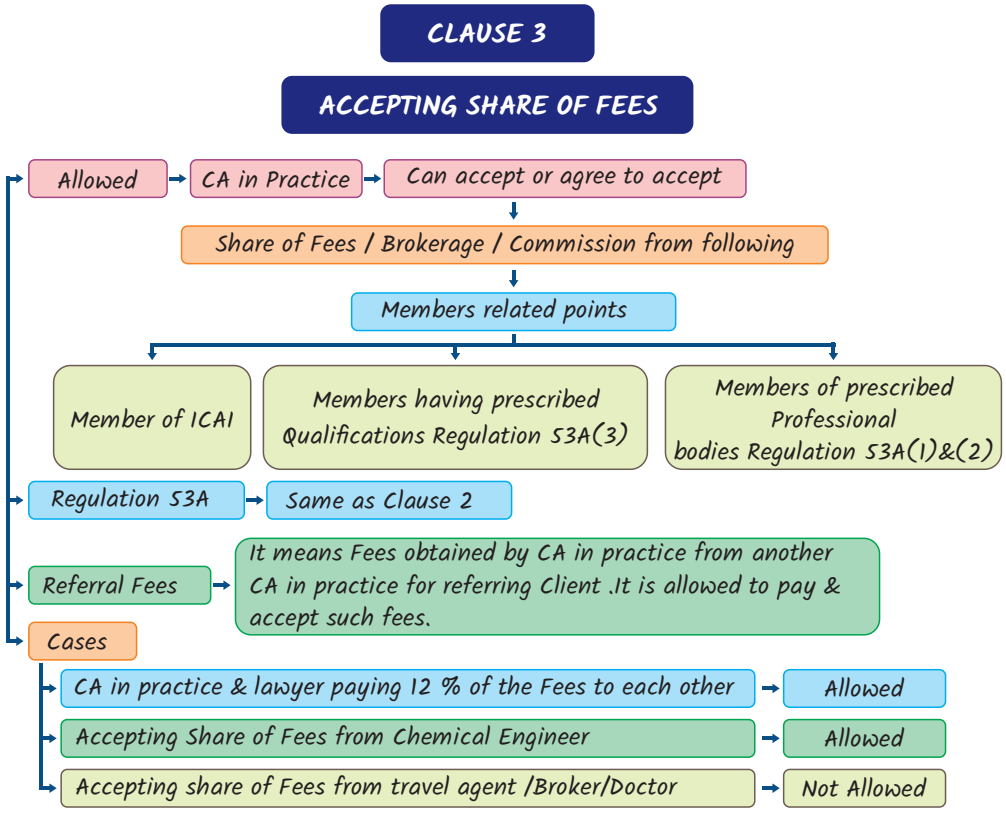
A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- **pays or allows or agrees to pay or allow, directly or indirectly,**
- **any share, commission or brokerage in the fees or profits of his professional business,**
- **to any person other than**
  - **a member of the Institute or**
  - **a partner or**
  - **a retired partner or**
  - **the legal representative of a deceased partner, or**
  - **a member of any other professional body or**
  - **with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.**

Explanation – In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of clause (4) of this Part.

(CNO—PE.620) CLAUSE 3 – (CAN CA ACCEPT SHARE OF FEES / PROFITS?) (QNO-662.010)

Chart



Referal Fees

Referral fees amongst members: It is not prohibited for a member in practice to charge Referral Fees, being the fees obtained by a member in practice from another member in practice in relation to

Clause 3 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, it's not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

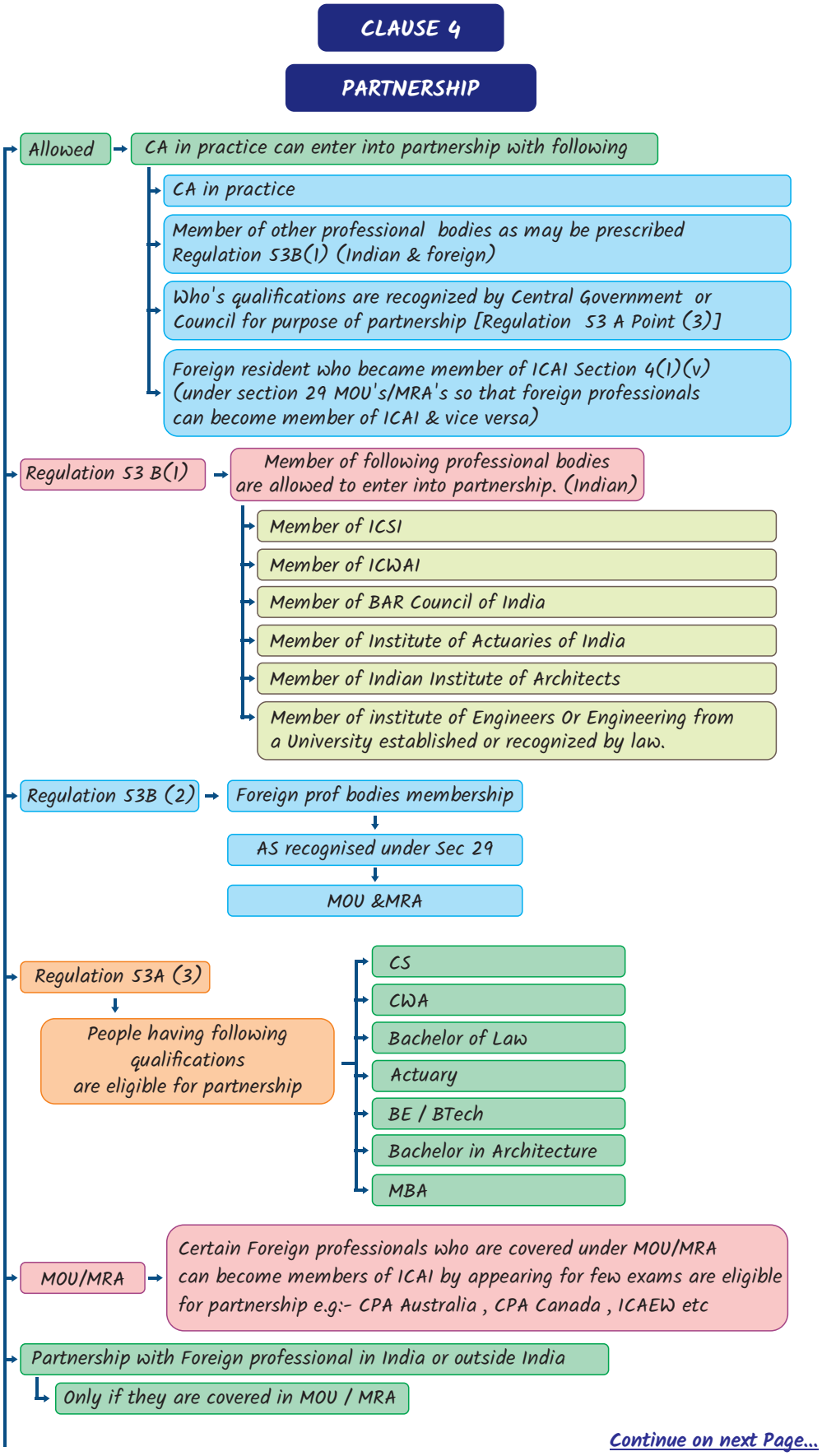
- **accepts or agrees to accept**
- **any part of the profits of the professional work of a person**
- **who is not a member of the Institute.**

Provided that nothing herein contained shall be construed as prohibiting a member 'from entering into

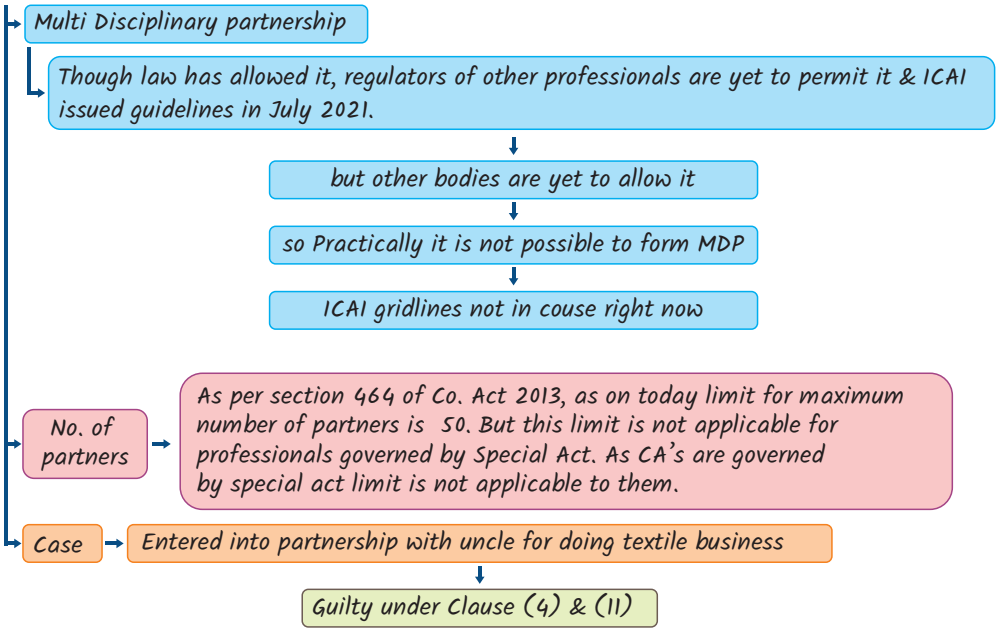
fees, with a member of such professional body or other person having qualifications, as is referred to in Clause (2) of this part.

(CNO—PE.640) CLAUSE 4 (PARTNERSHIP) (QNO-664.000/665.000/666.000) (MCQ- Incs.04.5)

Chart



Continue on next Page...



Multi-Disciplinary Partnerships

A Chartered Accountant in practice is not permitted to enter into partnership with any person other than a Chartered Accountant in practice or such other persons as may be prescribed by the Council from time to time. The members may however take note of the fact that they cannot form Multi-Disciplinary partnerships till such time that Regulators of such other professionals also permit partnership with chartered accountants.

Clause 4 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, it's not necessary to write each word as it is but content and its meaning should be same with all points covered)

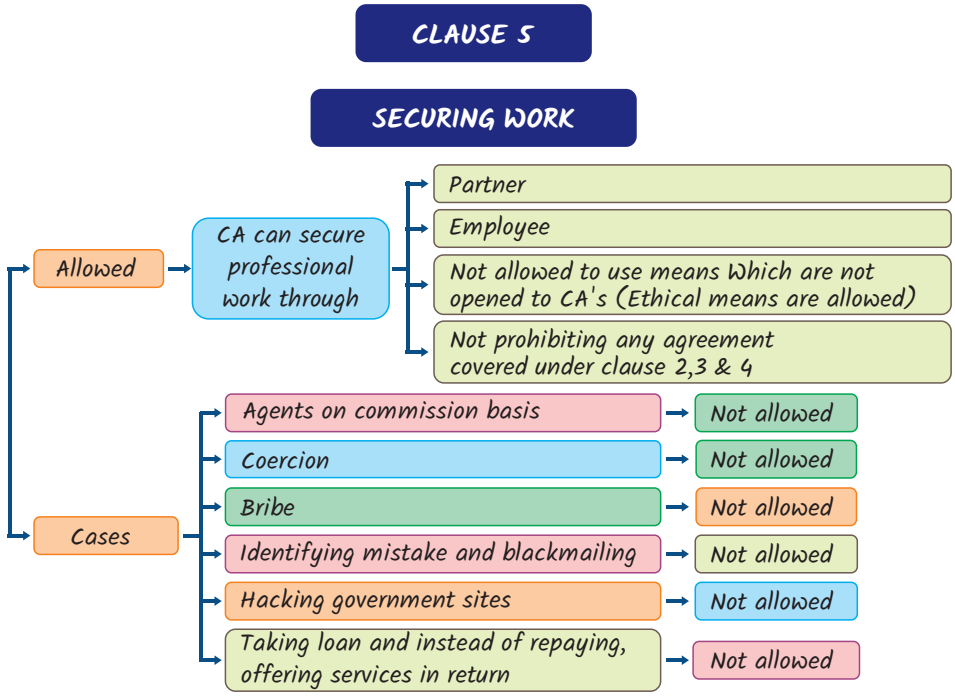
A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- **enters into partnership, in or outside India,**
- **with any person other than Chartered Accountant in practice or**
- **such other person who is a member of any other professional body having such qualifications as may be prescribed,**

including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub-section (1) of section 4 or whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships.

(CNO—PE.660) CLAUSE 5 (Securing professional work ?)

Chart



Clause from Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, it's not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

Secures either through the services of a person

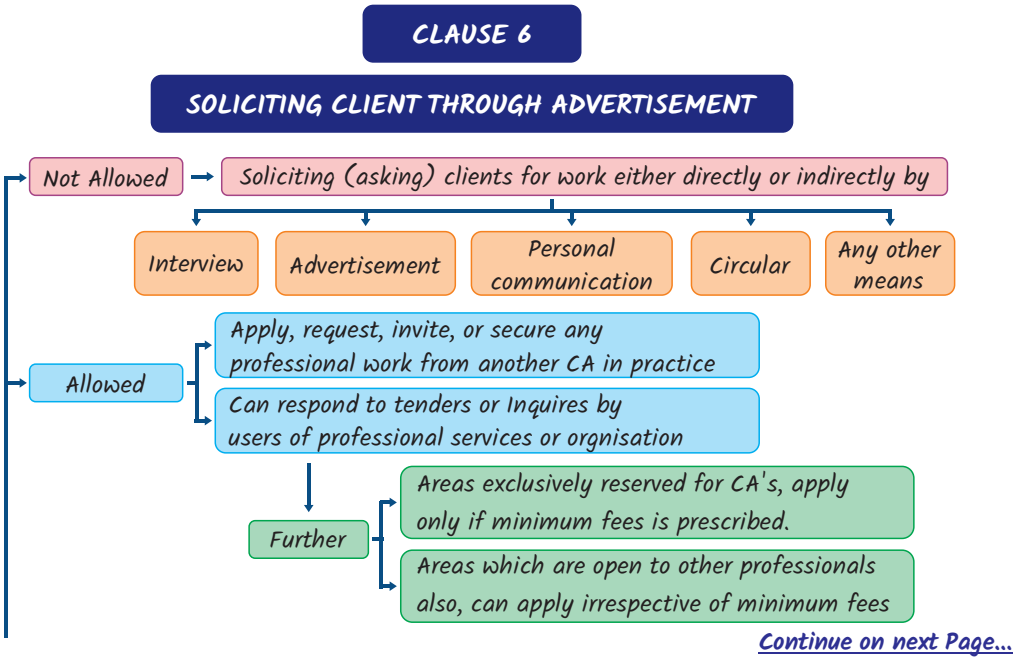
- **who is not an employee of such Chartered Accountant or**
- **who is not his partner or**
- **by means which are not open to a Chartered Accountant, any professional business.**

Provided that nothing herein contained shall be construed as prohibiting any agreement permitted in

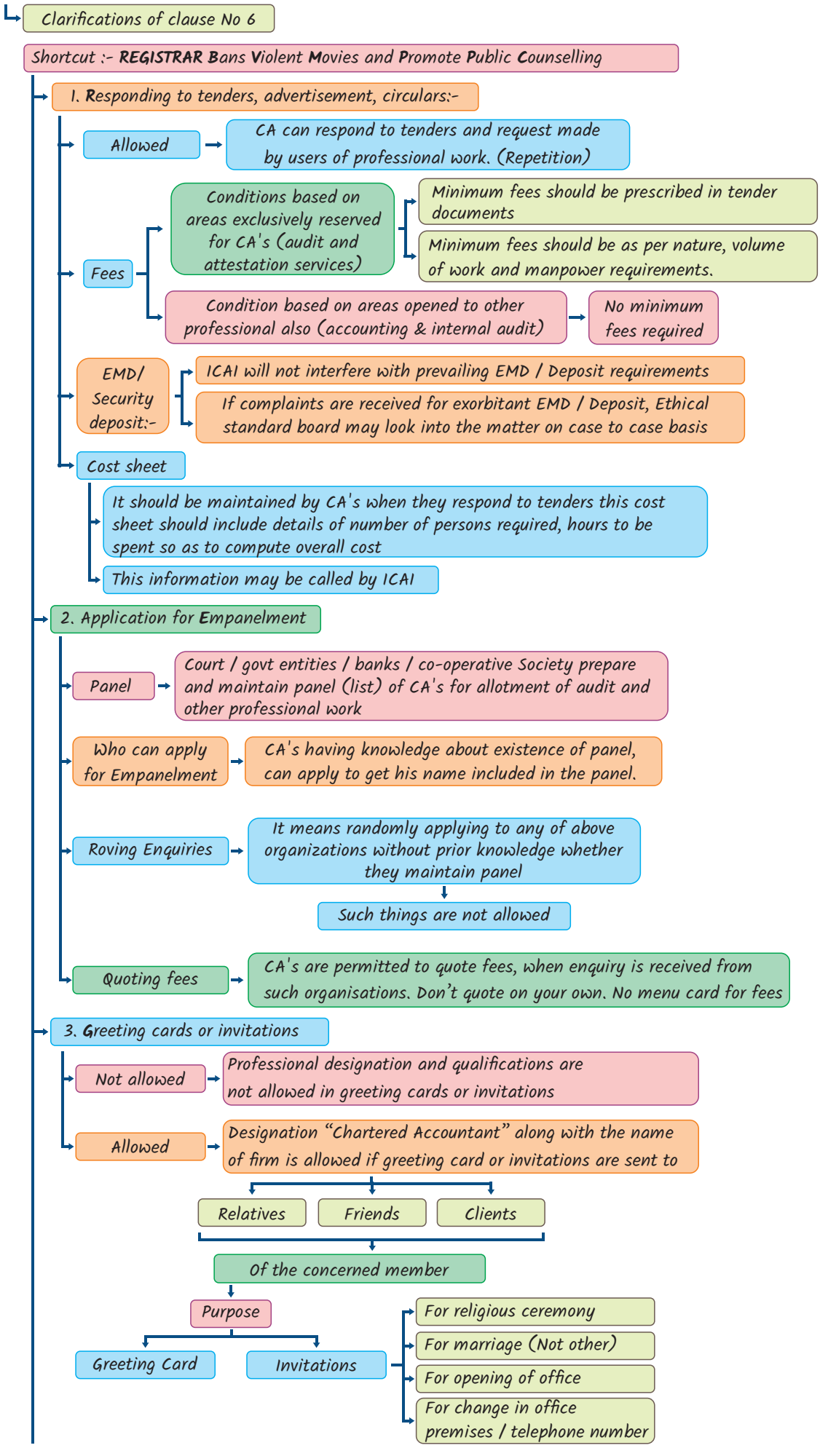
(CNO—PE.680) CLAUSE 6 (Soliciting Work Through Advertisement ?)

(QNO- 666.050 / 667.000 / 668.000 /668.100/ 669.000 / 670.000 / 672.000 / 673.000 / 674.000 / 675.000 / 676.000 / 677.000 / 677.500 / 678.000 / 678.010 / 679.000/ 681.000 / 682.000 / 682.500 / 683.000 /684.000 / 685.000 /686.000 /687.000 /688.000 /695.010) (MCQ-PE.3, Incs.06.4, Incs.50.5, Incs.06.4)

Chart



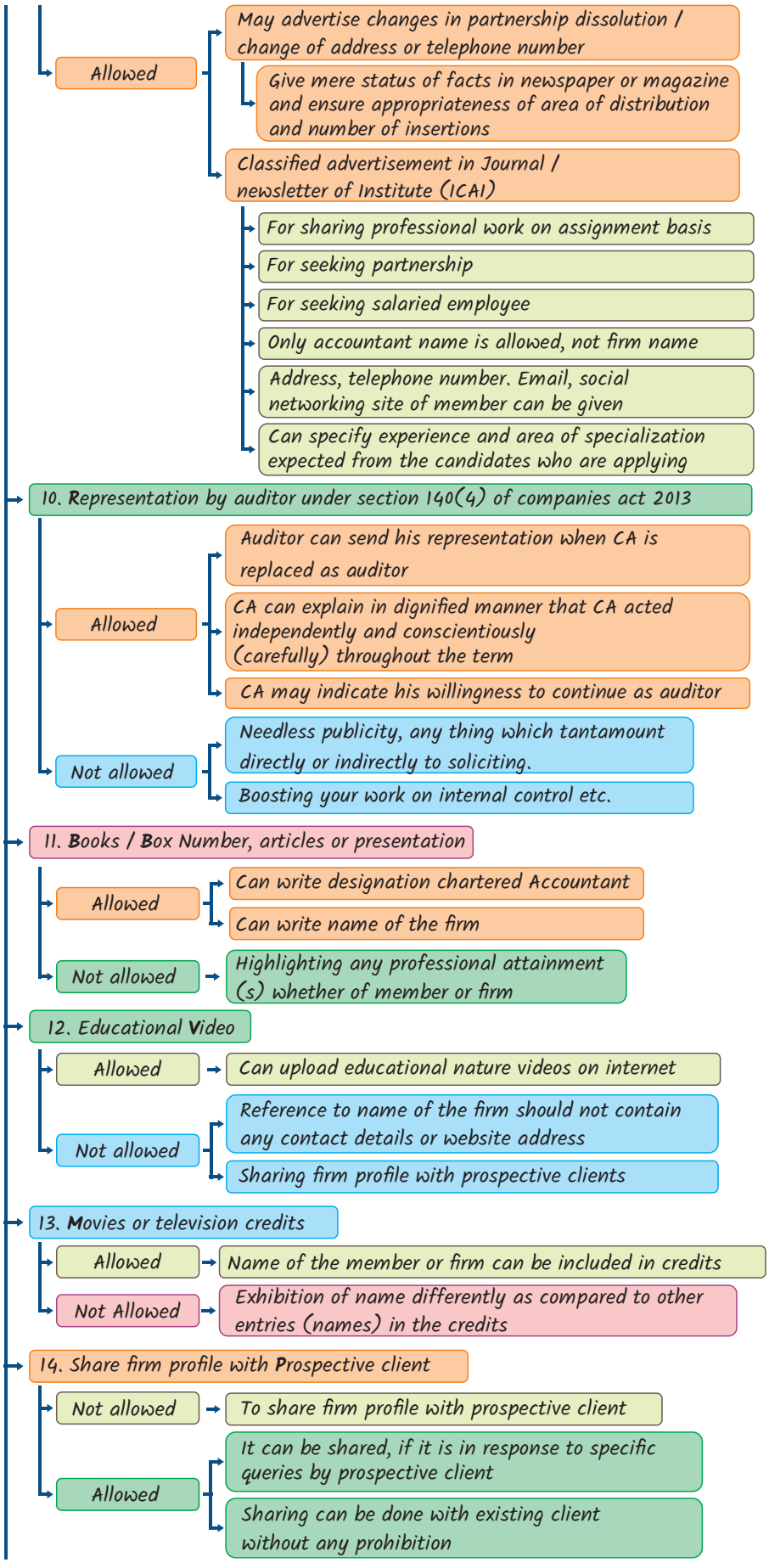
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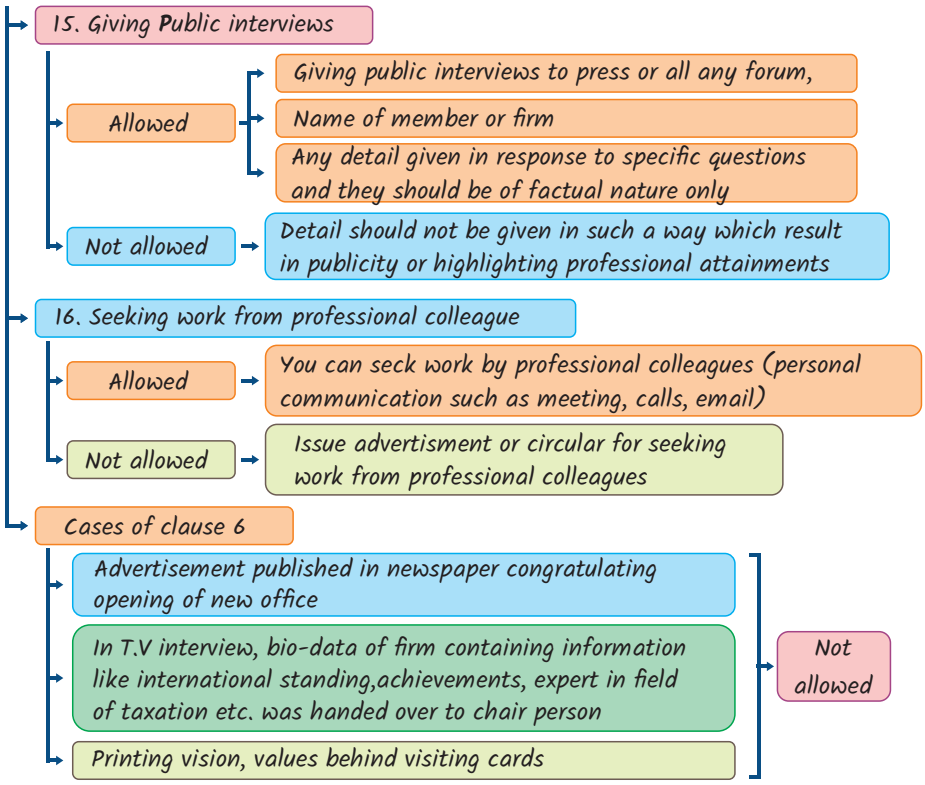
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- 4. Introduction to client of another CA:-
  - Situation → Another CA started giving professional services to a particular client such assignment will be called original professional work. Now such CA introduced his client to us.
  - Not allowed
    - Original professional work cannot be accepted by us.
    - If any other professional works is directly offered by client to us then we should ask client to come through other CA who introduced us. (CA should be informed and kept in loop)
- 5. Sponsoring activities
  - Not allowed → CA's are not permitted to sponsor an event
  - Allowed
    - Can sponsor events if 2 condition are satisfied
    - Event conducted by programme organizing unit (POU) of ICAI
    - Such event has proper approval by CPE Directororate of ICAI
  - CSR Activities → Sponsoring such activities are allowed provided only individual name with prefix CA should be given and no mention of CA firm name or CA logo is permitted
- 6. Silver, golden, platinum or Centenary celebrations advertisement
  - Not allowed → In general Cannot advertise event organized by CA/ CA firms
  - Allowed → If event is in nature of silver, golden/ diamond, platinum or centenary celebration of CA firm then advertisement can be published in newspaper or news letter
- 7. Teaching / coaching / activities by CA
  - Permission → Such member should take appropriate permissions as required by clause 11 and regulation 190 A
  - Not allowed
    - Member in practice should not put advertisement of coaching / teaching activities it will lead to indirect solicitation or solicitation by other means under clause 6.
    - Abstain from advertising their association with coaching / teaching activities through hoardings banners, poster and any other means
  - Allowed → Can put sign board giving following details.
    - Name of coaching / teaching institute
    - Subject taught
    - Contact details
    - It should be outside their coaching / teaching premises
    - Size should be as applicable to their name board
- 8. Roving Enquires
  - Not allowed → Not permissible to address letter, emails or circular to people without any request or requirement from their side, it would tantamount to advertisement
- 9. Advertisement & Note in press
  - Not Allowed
    - To advertise for soliciting work or any advertisement which can be interpreted as solicilation
    - Circulating letters to even to small field of possible clients
    - Personal canvassing (Door to Door)

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Clause 6 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, it's not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- ***Solicits clients or professional work either directly or indirectly by***
  - ***circular,***
  - ***advertisement,***
  - ***personal communication or***
  - ***interview or***
  - ***by any other means.***

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

- ***Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or***
- ***A member from responding to tenders or enquiries issued by various users of professional services or***

Discussion (Applying for ender & Teaching Activity)

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 issue d by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

Further, keeping in view the broad purview of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, an advertisement of Coaching /teaching activities by a member in practice may amount to indirect solicitation, as well as solicitation by any other means, and may therefore be violative of the provisions of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

Clarifications

Some forms of soliciting work which the Council has prohibited are discussed below:

(a) Advertisement and note in the press – *Members should not advertise for soliciting work or advertise in a manner which could be interpreted as soliciting or offering to undertake professional work. They are also not permitted to use the less open method of circulating letters to a small field of possible clients. Personal canvassing or canvassing for clients of previous employer through the help of the employees are also not permitted. The* ***exceptions*** *to the above rule are:*

(i) A member may request another Chartered Accountant in practice for professional work.

(ii) a member may advertise changes in partnerships or dissolution of a firm, or of any change in address of practice and telephone numbers. Such announcements should be limited to a bare statement of facts and consideration given to the appropriateness of the area of distribution of the newspaper or magazine and number of insertions.

(iii) a member is also permitted to issue a classified advertisement in the journal/ newsletter of the Institute intended to give information for sharing professional work on assignment basis or for seeking partnership or salaried employment of an accountancy nature, provided it only contains the accountant's name, address or telephone number, fax number, e-mail address and address(es) ***of social Networking sites of members. However, mere factual position of experience and area of specialization, relevant to seek response to the advertisement, are permissible.***

(b) Application for empanelment for allotment of audit and other professional work – *The Government departments, government companies/Corporations, courts, co-operative societies and banks and other similar institutions prepare panels of chartered accountants for allotment of audit and other professional work. Where the existence of such a panel is within the knowledge of a member, he is free to write to the concerned organization with a request to place his name on the panel.* ***However, it would not be proper for the Chartere Accountant to make roving enquiries by applying to any such organization for having his name included in any such panel.*** *It is permissible to quote fees on enquiries being received from such bodies, which maintain such panel.*

(c) Responding to Tenders, Advertisements and Circulars : *It is not prohibited to the members to respond to tenders and requests made by users of professional work. This is however subject to conditions that may be issued by the Council from time to time.*

The Council has issued Guidelines No. 1-CA(7)/03/2016 dated 7th April 2016 (see ***Appendix*** *'J') which stipulate that a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for Chartered Accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants. The "minimum fee" for this purpose should be such that it commensurates with size, value, volume, manpower requirement and nature of work .*

EMD/Security Deposit : *The Council is of the view that while interference with the practices prevailing for requirement of EMD/Deposit is not required. However, on having received complaint/ instance of exorbitant EMD/Deposit, the Ethical Standards Board may look into the matter on case to case basis.*

A cost sheet be maintained by members of the Institute responding to tenders, incorporating details of the costs being incurred therein having regard to number of persons involved, hours to be spent, etc, so that the same may be called for by the Institute for perusal.

or an article published by him, or a presentation made by him, any professional attainment(s), whether of the member or the firm of chartered accountants, with which he is associated. However, he may indicate in a book, article or presentation the designation "Chartered Accountant" as well as the name of the firm.

(e) Issue of Greeting Cards or Invitations : The Council does not approve of the issue of greeting cards or personal invitations by members indicating their professional designation, status and qualifications etc. However, the Council is of the view that the designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards, invitations for marriages and religious ceremonies and any invitations for opening orinauguration of office of the members, change in office premises and change in telephone numbers, provided that such greeting cards or invitations etc. are sent only to clients, relatives and friends of the members concerned.

(f) Advertisement for Silver, Golden, Platinum or Centenary celebrations : It is not permitted to advertise the events organised by a Firm of Chartered Accountants. However, considering the need of interpersonal socialization/relationship of the members through such get together occasions, the advertisement for Silver, Golden, Diamond, Platinum or Centenary celebrations of the Chartered Accountants Firms may be published in newspaper or newsletter.

(g) Sponsoring Activities

(a) A member in practice or a Firm of Chartered Accountants is not permitted to sponsor an event. However, such member or Firm may sponsor an event conducted by a Programme Organizing Unit (PoU) of the ICAI, provided such event has the prior approval of Continuing Professional Education (CPE) Directorate of the ICAI.

(b) Members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, the mention of Firm name or CA Logo is not permitted.

(h) Advertisement of Teaching/Coaching activities by members : The members engaged in teaching /coaching activities, while advertising such teaching /coaching activities, shall comply with the Regulation 190A of the Chartered Accountants Regulations, 1988(discussed in the Chapter in Clause II).

Keeping in view the broad purview of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, an advertisement of Coaching /teaching activities by a member in practice may amount to indirect solicitation, as well as solicitation by any other means, and may therefore be violative of the provisions of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

In view of the above, such members are advised to abstain from advertising their association with Coaching /teaching activities through hoardings, posters, banners and by any other means, failing which they may be liable for disciplinary action, as per the provisions of Chartered Accountants Act, 1949 and Rules/Regulations framed thereunder.

Subject to the above prohibition, such members may put, outside their Coaching/ teaching premises, sign board mentioning the name of Coaching/teaching Institute, contact details and subjects taught therein only. As regards the size and type of sign board, the Council Guidelines as applicable to Firms of Chartered Accountants would apply.

(i) Sharing Firm Profile with prospective Client : It is not permitted to share Firm profile with a prospective Client unless it is in response to a proposed client's specific query, and otherwise not prohibited to be used by the client.

Accountants for inclusion in Television or Movie Credits , it must be taken care of that exhibition of name is not made differently as compared to other entries in the credits.

(k) Soliciting professional work by making roving enquiries: *It is not permissible for a member to address letters, emails or circulars specifically to persons who are likely to require services of a Chartered Accountant since it would tantamount to advertisement.*

(l) Seeking work from Professional Colleagues : *The issue of an advertisement or a circular by a Chartered Accountant, seeking work from professional colleagues on any basis whatsoever except as provided above would be in violation of this clause.*

(m) Scope of representation which an auditor is entitled to make under Section 225(3) of the Companies Act, 1956 (Section 140(4) of the Companies Act, 2013) : *The right to make representation does not mean that an auditor has any prescriptive right or a lien to an audit. The wording of his representation should be such that, apart from the opportunity not being abused to secure needless publicity, it does not tantamount directly or indirectly to canvassing or soliciting for his continuance as an auditor. The letter should merely set out in a dignified manner how he has been acting independently and conscientiously through the term of office and may, in addition, indicate if he so chooses, his willingness to continue as auditor if reappointed by the shareholders.*

(n) Acceptance of original professional work by a member emanating from the client introduced to him by another member: *The Council has decided that a member should not accept the original professional work emanating from a client introduced to him by another member. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.*

(o) Giving Public Interviews: *While giving any interview or otherwise furnishing details about themselves or their firms in public interviews or to the press or at any forum, the members should ensure that, it should not result in publicity. Due care should be taken to ensure that such interviews or details about the members or their firms are not given in a manner highlighting their professional attainments. Any detail which is given must, in addition to meeting the above requirements, be given only as a response to a specific question , and of factual nature only.*

(p) Members and/or firms who publish advertisements under Box numbers: *Members/Firms are prohibited from inserting advertisements for soliciting clients or professional work under box numbers in the newspapers. This practice is in violation of this clause.*

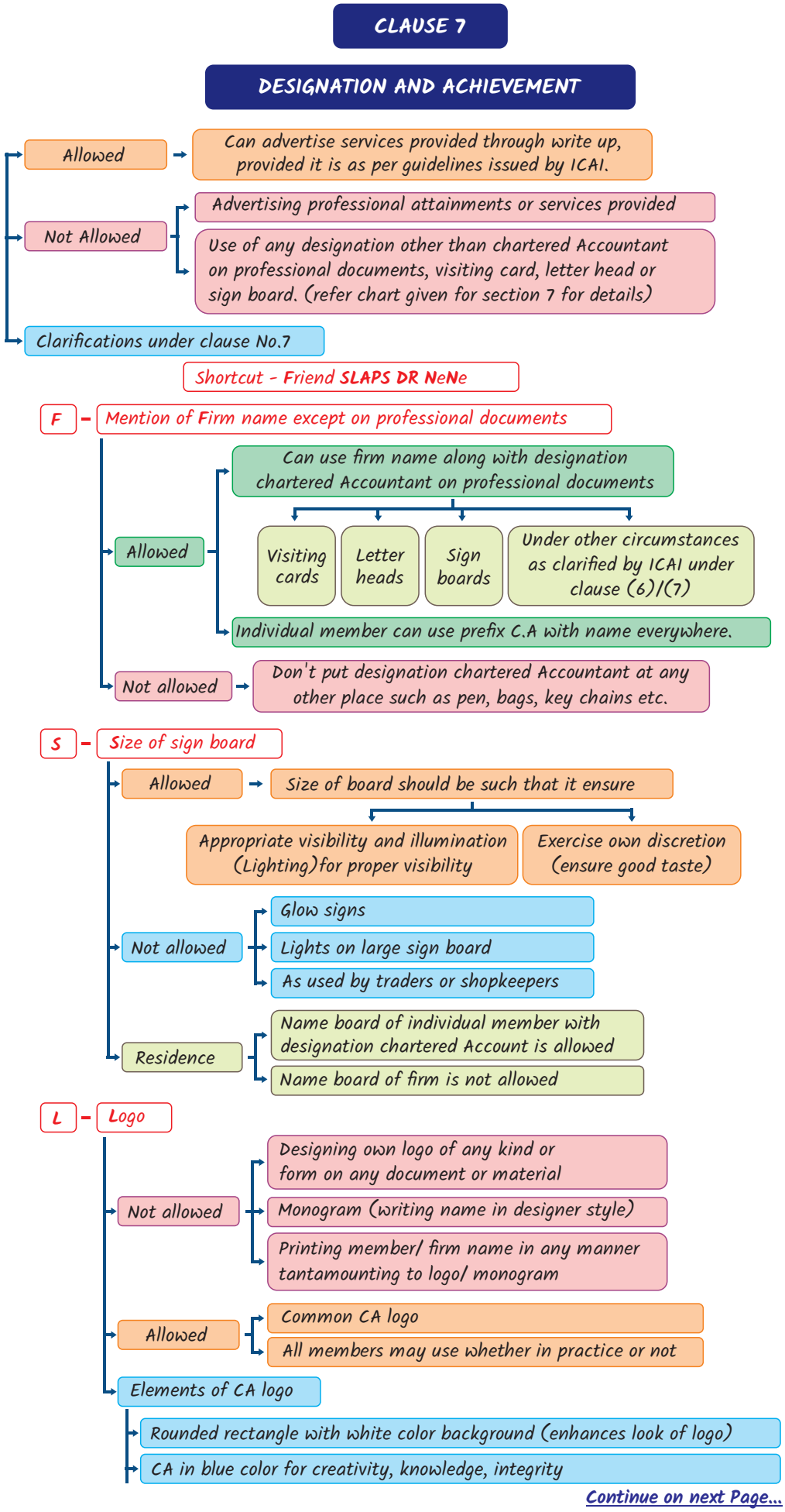
(q) Educational Videos: While the videos of educational nature may be uploaded on the internet by members, no reference should be made to the Chartered Accountants Firm wherein the member is a partner/ proprietor. Further, it should not contain any contact details or website address.

(CNO—PE.700) CLAUSE 7 - DESIGNATION & ADVERTISING PROFESSIONAL ATTAINMENTS

(QNO-664.000/673.000/689.000/691.000/692.000/692.100/693.000/694.000/695.000/695.010)

(MCQ-PE.11 / PE.12 / Incs.41.1 / Incs.51.4)

Chart



Continue on next Page...

- Tick Mark in green color for prosperity and harmony
- Tick mark (upside down) symbolizes wisdom and value of profession

A – Appearance of CA on electronic media (including internet)

- Allowed
  - Appear on
    - Internet
    - Films
    - Television
    - Radio
    - Lectures at forum
  - May give names and describe themselves as Charted Accountants
  - Firm name is also allowed
  - Specialized knowledge or questions related to subject matter allowed
  - Objective professional view on topic under discussion
- Not allowed
  - Any exaggerated claim
  - Comparison not permissible
  - Promotion of him or his firm

P – Important appointments or views of Public importance

- Situation
  - CA is appointed or is in position of local or national importance e.g MP, MLA, Chairman of committee
  - CA ask to give views on matter of local or national important
- Allowed
  - Mention membership of ICAI
  - Aim to active suitable Publicity for ICAI and its members generally
- Not allowed → Reference to professional firm.

S – Seminars, training courses for staff

- Allowed
  - Holding seminars, training courses
    - For his staff
    - For staff of other CA'c
    - For clients and his staff
  - Name of CA is allowed in booklet or document but undue prominence should not be given
- Not allowed → Name of firm (not specifically mentioned but it is implied)

D – Public announcement with details of Director

- Situation → CA is appointed as director in a company
- Important step
  - CA should specifically inform
  - company regarding clause 6 & 7 of Ist schedule to CA Act
  - CA should request company that prospectus or public announcement or communication mentioning his name & material concerned to him, should be first issued to him so that CA can approve it and then it can be published
- Allowed
  - Designation Chartered Accountant
  - Directorship held in other companies
- Not allowed
  - Expertise, specialization and knowledge in any particular fields or other appellations or any other professional attainments.(Title)
  - Firm name

Continue on next Page...

D – Date of setting up of practice / year of establishment

- Not allowed
  - Date of setting up of practice or establishment
  - On letterhead
  - On other professional documents

R – Reports & certificate

- Allowed
  - Report and certificates should be issued on the letter head of the firm
  - It will bring notice of public in a greater or lesser degree
  - Extent and manner of publication of certificates should be limited to what is necessary to serve its proper purpose

N – Notice in the press related for success in examination

- Allowed
  - Notice can be published in press for success in examination
  - Local newspaper can publish details of examination success.
  - Name / Address / School / local background
  - Details of examination passed / prize, place gained.
  - Name of the firm / Name of Principal / Town
- Not Allowed → Undesirable publicity of firm / Principal / article.

N – Network firm, network guidelines

- As clause 6 & 7 are applicable to CA and CA firms in same manner it is applicable to network of CA firms also

VISITING CARD

Allowed	Not allowed
-Name -Designation "Chartered Accountant" /Qualification -Firm Name (All firms where CA is associated, no restrictions) (CL 7) -CA LOGO -Address / Email ID -Website Address (Only Name Don't Use Please Visit / Click etc.) (CL 6) -Quick Response Code (It should give only that info which is allowed) (CL 7)	-Year of Establishment (CL 7) -Photograph (CL 7) -Any Other Logo (CL 7) -Associates of "Some Other Firm" (CL 7) -ISO Certification (CL 7) -Celebrating 75 years (CL 6 & CL 7) -Vision / Mission of the Firm (CL 6)

Clause 7 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- **Advertises his professional attainments or services, or**
- **uses any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University:-**
  - **established by law in India or**
  - **recognized by the Central Government or**
  - **a title indicating membership of the Institute of Chartered Accountants or of any other**

institution that has been recognized by the Central Government or may be recognized by the Council.

- ***Provided that a member in practice may advertise through a write up, setting out the service provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council.***

Discussion

Other Designations: *It is improper for a Chartered Accountant in practice to state on his professional documents that he is an Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant.*

While noting that it had already allowed its members to appear before the various authorities including Company Law Board, Income Tax Appellate Tribunal, Sales Tax Tribunal where the law has permitted the same, so far as the designation "Corporate Lawyer" is concerned, the Council was of the view that as per the existing provisions of law, a Chartered Accountant in practice is not entitled to use the designation "Corporate Lawyer".

A member must not use the designation such as 'Member of Parliament', 'Municipal Councilor' nor any other functionary in addition to that of Chartered Accountant.

A member empanelled as Insolvency Professional or Registered Valuer can mention "Insolvency Professional" or "Registered Valuer" respectively on his visiting card and letter head.

Permission to mention qualifications of certain Institutions : *The members are permitted to mention a title on their visiting cards to indicate membership of a foreign Institute of Accountancy , which has been recognised by the Council e.g. South African Institute of Chartered Accountants (SAICA), Institute of Certified Public Accountants (CPA Ireland) and Institute of Chartered Accountants in England and Wales (ICAEW).*

Date of setting-up practice: *The date of setting up the practice by a member or the date of establishment of the firm on the letter heads and other professional documents etc. should not be mentioned.*

Practice as Advocate : *Members of the Institute in practice who are otherwise eligible may practise as advocates subject to the permission of the Bar Council but in such case, they should not use designation 'Chartered Accountant' in respect of the matters involving the practice as an advocate. In respect of other matters they should use the designation 'Chartered Accountant'* ***but they should not use the designation 'Chartered Accountant' and 'Advocate' simultaneously.***

Practice as Company Secretary/Cost Management Accountant : *Members of the Institute in practice who are otherwise eligible may also practice as Company Secretaries and/or Cost Management Accountants. Such members shall, however, not use designation/s of the aforesaid Institute/s simultaneously with the designation "Chartered Accountant".*

It is clarified that in the event of the permission being granted to a member in practice to also hold COP of sister Institute(s)/Bar Council, such a member be treated as a member in full -time practice.

Mention of Firm name except on Professional Documents : *It is not proper for a Firm of Chartered Accountants to use the designation 'Chartered Accountant' except on professional documents, visiting cards, letter heads or sign boards and under the circumstances clarified under Clause (6). However, an individual member may use the prefix "CA" with his name.*

Notice in the Press relating to the Success in an Examination: *Notice in the press relating to the success in an examination of an individual candidate, should not contain any element of undesirable publicity either in relation to the articled/audit assistant or an employee or the member or the firm with whom he was served.*

It is usual for local papers to publish details of the examination success of local candidates. Some biographical information is often included. The rule aforementioned is not intended to discourage the printing of news of local interest but is intended to indicate the need for restraint. The candidate's name and address, school and local background, examination passed with details of any prize or place gained, the name of the principal, firm and town in which the principal practices may be published.

Reports and Certificates : *The reports and certificates issued by a Chartered Accountant bring him to the notice of the public in a greater or lesser degree. It is therefore incumbent upon him to ensure that the extent and manner of publication of certificates are limited to what is necessary to enable the report or certificate to serve its proper purpose. The members may however note that they should use letterhead of their Firm for issuing reports and certificates.*

Appearance of Chartered Accountants on Electronic Media (including Internet) : *Members may appear on television, films and Internet and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialised knowledge directly relevant to the subject matter of the programme may also be given. Firm name may also be mentioned, however, any exaggerated claim or any kind of comparison is not permissible. What he may say or write must not be promotional of him or his firm but must be an objective professional view of the topic under consideration.*

Publicity is permitted for appointments to positions of local or national importance or for the views of members on matters of similar importance. Mention of the membership of the Institute is desirable in such cases. What should be aimed at is to achieve suitable publicity for the Institute and its members generally. Members giving talks or lectures or attending conference may describe themselves as Chartered Accountants only when they are acting in their capacity as Chartered Accountants. However, reference to the professional firm of the member should not be given.

Organising Training Courses, Seminars etc. for his staff: *A Chartered Accountant in practiceholding training courses, seminars etc. for his staff may also invite the staff of other Chartered Accountants and clients to attend the same. However, undue prominence should not be given to the name of the Chartered Accountant in any booklet or document issued in connection there with.*

Writing Articles or Letters to the Press: *Members writing articles or letters to the Press on subjects connected with the profession may give their names and use the description Chartered Accountants.*

Size of Sign Board: *With regard to the size of sign board for his office that a member can put up, it is a matter in which the members should exercise their own discretion and good taste while keeping in mind the appropriate visibility and illumination (limited to the sake of visibility). However, use of glow signs or lights on large-sized boards as is used by traders or shop-keepers is not permissible. A member can have a name board at the place of his residence with the designation of a Chartered Accountant, provided it is a name plate or name board of an individual member and not of the firm.*

Public Announcements with details of Directors: *The Council's attention has been drawn to the fact that more and more Companies are appointing Chartered Accountants as Directors on their Boards. The prospectus or public announcements issued by these Companies often publish descriptions about the*

adjectives to their names. Attention of the members in this context is invited to the provisions of Clause (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act.

In order that the inclusion of the name of a member of the Institute in the prospectus or public announcements or other public communications issued by the Companies in which the member is a director does not contravene the above noted provisions, it is necessary that the members should take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the member. While it may be difficult to lay down a rigid rule in this respect, the members must use their good judgement, depending upon the facts and circumstances of each case to ensure that the above noted provisions are complied with both in letter and spirit.

It is advisable for a member that as soon as he is appointed as a director on the Board of a Company, he should specifically invite the attention of the management of the Company to the aforesaid provisions and should request that before any such prospectus or public announcements or public communication mentioning the name of the member concerned, is issued, the material pertaining to the member concerned should, as far as practicable be got approved by him. The use of the expression 'Chartered Accountant' is permissible. However, the member must ensure that descriptions about his expertise, specialisation and knowledge in any particular field or other appellations or adjectives are not published with his name. Particulars about directorships held by the member in other Companies can, however, be given, but the name of the firm of Chartered Accountants in which the member is a partner, should not be given.

Network Firms and Networking Guidelines : The Council has permitted Network amongst the Firms registered with the Institute. A member of the Network may advertise to the extent permitted by the Advertisement Guidelines issued by Institute.

Use of Logo : For use of logos by Members on letter heads, visiting cards etc. the Council had decided that the logos unconnected with the first letter of the name of the firm or its partners or proprietors would not be permitted for use by members in practice/firms of Chartered Accountants on their letter heads, visiting cards etc. as the same would have amounted to advertisement or smacking of publicity. Subsequent to above, the Institute came across cases of registration of firm name in circumvention of the provisions contained in the Regulation 190 of the Chartered Accountants Regulations, 1988. The members/firms by themselves or through engineered name had been seeking to obtain firm name approval based on the name of the partner/s selected in the manner that logo of the firm would be identical to the firm name which would have not otherwise been permissible as firm name under Regulation 190.

In order to ensure compliance with the Regulations, the Council decided that the use of logo/monogram of any kind/form/ style/design/colour etc. whatsoever on any display material or media e.g. paper stationery, documents, visiting cards, magnetic devices, internet, sign board, by the members in practice and/or the firm of Chartered Accountants, be prohibited. Use/printing of member/firm name in any other manner tantamounting to logo/monogram was also prohibited.

Common CA Logo : To promote the brand of CA profession and responding to the long felt need to have a symbol of CA Profession in India, ICAI came up with a unique logo which could be used by all members, whether in practice or not. Encapsulating the current beliefs, attitudes and values of the profession, the CA Logo seeks to enhance the identity of the members. The logo consists of the letters 'CA' with a tick mark (upside down) inside a rounded rectangle with white background. The letters 'CA' have been put in blue, the corporate colour which not only stands out on any background but also denotes creativity, innovativeness ,

chartered accountants, has been included to symbolize the wisdom and value of the professional. The green colour in the tick mark signifies growth, prosperity, harmony and freshness. Members are encouraged to use this logo. The Council has decided that use of CA logo in the stamp is permissible, subject to CA logo guidelines.

Guidelines for elected Members of the Council/ office Bearers of the Regional Council in the context of use of designation etc. and manner of Printing of Letter-heads and visiting cards.

The guidelines/directions laid down by the Council as revised by the Council from time to time for use of designation etc. and manner of printing letter-heads and visiting cards of the President, Vice President of the Institute, Members of the Council, Chairmen of various non-standing Committees of the Institute; Chairmen, other office bearers and Members of the Regional Councils; Chairmen, other office-bearers and Members of the Managing Committees of the Branches are appearing in Appendix 'F' to Code of Ethics publication.

RECENT CLARIFICATION / CASES W.R.T CLAUSE 7

(We have aligned our content strictly as per ICAI module and questions. Question asked in exam, MTP, RTP. We have left out unimportant things which were not emphasized over long period of time)

Shortcut- **KIA Firms QR**

- **K** – Knowledge partner / Thank you advertisement
  - Allowed → Name of individual member as prefix or suffix CA, as knowledge partner
  - Not allowed → Name of CA firm as knowledge partner
- **I** – ISO certification
  - Allowed → To obtain ISO certification
  - Not allowed → Use expression like 'ISO certificate' in professional documents like letter head visiting cards, sign board
- **A** – Associates of CA firm
  - Not allowed → To write associates of / correspondence of other firms on letter head, visiting card, professional documents
  - Allowed → Can enter in association or firm network but in such case you have to use words "affiliate of network"
- **F** – Firms
  - Allowed → If CA is in partner in multiple firms, name of all the firms can be given in letter heads, visiting card, professional documents.
- **QR** – Quick Response code
  - Allowed → Yes it can be printed. But it should contain only that information which is allowed in visiting card

Some Recent Clarification (CAR-KI Clarifications)

- ***CCM, RCM and Member of Managing Comm. of Branches*** may print either their residential address, or office address including Tel. / Fax No. without mentioning the firm's name on the back of the visiting cards"
- ***Associates of CA Firms:*** The Council has issued the following guidelines for use of expressions such as 'Associates of 'Correspondents of... etc. on letter heads, visiting cards etc. of firms of Chartered Accountants:(Association etc)
  The use of expressions / words 'in Association with .... 'Associates of 'Correspondents of.... etc., on the

stationery letter heads, visiting cards and professional documents etc. of firms of Chartered Accountants is not permissible in view of the provisions of clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 irrespective of whether the connection bearing name sought to be used was the name of an Indian firm or a foreign firm. The Council has not barred entering into such association and the restriction given under the above clause is to bar an advertisement appearing / derived from such associations."

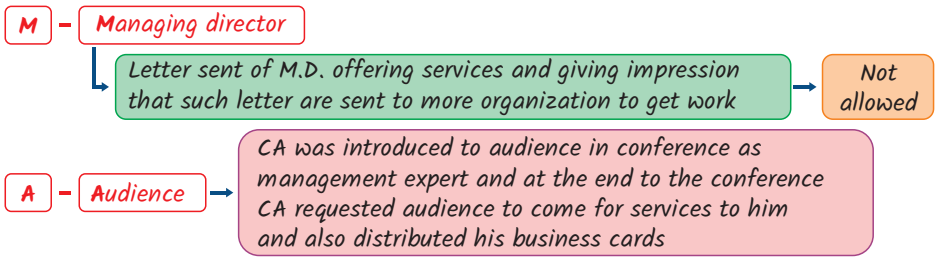
- **Rotary Visiting Card:** Member who is in practice cannot use the designation of`District Governor' in his rotary visiting card along with the word`Chartered Accountant' "
- **Knowledge Partner:** Permitting the use of firm name by client, mentioning the firm as a "Knowledge Partner" or in the "Thank You" advertisement, is not permissible, however mention of name of an individual member with prefix/suffix "CA" as a "knowledge partner " is permissible.
- **ISO Certification:** Whether the office of a CA is permitted to go in for ISO 9001:2000 certification or other similar certifications?
  Yes, there is no bar for a member to go in for ISO9001:2000 certification or other similar certifications.

  However, the member cannot use the expression like "ISO Certified" on his professional documents, visiting cards, letterheads or sign boards etc."
- **Common CA Logo :**
  - **Brand Promotion:** To promote the brand of CA profession and responding to the long felt need to have a symbol of CA Profession in India, ICAI came up with a unique logo which could be used by all members, whether in practice or not. Encapsulating the current beliefs, attitudes and values of the profession, the CA Logo seeks to enhance the identity of the members.
  - **Significance of Colours:** The logo consists of the letters 'CA' with a tick mark (upside down) inside a rounded rectangle with white background. The letters 'CA' have been put in blue, the corporate colour which not only stands out on any background but also denotes creativity, innovativeness , knowledge, integrity, trust, truth, stability and depth. The upside down tick mark, typically used by the chartered accountants, has been included to symbolize the wisdom and value of the professional. The green colour in the tick mark signifies growth, prosperity, harmony and freshness. Members are encouraged to use this logo. The Council has decided that use of CA logo in the stamp is permissible, subject to CA logo guidelines.

CASES WHERE BOTH CLAUSE 6 & 7 APPLICABLE (COMMON CASES)

Shortcut: **FB & CHROMA**

- **F** – Firms issue circular to non-clients that partner in charge of one of the largest accounting Firms has joined them now, they can take firms services → Not allowed
- **B** – Banner → Banner with name of CA firm → Not allowed
- **C** – Centenary → Centenary celebration etc. are allowed (as discussed earlier)
- **H** – History → Publishing book containing history, to be distributed to clients, associates, well-wishers and printing of words 'celebrating 75years in the profession on letter head and envelopes → Not allowed
- **R** – Ranking → Providing data to other entities so that they can rate and compare CA firms, determine their ranking → Not allowed
- **O** – Offer document → Professional attainments etc.
  → Not allowed (see points discussed earlier)



Cases where both clause 6 & clause 7 are applicable	1. The offer document of a listed company in which Mr. D, a practising Chartered Accountant is a director mentions the name of Mr. D as a director along with his various **professional attainments and spheres of specialisation.**	The Council of the **ICAI has in a communication to members** stated that if a public company, in which a chartered accountant in practice is a director, issues a prospectus or gives any announcement that gives descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field, it shall constitute a misconduct under Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The Council has further stated that in such cases the **member concerned has to take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients** for professional work by the members. Thus in the instant case, Mr. D would be held to be guilty of professional misconduct and liable for
	2. A Chartered Accountants firm **issued circulars** to the non- clients that a Chartered Accountant who was the former partner in-charge of Taxation of one **of the largest accounting firms of the world,** had joined them as partner. Can they do it?	Clause 6 - Circular Clause 7 - Professional Attainments
	3. Mr. Nigal, a Chartered Accountant in practice, delivered a speech in the **national conference organized** by the Ministry of Textiles. While delivering the speech, he told to the audience that he is a **management expert** and his firm provides services of taxation and audit at reasonable rates. He also **requested the audience to approach his firm of chartered accountants for these services** and at the request of audience he also distributed his business cards and telephone number of his	Solicitation under Clause (6) & 'Management Expert' - Inappropriate Designation under Clause (7)
	4. Can a Chartered Accountants firm give advertisement in relation to Silver, Diamond, Platinum or Centenary celebration of the firm? (Clarification issued by ICAI)	The advertisement for Silver, Diamond, Platinum and Centenary celebrations of the firms has been permitted to be published in any newspaper or in the newsletters. It has been allowed after

5. *Ranking*

It has been brought to the notice of some members that certain entities are seeking details of the Chartered Accountants firms, for the purpose of making ranking of the various Firms through comparison of different parameters.

In this regard, Members are hereby informed that sharing of details of their Chartered Accountants firms in the ***aforesaid manner does not fall within the permitted categories*** *, and would therefore be violative of Clause 6 of Part-I of First Schedule to The Chartered Accountants Act, 1949 .*

Further, as it is known beforehand that the information regarding firms would be used for ranking purposes, the sharing of such details would ***tacitly result in claiming superiority of one firm over other,*** *which is prohibited in terms of the Advertisement Guidelines of the ICAI under Clause 7 of Part –I of First Schedule to The Chartered Accountants Act, 1949. Members are therefore advised to abstain from such sharing of details of their Chartered Accountants Firms.*

6. *The use of* ***banner*** *with name of CA firm is not permissible in terms of provisions of Items 6 and 7 of Part –I of First Schedule to The Chartered Accountants Act, 1949*

7. *Where a Chartered Accountant had addressed a* ***letter to the Managing Director*** *of a company offering his services as a practicing chartered accountant and* ***giving impression that the letter had been addressed to more than one organization*** *for the above purpose, it was held that the member had contravened the provisions of Clauses (6) & (7). [Yogesh Gupta (1996)]*

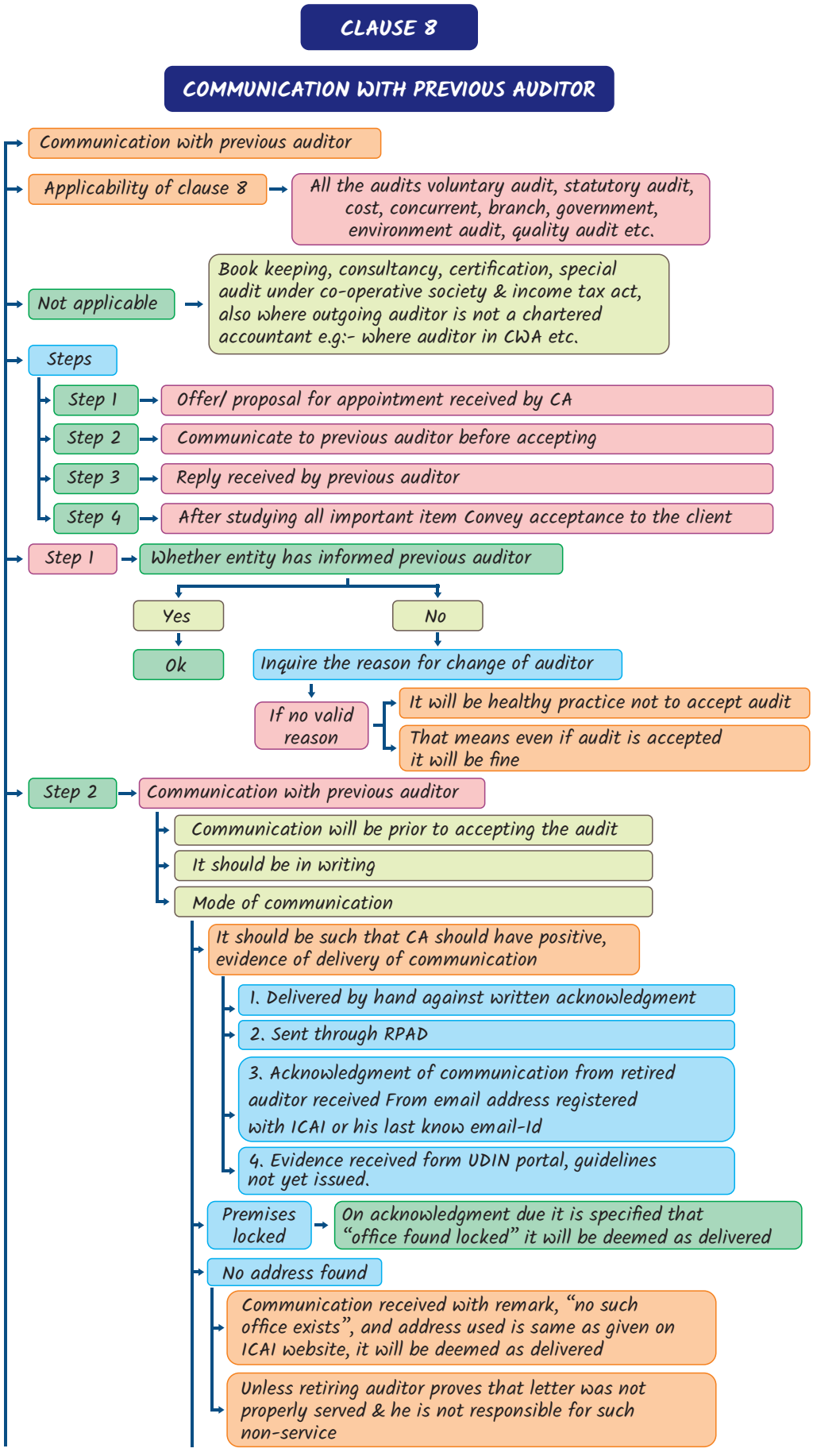
8. *Publishing a* ***book by a firm containing its history*** *for the purpose of distributing to clients, associates, friends and well wishers* ***And printing of the words 'Celebrating 75 years in the Profession' on special letterheads and envelopes of the firm*** *will lead to solicitation of professional work, hence not permissible as per the provisions of Clauses (6) and (7) of Part I of*

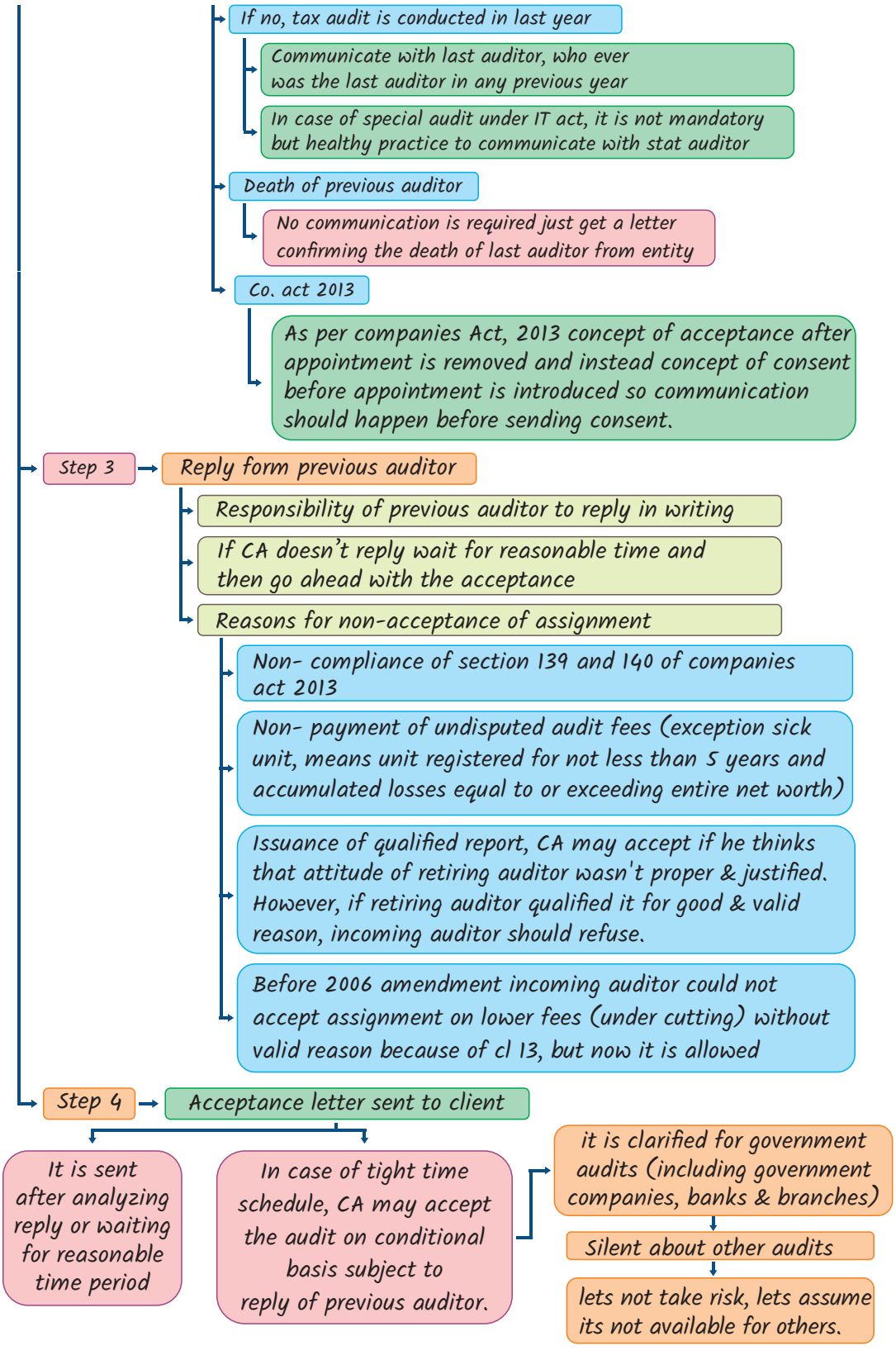
(CNO—PE.720) CLAUSE 8 - COMMUNICATION WITH PREVIOUS AUDITOR BEFORE ACCEPTING AUDIT

(QNO-696.000/ 696.100/ 698.000/ 699.000/ 700.000/ 702.000/ 704.000 / 704.500)

(MCQ - PE.16/ Incs.04.3/ Incs.06.3 / Incs.24.2/ Incs.24.4/ Incs.42.5 / Incs.44.4/ Incs.45.2/ Incs.55.1)

Chart





Applicability of Clause 8

- It is applicable to all audits (Previously held by Chartered Accountant)
  - Voluntary Audit (Proprietorship Audit/ Partnership Audit)
  - Statutory Audit (Company Audit /Trust Audit /Co-Operative Society Audit /Bank Audit etc.)
  - Cost Audit
  - Internal Audit
  - Concurrent Audit
  - Government Company Audit
  - Branch Audit
  - Environment Audit
  - Quality Audit etc.

Not applicable to

- Bookkeeping / Certification / Consultancy
- Special Audit under Multi State Co-operative / Special Audit under Income Tax Act Under Section 142 (2A)
- Where earlier auditor was not CA.

Steps

- ***Step 1 – Appointment Letter Received from Client***

  Whether entity has informed previous auditor, if not then enquire with entity regarding reason for change of auditor, if there is no valid reason then it will be healthy practice not to accept such audit.

- ***Step 2 – Communication with previous auditor***
  - Communication should be prior to accepting audit.
  - It should be in writing.
  - By R.P.A.D (Registered Post Acknowledgement Due) or by hand against an acknowledgement in writing. Not under; certificate of posting, speed post, private courier etc
  - **Mode of Communication:** Members should communicate with a retiring auditor in such a manner as to retain in their hands positive evidence of the delivery of the communication to the addressee. In the opinion of the Council, the following would in the normal course provide such evidence:-

    (a) Communication by a letter sent through "Registered Acknowledgement due", or

    (b) By hand against a written acknowledgement, or

    (c) Acknowledgement of the communication from retiring auditor's vide email address registered with the Institute or his last known official email address, or

    (d) Unique Identification Number (UDIN) generated on UDIN portal (subject to separate guidelines to be issued by the Council in this regard)
  - **Premises found Locked:** The communication received back by the Incoming Auditor with "Office found Locked" written on the Acknowledgement Due shall be deemed as having been delivered to the retiring auditor.
  - **Firm not found at the given Registered address:** If the Communication sent by the Incoming auditor is received back with remarks "No such office exists at this address", and the address of communication is the same as registered with the Institute on the date of dispatch, the letter will be deemed to be delivered, unless the retiring auditor proves that it was not really served and that he was not responsible for such non-service.
  - Even if no tax audit was conducted in last year then also CA should communicate with whoever was last auditor during previous years.
  - No communication is required in case of death of previous auditor, However CA may be required to get a letter from the entity to confirm the factum of death of previous auditor.
  - In case of companies as per company act 2013, concept of acceptance after appointment is removed instead consent is taken before appointment in such case now communication should take place before sending consent.
- ***Step 3 – Reply of previous auditor***
  - It is responsibility of previous auditor to reply communication in writing.
  - If he doesn't reply, then we have to wait for reasonable time and then we can go ahead with acceptance.
  - If he has sent back objections, then we have to scrutinize reasons.
    - Non-compliance of provisions of Section 139 (Previously Sec 224) & Section 140 (Previously 225) of Companies Act.
    - Non-payment of undisputed audit fee (except sick units)

      Terms undisputed audit fee and sick unit is discussed in council guidelines 2008 which we will study latter

- Issuance of qualified report--CA may accept if he thinks that attitude of retiring auditor wasn't proper & justified. However, if retiring auditor qualified it for good & valid reasons, incoming should refuse.

- **Step 4 - Acceptance letter sent to client**
  - It is sent after analyzing reply or waiting for reasonable time schedule.
  - yet in the case of audit of government, Companies/ banks or their branches In case there is tight time schedule, he may immediately accept audit on conditional basis, subject to reply of previous auditor.

Clause 8 From Bare Act

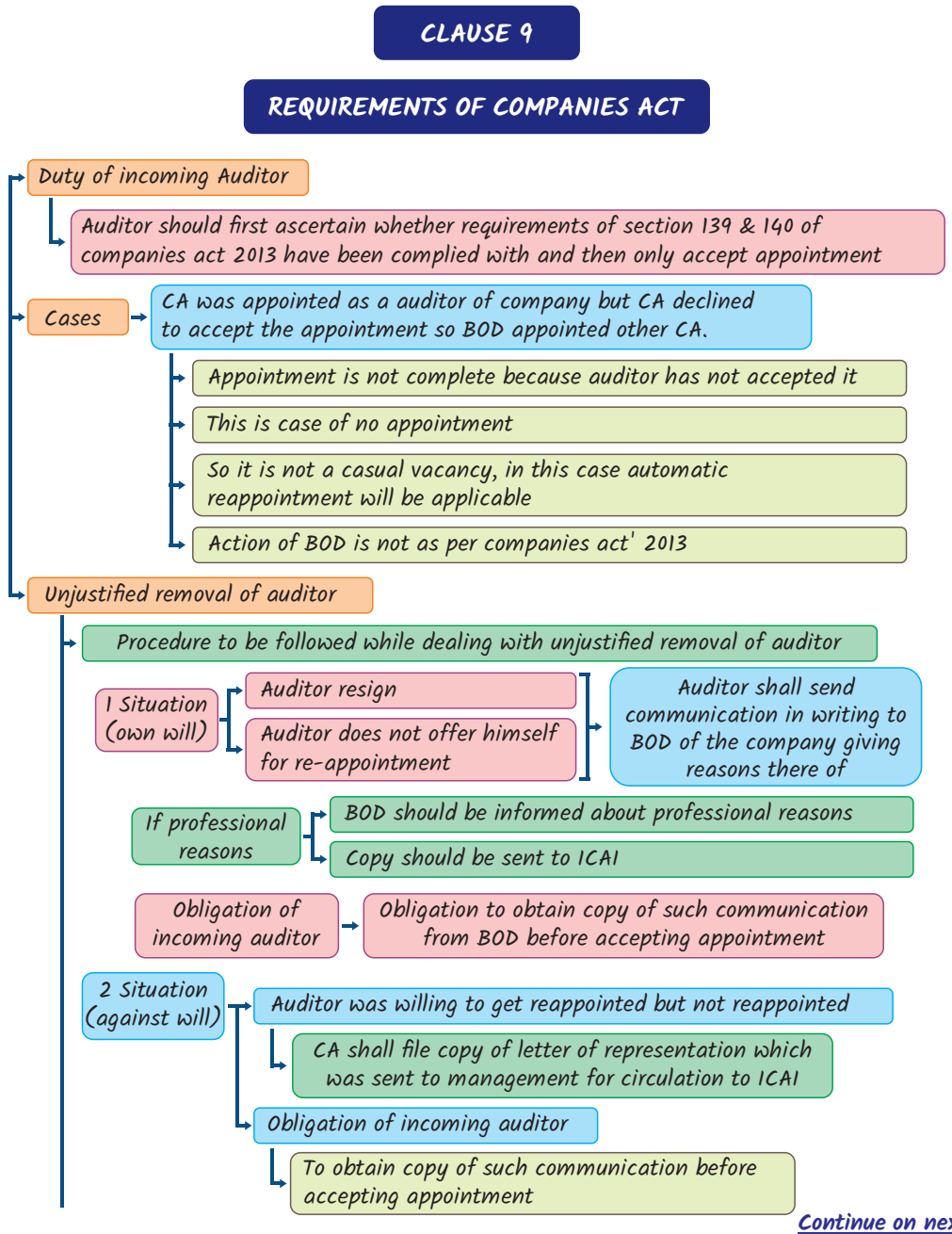
(Try to write all the contents as given in below clause, to cram language is difficult for few, it's not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is 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**
-

(CNO—PE.740) CLAUSE 9 - ASCERTAIN WHETHER REQUIREMENTS OF COMPANIES ACT ARE COMPLIED (QNO- 704.600/ 705.000/ 706.000)

Chart



Continue on next Page...

- Responsibility of Ethical standard Board
  - ESB should review communication in situation 1 & 2 as discussed above
  - ESB may ask for more information from incoming auditor / outgoing auditor / company
  - And then make a report for council Of ICAI as necessary
- Removal of auditor by govt & other statutory authorities
  - Same procedure as discussed above (2nd situation) will be applied.

Clause 9 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, it's not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- **Accepts an appointment as auditor of a company**
- **without first ascertaining from it**
- **whether the requirements of Section 225 of the Companies Act, 1956, in respect of such appointment have been duly complied with (now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013)**

Unjustified Removal of Auditor (MCQ – Incs.41.5 / Incs.55.2)

Unjustified removal of auditors : In order to examine various ethical issues and safeguard the independence of the Auditors, the Council has set up a Ethical Standards Board (ESB). This Board examines various issues concerning professional ethics governing the members of the Insti tute which are either raised by the members or are taken up based on their importance. The recommendations of the Board are forwarded to the Council for its consideration. This Board is also charged with the responsibility of looking into the cases of removal and resignation of auditors and making an appropriate report to the Council.

The following guidelines have been issued for the Board for looking into the cases of Removal of Auditors:

A. Where an auditor resigns his appointment as an auditor of a Company or does not offer himself for reappointment as auditor of such Company, he shall send a communication, in writing, to the Board of Directors of the Company giving reasons therefor, if he considers that
there are professional reasons connected with his resignation or not offering himself for reappointment which, in his opinion, should be brought to the notice of the Board of Directors, and shall send a copy of such communication to the Institute. It shall be obligatory on the incoming auditor, before accepting appointment, to obtain a copy of such communication from the Board of Directors and consider the same before accepting the appointment.

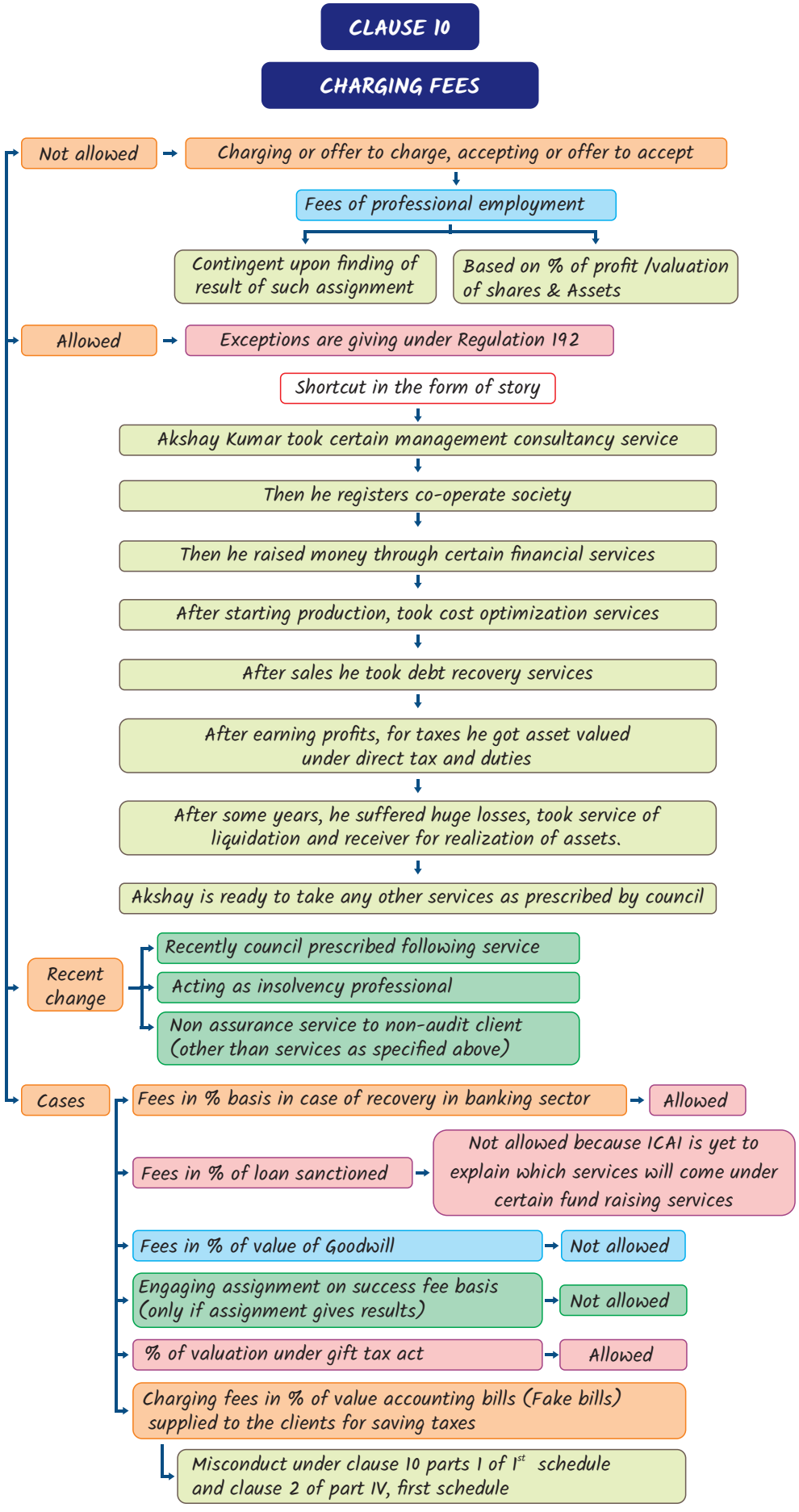
B. Where an auditor, though willing for re-appointment has not been reappointed, he shall
file with the Institute a copy of the statement which he may have sent to the management of the Company for circulation among the shareholders. It shall be obligatory on the incoming auditor before accepting the appointment, to obtain a copy of such a communication from the Company and consider it, before accepting the appointment.

C. The Ethical Standards Board, on a review of the communications referred to in paras (A) and (B), may call for such further information as it may require from the incoming auditor, the outgoing auditor and the Company and make a report to the Council in cases where it considers necessary.

D. The above procedure is also followed in the case of removal of auditors by the government and other statutory authorities.

(CNO—PE.760) CLAUSE 10 (Charging Fees?) (QNO-707.000/707.020/709.000) (MCQ-Incs.01.4 / Incs.27.1)

Chart



Clause 10 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- ***Charges or offers to charge, accepts or offers to accept***
- ***in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment,***
- ***except as permitted under any regulations made under this Act***

Regulation 192

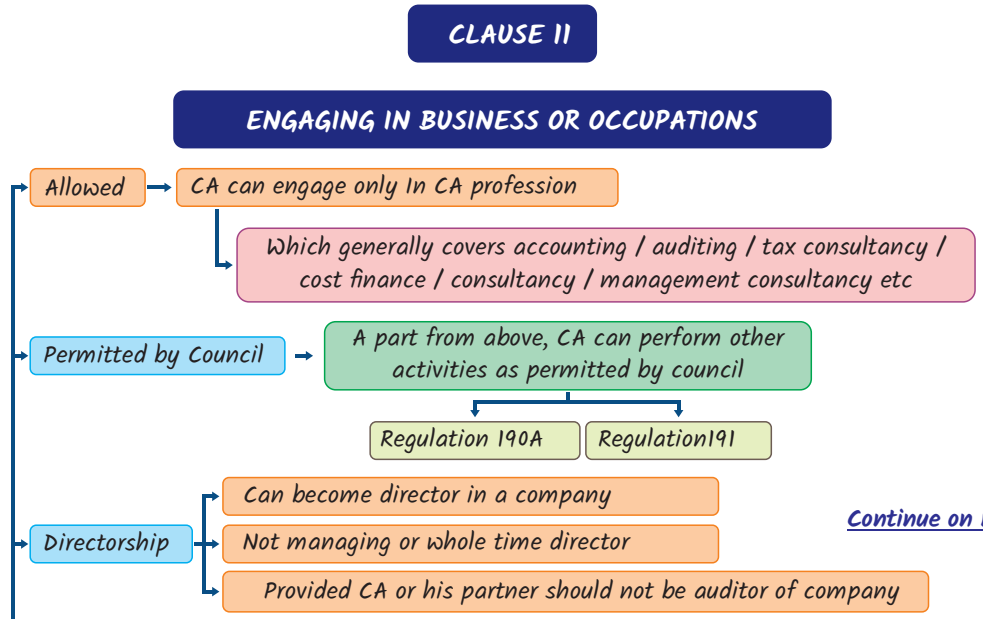
- *No Chartered Accountant in practice shall charge or offer to charge, accept or offer to accept, in respect of any professional work, fees which are based on a percentage of profits, or which are contingent upon the findings or results of such work, provided that:*
  - *a) in the case of **certain management consultancy services** as may be decided by the resolution of the Council from time to time, the fees may be based on percentage basis which may be contingent upon the findings, or results of such work;*
  - *b) In the case of an auditor of a co-operative society, the fees may be based on a percentage of the paid-up capital or the working capital or the gross or net income or profits;*
  - *c) in the case of certain fund-raising services, the fees may be based on a percentage of the fund raised;*
  - *d) in the case of services related to cost optimisation, the fees may be based on a percentage of the benefit derived; and*
  - *e) in the case of debt recovery services, the fees may be based on a percentage of the debt recovered;*
  - *f) In the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of property valued*
  - *g) "In the case of a receiver or a liquidator, the fees may be based on a percentage of the realization or disbursement of the assets.*
  - *h) any other service or audit as may be decided by the Council.*

  [Following activities have been decided by the Council under "h" above :-
  - *(I) Acting as Insolvency Professional;*
  - *(ii) Non-Assurance Services to Non-Audit Clients]*

(CNO—PE.780) CLAUSE 11 - BUSINESS OR OCCUPATION (QNO-666.000/ 668.100/ 711.000/ 712.000/ 712.500/ 713.000/ 713.500/ 713.600/ 714.000 / 714.500 / 715.000 / 716.000 / 717.000/ 717.500 / 719.000 / 720.000 / 721.000 / 721.500)

(MCQ-Incs.06.2 / Incs.11.5 / Incs-58.4)

Chart



Continue on next Page...

Regulation 190A

Permission granted generally

CA can engage into following activities without any specific permission from council

Shortcut – **SERVE CAMEL** in **PAIN**

- **S** – Acting as **S**urveyor / Loss assessor under insurance act.
- **E** – **E**mployment under CA / CA firm (In practice)
- **R** – **R**ecovery consultant in banking sector
- **V** – **V**aluation of paper, Paper setter, head examiner or moderator for any exam
- **E** – **E**ditorship of professional journal.
- **C** – Attending **C**lass and appearing in any exams, (articleship of CS)
- **A** – **A**uthorship of books / articles
- **M** – Holding public elective office (MP, MLA)
- **E** – Honorary office of charitable **E**ducational Institute or any other non-commercial org
- **L** – Holding **L**ife insurance agency license (only for limited purpose of getting renewal commission)
- **P** – **P**rivate tutorship
- **A** – Owing **A**gricultural land and carrying agricultural activity
- **I** – Part time tutorship under coaching organization of **I**nstitute
- **N** – **N**otary public, Justice peace, special executive magistrate

Specific permission prior approval from council required

Shortcut - **LEMON FEE**^{2}

- **L** – Part time or full time **L**ectureship for courses other than those relating to the / Institute examination conducted, under the auspices of the institute or the regional councils or their branches
- **O** – Apart from those discussed here, Any **O**ther business or occupation for which the Executive Committee considers that permission may be granted.
- **N** – Full-time or part-time employment in **N**on-business concern.
- **E** – Full-time or part-time **E**mployment in business concern provided that the member and/or his relatives do not hold "substantial interest" in such concern".
- **E** – Part-time or full-time tutorship under any **E**ducational institution other than the coaching organization of the Institute.
- **F** – Interest in **F**amily business concern or concern in which interests has been acquired as a result of relationships and in the management of which no active part is taken.
- **E** – Interest in an **E**ducational institution.
- **M** – Office of **M**anaging director or a whole-time director or body corporate within the meaning of the Companies Act, 2013 provided that the member and/or any of his relatives do not hold substantial interest in such concern
- **E** – **E**ditorship of journals other than professional journals.

Note:– Specific Permission

Council may refuse to give permission in individual cases, even if it is covered in list of specific permission.

Continue on next Page...

→ Regulation 191 → Part time employment a CA in practice may accept

- Company related (In the sequence of power)
  - Administrator
  - Liquidator
  - Receiver
  - Arbitrator
  - Advisor or representative for costing, Financial, taxation matter
- Other
  - Trustee
  - Executor
- Govt related
  - Appointment by CG / SG / Court
  - Act as secretary

Note:- Provided all above arrangements should not be on salary cum full time basis

PART TIME PRACTICE

CA's doing following activities will be considered in part time practice

Shortcut – **SET**

- **S** – CA's who have taken **s**pecific permission for any activity as discussed above will be considered in part time practice
- **E** – CA's who are in **E**mployment in CA or CA firm under general permission will be in part time practice.
- **T** – CA's who are involved in **T**eaching in the form of private tutorship, part time tutorship under CA institute part time or fulltime tutorship under coaching organization or lectureship will be considered in part time practice if teaching hours exceed 25 hours a week

Note:- CA's in part time practice will not be allowed to perform attest function (sign reports, certificates) and they will not be allowed to train articles.

EXPLANATION

- Relative → Means husband, wife, brother, sister any lineal ascendant or descendant of CA
- Substantial Interest
  - In case of company
    - 20% or more of voting power at any point of time is held by CA or relatives or any concern in which they are having substantial interest.
  - In case of other concern
    - 20% or more of the profits are entitled to CA or relatives or any concern in which they are having substantial interest
- Deemed to be M.D / W.T.D → Where a person is not designated as MD / WTD, he can be deemed MD / WTD, If he is interested in whole or substantially the whole of the management of affairs of the company.

CLARIFICATIONS ISSUED UNDER CLAUSE II

- Director related points
  - Director / Simplicitor
    - Ordinary / Simple director who is not WTD / MD
    - Who attends only board meetings and not paid any remuneration except fees for attending such meeting
    - Permission → No specific permission is required from ICAI as this thing is allowed in clause itself. Provided CA or his partners are not Auditors in the Company and its fine if relatives hold substantial interest in that company
  - Can auditors of subsidiary company become director of holding company
    - ESB (Ethical standard board) has clarified that auditor of subsidiary company cannot become auditor of holding company as it will affect independence of auditors
  - Promoter / Promoter Director
    - CA can become Promoter / Promoter Director of company
    - CA can be signatory to MOA / AOA of any company
- Member in practice in HUF doing business
  - CA can hold interest in HUF
  - Provide evidence that interest in family business, devolved on CA as a result of inheritance / succession / partition of family business
  - Show that CA was not actively engaged in carrying on the business
  - Prove that this business was not created by himself
  - Furnish in prescribed format, documents acting as evidence to concerned de-centralized office of ICAI
  - CA can acquire interest in the family business in following form
    - As a proprietary firm
    - As a partnership firm
    - Karta or member of HUF
- Trading Activity by CA in practice
  - Equity / Derivative
    - Personal Capacity (Individual level) → Allowed
    - Professional Capacity (on behalf of clients) → Not Allowed
  - Commodity Derivatives → Not allowed in any Capacity

CASES UNDER CLAUSE II

Guilty of professional misconduct

- Doing business without permission.
- Becoming executive chairman without permission
- Becoming employee without permission
- Becoming LIC agent
- Becoming partner of Brother in business without permission
- Becoming fulltime lecture in college without permission
- Doing trading in commodities derivatives which is not allowed in general permission

RECENT DECISIONS

Shortcut – False Clever Dreams

F	Financial Adviser → Receiving fess / Commission → From MFs / Insu Co/ NBFCs	Not Allowed
C	Holding Custom Broker Licence	Not Allowed
D	Director V/s 149(3) Residing in india for 182 days in Previous Calender year	Allowed
R	Registration Authority for Digital Signature (Facilitates in obtaining DSC)	Allowed
E	Equity research Adviser	Allowed
	Publishing retail report (Buying / selling recommendations to retail investors)	Not Allowed
A	Agencies of UTI/ GIC/ NSDL	Not Allowed
M	Mediators in court (Like Arbitrator)	Allowed
S	Settler of trust (Creator of trust)	Allowed

Clause II From Bare Act (MCQ- Incs.30.5, Incs.40.2)

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he

- **Engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. (190A/191)**
- **Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company (Not being managing director or a whole time director) unless he or any**

Regulations

The Council, on a very careful consideration of the matter, has formulated Regulation, 190A and 191 which are reproduced below, specifying the activities with which a member in practice can associate himself with or without the permission of the Council.

Regulation 190A

190A. Chartered Accountant in practice not to engage in any other business or occupation. "A chartered accountant in practice not to engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council".

Permission granted generally

Members of the Institute in practice be generally permitted to engage in the following categories of occupations, for which no specific permission from the Council would be necessary in individual cases:

(1) Employment under Chartered Accountants in practice or firms of such chartered accountants.
(2) Private tutorship.
(3) Authorship of books and articles.
(4) Holding of Life Insurance Agency License for the limited purpose of getting renewal commission.
(5) Attending classes and appearing for any examination.
(6) Holding of public elective offices such as M.P., M.L.A. and M.L.C.
(7) Honorary office leadership of charitable-educational or other non-commercial organisations.
(8) Acting as Notary Public, Justice of the Peace, Special Executive Magistrate and the like.
(9) Part-time tutorship under the coaching organisation of the Institute.
(10) Valuation of papers, acting as paper-setter, head-examiner or a moderator, for any examination.
(11) Editorship of professional journals.
(12) Acting as Surveyor and Loss Assessor under the Insurance Act, 1938 provided they are otherwise eligible.
(13) Acting as recovery consultant in the banking sector
(14) Owning agricultural land and carrying out agricultural activity (w.e.f. August 9th, 2008).

Specific Resolution

Members of the Institute in practice may engage in the following categories of business or occupations, after obtaining the specific and prior approval of the Council in each case:

(1) Full-time or part-time employment in business concerns provided that the member and/or his relatives do not hold "substantial interest" in such concerns.
(2) Full-time or part-time employment in non-business concern.
(3) Office of managing director or a whole-time director of a body corporate within the meaning of the Companies Act, 1956 (now Companies Act, 2013) provided that the member and/or any of his relatives do not hold substantial interest in such concern.
(4) Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken.
(5) Interest in an educational institution.
(6) Part-time or full-time lectureship for courses other than those relating to the Institute's examinations conducted under the auspices of the Institute or the Regional councils or their branches.
(7) Part-time or full-time tutorship under any educational institution other than the coaching organization of the Institute.
(8) Editorship of journals other than professional journals.
(9) Any other business or occupation for which the Executive Committee considers that permission may be granted.

However, it is open to the Council to refuse permission in individual cases though covered under any of the above categories. For the purpose of the above resolution:

(i) the expression "relative", in relation to a member, means the husband, wife, brother or sister or any lineal ascendant or descendant of that member;
(ii) a member shall be deemed to have a "substantial interest" in a concern -

(i) in a case where the concern is a Company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of voting power at any time, during the relevant years are owned beneficially by such member or by any one or more of the following persons or partly by such member and partly by one or more of the following persons:

(a) One or more relatives of the member;
(b) Any concerns in which any of the persons referred to above has a substantial interest;

(ii) in the case of any other concern, if such member is entitled or the other persons referred to above or such member and one or more of the other persons referred to above are entitled in the aggregate, at any time during the relevant years to not less than twenty percent of the profits of such concern.

Regulation 191

Part-time employment a Chartered Accountant in practice may accept.

"Notwithstanding anything contained in Regulation 190A but subject to the control of the Council, a Chartered Accountant in practice may act as a liquidator, trustee, executor, administrator, arbitrator, receiver, adviser or representative for costing, financial or taxation matter, or may take up an appointment that may be made by the Central Government or a State Government or a court of law or any other legal authority or may act as a Secretary in his professional capacity, provided his employment is not on a

Clarifications

Director of a Company

(i) The expression "Director Simplicitor" means an ordinary / simple Director who is not a Managing Director or Whole time Director and is required only in the Board Meetings of the company and not paid any remuneration except for attending such meetings.

(ii) A member in practice is permitted generally to be a Director Simplicitor in any Company including a board-managed Company and as such he is not required to obtain any specific permission of the Council in this behalf unless he or any of his partners is interested in such Company as an auditor, irrespective of whether he and/or his relatives hold substantial interest in that Company.

A question arises, whether the auditor of a Subsidiary Company can be a Director of its Holding Company –

The Ethical Standard Board (ESB) noted that, in terms of Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 a Chartered Accountant in practice cannot engage (unless permitted by the Council so to engage) in any business or occupation other that the profession of Chartered Accountant but he can be a director of a Company (not being a managing director or whole-time director) wherein he or any of his partners is not interested in such company as an auditor. The Board further noted that Public conscience is expected to be ahead of the law. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence. In view of the above, the Board, via a clarification, decided that the auditor of a Subsidiary Company can't be a Director of its Holding Company, as it will affect the independence of an auditor.

***(b) Promoter/Promoter Director** – There is no bar for a member to be a promoter / signatory to the Memorandum and Articles of Association of any company. There is also no bar for such a promoter / signatory to be a Director Simplicitor of that company irrespective of whether the object of the company include areas which fall within the scope of the profession of Chartered Accountants Therefore, members are not required to obtain specific permission of the Council in such cases. It must be clarified that under Section 25 of the Chartered Accountants Act, no Company can practiseas a Chartered Accountant.*

***(c) Member in practice in a HUF doing business** – "A member of the Institute can acquire interest in family business in any of the following manner:*

(i) as a proprietary firm
(ii) as a partnership firm
(iii) in the name and style of Hindu Undivided Family as its Karta or a member.

It would be necessary for the members to provide evidence that interest in the family businessconcern devolved on him as a result of inheritance/succession/partition of the family business. It is also necessary for the member to show that he was not actively engaged in carrying on the said business and that the family business concern in question was not created by himself.

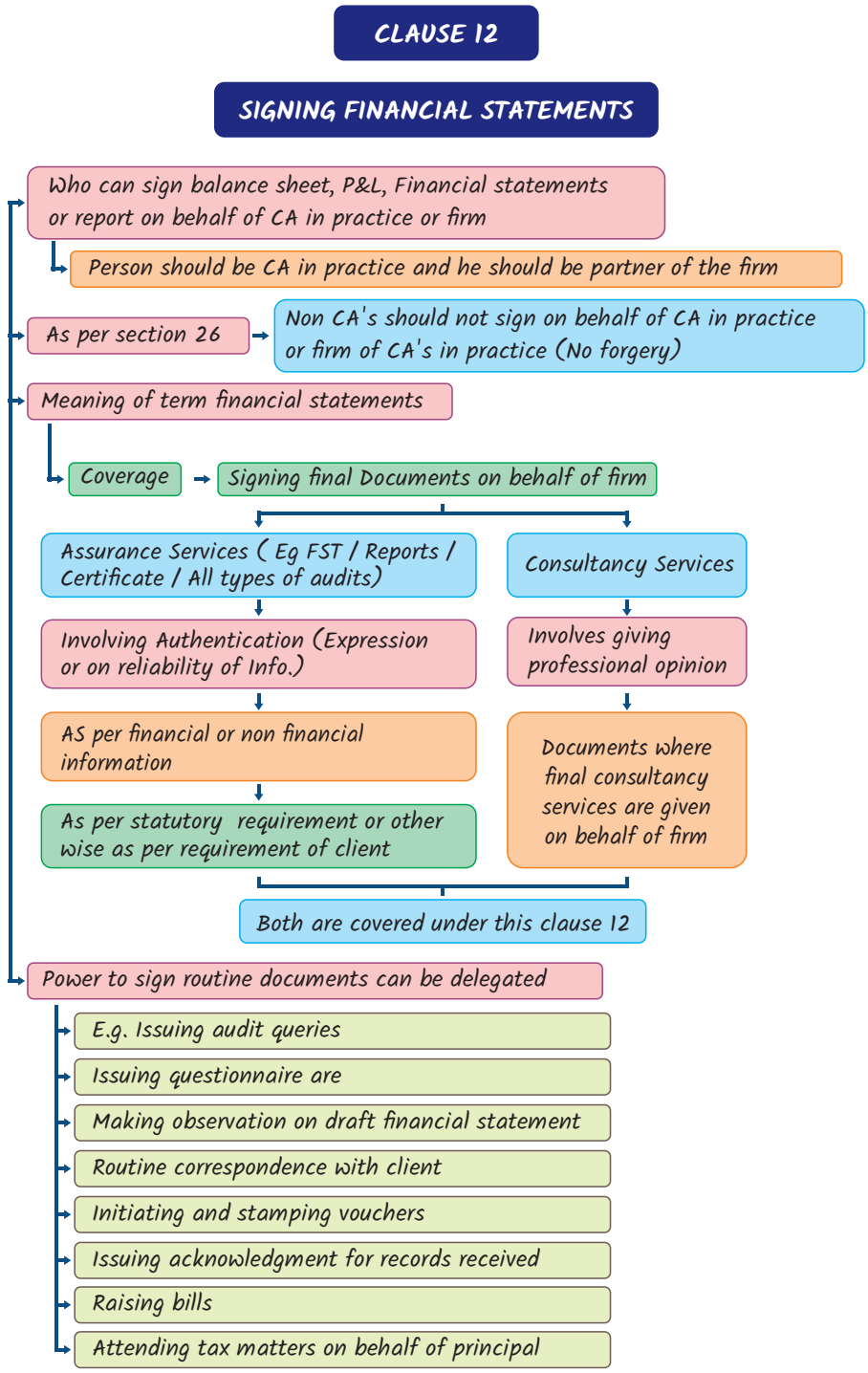
To establish his case, the member should furnish a declaration in the prescribed format and the documents evidencing above for consideration to the concerned Decentralized Office."

A member in practice engaged as Karta of a HUF doing family business, will be within the limit prescribed by Council if he makes investments from the funds pertaining to HUF only, provided, heis not actively engaged in the management of the said business.

Students may also note that as per decision taken by appropriate authority in Council, Regulation 190A of the Chartered Accountants Regulations, 1988 provides that a chartered accountant in practice shall not engage in any business or occupation other than the profession of accountancy, except with the permission granted in accordance with a resolution of the Council. The Council has
passed a Resolution under Regulation 190A granting general permission (for private tutorship, and part-time tutorship under Coaching organization of the Institute) and specific permission (for part - time or full-time tutorship under any educational institution other than Coaching organization of the Institute). Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should not exceed 25 hours a week in order to be able to undertake attest functions.

(CNO—PE.800) CLAUSE 12 (QNO-722.000/723.000/724.000/724.500)

Chart



Clause 12 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- **Allows a person**
- **not being**
  - **a member of the institute in practice or**
  - **a member not being his partner**
- **to sign on his behalf or on behalf of his firm,**
- **any balance sheet, profit and loss account, report or financial statements.**

Discussion

This clause is to be read in conjunction with Section 26 of the Chartered Accountants Act, 1949 which stipulates that 'No person other than a member of the Institute shall sign any document on behalf of a Chartered Accountant in practice or a firm of Chartered Accountants in his or its professional capacity'.

The term 'financial statement' for the purposes of this clause would cover an examination of the accounts or of financial statements given under a statutory enactment or otherwise. A report, however, may cover a wider range of documents but in the context in which it is used in this clause, it would mean only a report arising out of a professional assignment undertaken by him or his firm and submitted by him or his firm to the client(s) or where so required, to an outsider on behalf of himself or on behalf of the firm. The subject matter of report should be the expression of a professional opinion whether, financial or non-financial. The financial statements and the reports referred to in this clause obviously means the financial statements and reports as ultimately finalized and submitted to the outside authorities.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

(i) Issue of audit queries during the course of audit.
(ii) Asking for information or issue of questionnaire.
(iii) Letter forwarding draft observations/financial statements.
(iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
(v) Acknowledging and carrying on routine correspondence with clients.
(vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
(vii) Issuing acknowledgements for records produced.
(viii) Raising of bills and issuing acknowledgements for money receipts.
(ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
(x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

It is also clarified that where the authority to sign documents given above is delegated by a chartered accountant or by a firm of chartered accountants the fact that the documents have not been signed by a chartered accountant is not a defence to him or to the firm in an enquiry relating to professional misconduct.

FIRST SCHEDULE – PART II

FIRST SCHEDULE

PART – II

Professional misconduct in relation to CA's in SERVICE

(CNO—PE.820) CLAUSE 1

(MCQ – Incs.24.3)

- Clause 1
  - Not allowed → To pay or allows to pay, or to deduct or allowed to deduct
    - ↓ Any share in emoluments of the employment
  - Allowed → Sharing of emoluments among relatives, friends, dependents it will be considered as application of income provided such sharing is not related to procuring or securing the job

Clause 1 From Bare Act

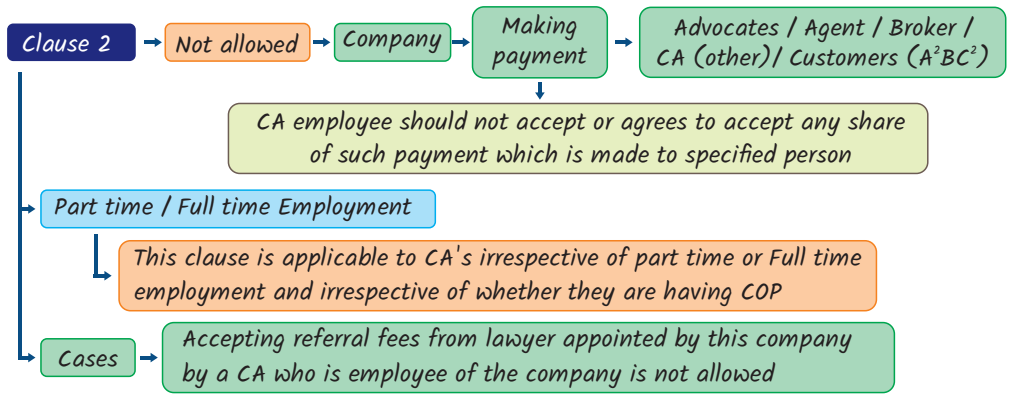
(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if

- *he being an employee of any company, firm or person*
- *pays or allows or agrees to pay directly or indirectly to any person*
- *any share in the emoluments of the employment undertaken by him.*

(CNO—PE.840) Clause 2 (QNO-729.000)

Chart



Clause 2 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if

- ***he being an employee of any company, firm or person***
- ***accepts or agrees to accept any part of fees, profits or gains***
- ***from a lawyer, a chartered accountant or broker engaged by such company, firm or person or***

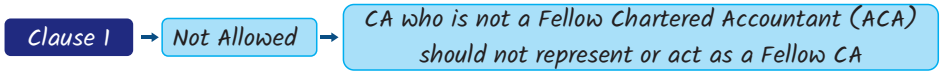
FIRST SCHEDULE - PART III

FIRST SCHEDULE

PART - III

Professional misconduct in relation to CA's in GENERAL (either in practice or service)

(CNO—PE.860) CLAUSE 1 (MCQ-PE.17)



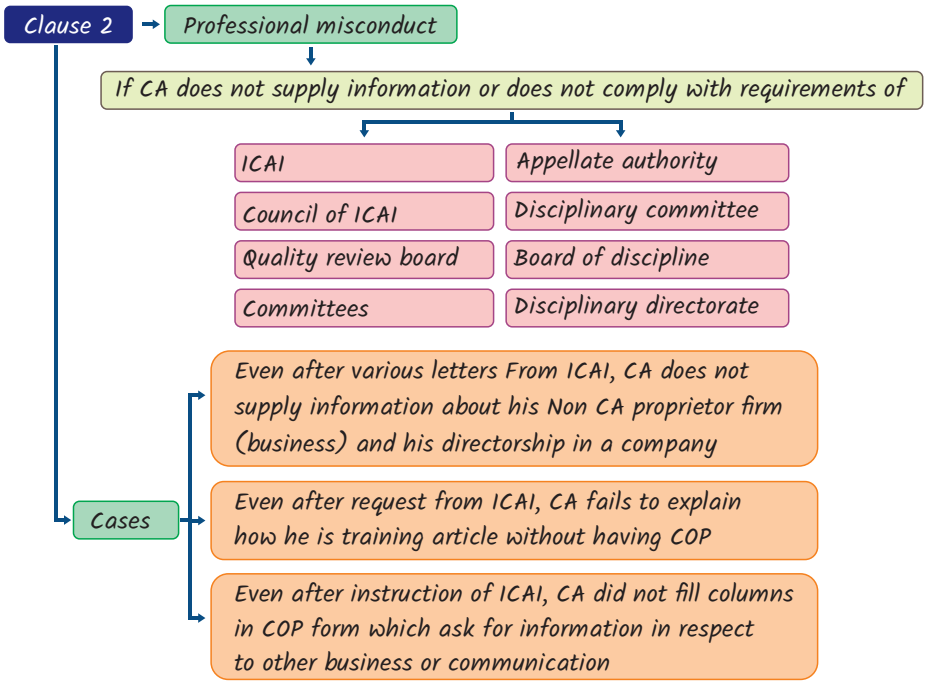
Clause 1 from Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he

- ***not being a fellow of the Institute, acts as a fellow of the Institute***

(CNO—PE.880) CLAUSE 2 (QNO-730.000/731.000/731.100)



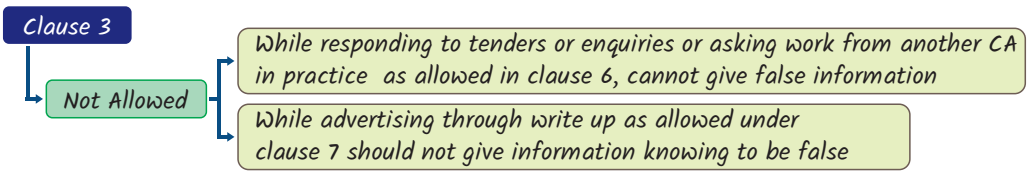
Clause 2 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he –

- **does not supply the information called for, or does not comply with the requirements asked for,**
- **by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline,**

(CNO—PE.900) Clause 3



Clause 3 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he

- **while inviting professional work from another chartered accountant or**
- **while responding to tenders or enquiries or**
- **while advertising through a write up, or**
- **anything as provided for in items (6) and (7) of Part I of this Schedule,**

gives information knowing it to be false

FIRST SCHEDULE – PART IV (QNO-656.000/737.010)

(CNO—PE.920) CLAUSE 1



CHARTERED ACCOUNTANT → Convicted by Court for Crime → Imprisonment Not Exceeding 6 Months → Other Misconduct

Clause 1 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he –

- **is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months.**

(CNO—PE.940) Clause 2 (QNO-732.000/733.000/735.000/736.000/737.000/754.000) (MCQ-PE.2)



CHARTERED ACCOUNTANT → Activity → Disreputation Of ICAI → Misconduct

Clarification

Sending malicious emails against the Institute or its members, spreading false, misleading or defamatory statements brings disrepute to the profession or the Institute. And it is a misconduct under First Schedule Part IV Clause 2

http://www.icai.org/new_post.html?post_id=11612&c_id=219

1. A chartered accountant was involved in the arbitrage activities and worked as an arbitrageur for which he had not taken prior approval from the Council as contemplated under Item (11) of Part I of First Schedule. The Board of Discipline stated that the said act of the Respondent brought disrepute to the profession of the Chartered Accountancy and held him guilty of professional misconduct falling under Item (11) of Part I and Item (2) of Part IV of First Schedule.	✗
2. A chartered accountant misused his position as an insider to extract more money from the client, threatened and cheated the client, illegally held client's documents, used abusive language against the client and made false legal statements. The Board of Discipline while holding the Respondent guilty of 'Other Misconduct' under Item (2) of Part IV of First Schedule observed that the manner in which the emails were sent by the Respondent which were more in the nature of threatening one's client, the conduct of the Respondent is unbecoming of a Chartered Accountant and the same has brought disrepute to the profession of the Chartered Accountancy.	✗
3. Inappropriate behavior of candidate in elections ? Manifesto / Bribe / Caste religion etc.	✗

Clause	
4. X, a Chartered Accountant availed a loan against his shares held as investments from a nationalized bank. He issued 2 cheques towards repayment of the said loan. Both the cheques were returned back by the bank with the remarks "Refer to Drawer"	✗
5. YKS & Co., a proprietary firm of Chartered Accountants was appointed as concurrent auditor of a bank. YKS used his influence for getting some cheques purchased and thereafter failed to repay the loan/overdraft.	✗
6. Mr. R, a Chartered Accountant in practice approached Manager of a Nationalised Bank for a loan of Rs 25 lakhs. He has also informed the Manager that if the loan is sanctioned, the Income Tax return of the Manager and staff will be filed without charging any fees, as quid Pro quo for the loan sanctioned	✗ ✗
7. Mr. A, a practicing Chartered Accountant, failed to return the books of account and other documents of a client despite many reminders from the client. The client had settled his entire fees dues also.	

Clause 2 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he -

- *in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.*

Part - 3 SECOND SCHEDULE

PICTORIAL OVERVIEW OF SECOND SCHEDULE

Chart

IMAGE RECOGNITION TECHNIQUE OF SECOND SCHEDULE

Second Schedule Part - 1



Chris Gayle
Confidentiality
Clause 1



Rohit Sharma
Report on
Financial
Statements
Clause 2



Flintoff Future
Estimate
Clause 3



Sachin Tendulkar
Substantial
Interest
Clause 4



M S Dhoni
Material Fact Omitted
Clause 5



Motor Car Racing
Material
Misstatement
Clause 6



Golf
Grossly Negligent
Clause 7



Soccer
Sufficient Information
Clause 8



Archery
Audit Procedure
Clause 9



Basket Ball
Bank Account
Clause 10

Second Schedule Part 2



Comedy Nights
Contravene Act/
Regulations/Guidelines
Clause 1



Candy Crush
Confidentiality by
Employee
Clause 2



Facebook False
Information
Clause 3



Mobile Money
Defalcation
Clause 4

Second Schedule Part 3

Over Other Misconduct Clause 1



SECOND SCHEDULE- PART I

Chart

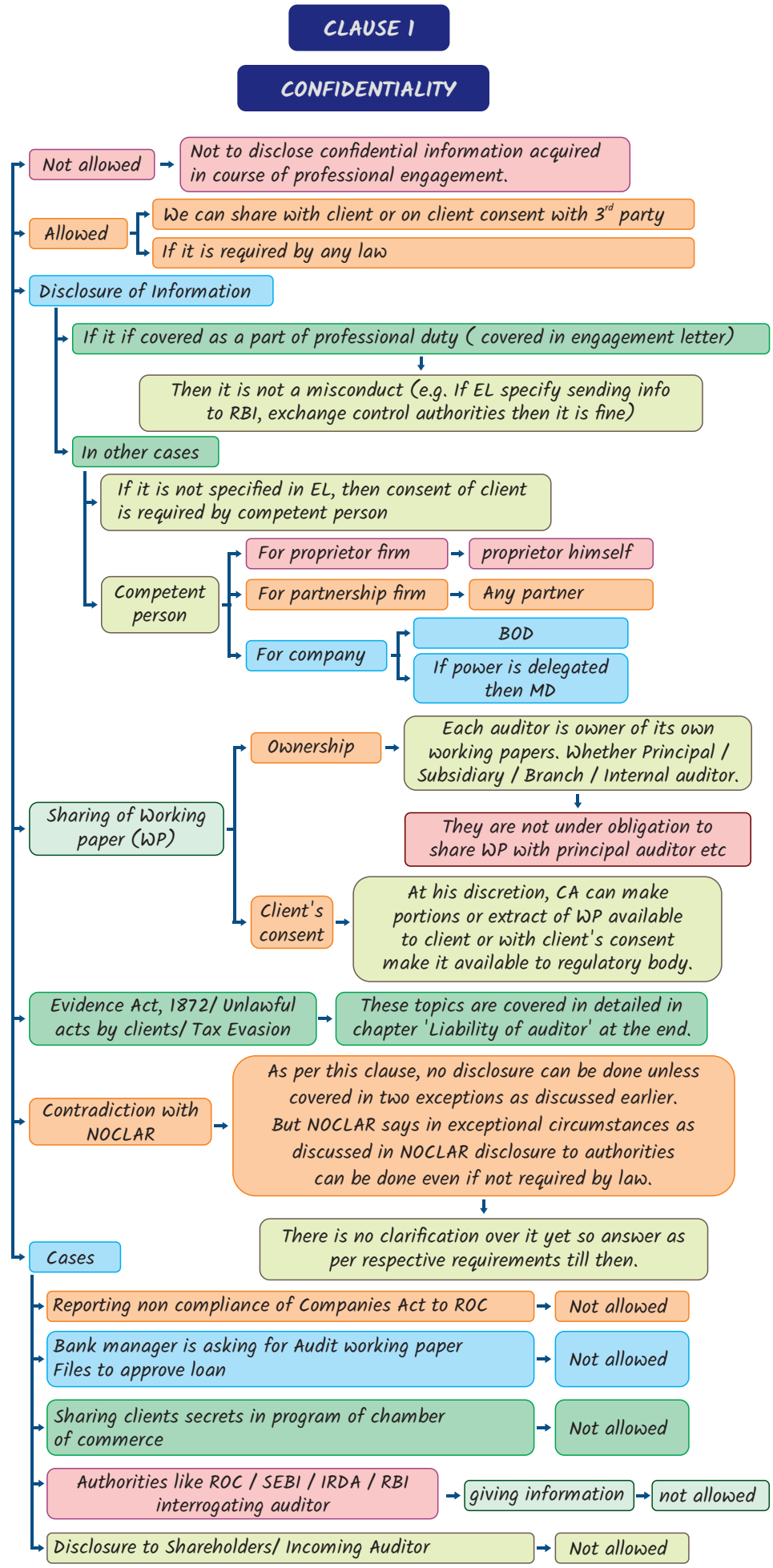
SECOND SCHEDULE

PART - I

Professional misconduct in relation to CA's in PRACTICE

(CNO—PE.960) CLAUSE I (QNO-738.000/739.000) (MCQ-PE.4)

Chart



Clause I From Bare Act

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he

- Discloses Information acquired in the course of his professional engagement to any person other than his client so engaging him.
- without the consent of
  - his client or
  - otherwise than as required by any law for the time being in force.

Discussion

If disclosure is required as a part of performance of professional duty by a practicing member in relation to a client, the fact that such performance is required by the client would itself amount to the client consenting to such disclosure. Thus, a member in practice submitting information to, say, exchange control authorities, while performing his professional duties cannot be considered to have made disclosure without the aforesaid consent. But, in all cases, the request or the initiative that the members does prefer the service, which would entail such disclosure, must come from the client in relation to whose affairs the disclosure would be entailed.

If disclosure is required in other cases, it would be necessary to ensure that the consent of the client is given by a person who is competent to accord such consent. Thus, in the case of a sole proprietary concern, the consent may be given by the proprietor or his constituted attorney who is legally empowered to give such consent. In the case of partnership firm, since in turn, every partner has the authority to bind the firm by his acts, the consent may be given by any partner. In the case of a company, by virtue of section 179 of the Companies Act, 2013, the Board of Directors is empowered to do all that the company in a general meeting may do unless a resolution by the company in general meeting is required by the Act or by the Memorandum or Articles of the company. Hence, the consent may be sought from the Managing Director if the powers of the Board of Directors are delegated to him comprehensively enough to include the power to give such consent, but if the powers of the Board of Directors are not so delegated, the consent should be obtained by means of resolution of the Board of Directors of the Company.

An auditor is not required to provide the client or other auditors of the same enterprise or its related enterprise such as a parent or a subsidiary, **access to his audit working papers.** The main auditors of an enterprise do not have right of access to the audit working papers of the branch auditors. In the case of a company, the statutory auditor has to consider the report of the branch auditor and has a right to seek clarifications and/or to visit the branch if he deems it necessary to do so for the performance of the duties as auditor. An auditor can rely on the work of another auditor, without having any right of access to the audit working papers of the other auditor. For this purpose, the term 'auditor' includes 'internal auditor'.

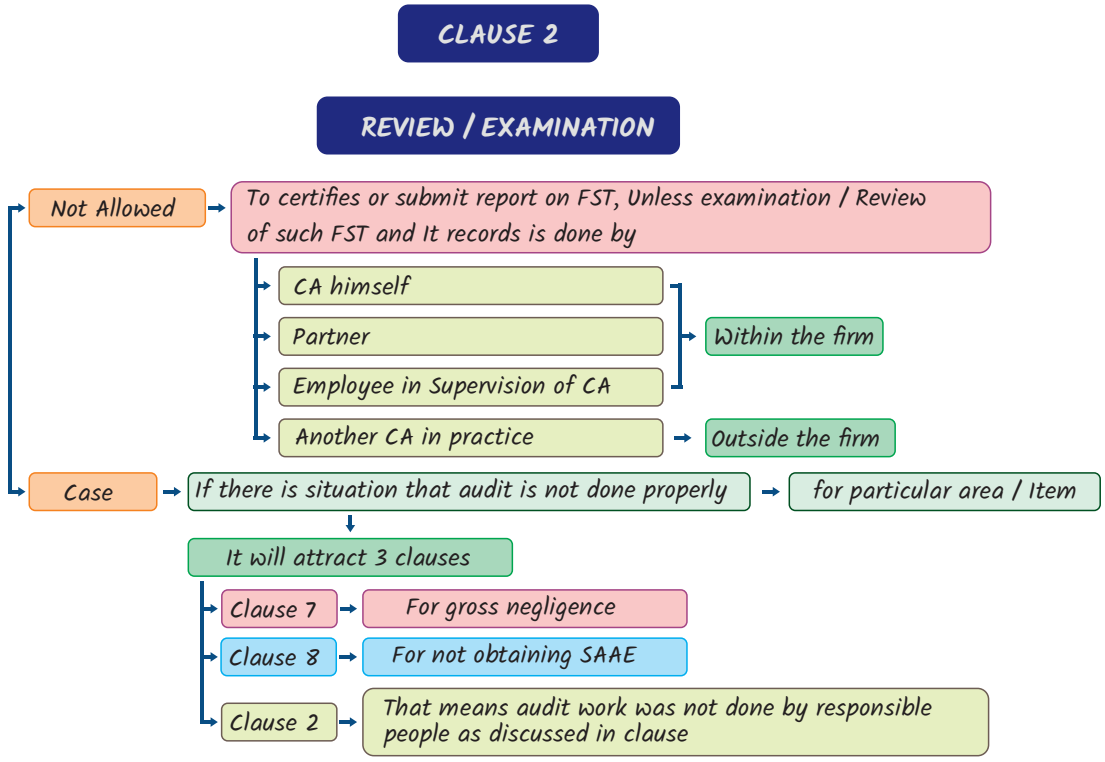
However, the auditor may, at his discretion, in cases considered appropriate by him, make portions of or extracts from his working papers available to the client.

There is a difference between sharing of working papers and sharing of information. So far as the information is concerned, he can provide the same to the client or to a Regulatory body after obtaining the consent of the client.

It is not possible to set out all the circumstances under which disclosure of information may be required by law. If under any legal compulsion and if it is not legally permissible to claim privilege under the Evidence Act, 1872 (Section 126), the disclosure made by a member of such information may not be considered as misconduct. However, such matters involve niceties of law and expert legal advice may be sought prior to such disclosure.

(CNO—PE.980) CLAUSE 2 (QNO-757.000/759.000)

Chart



Clause 2 From Bare Act

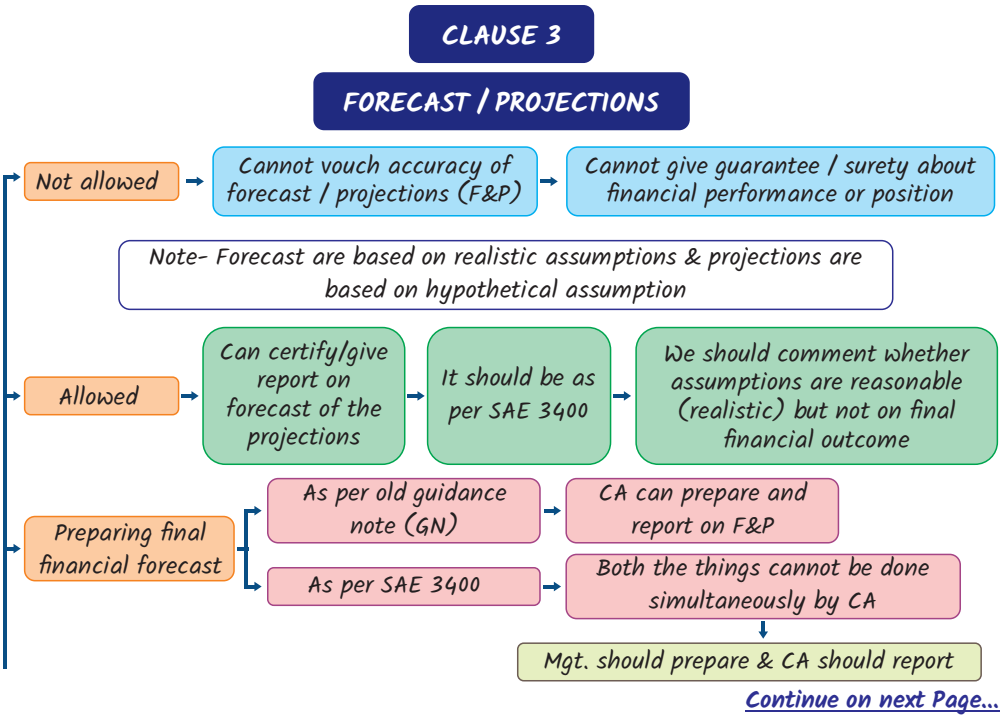
(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he :-

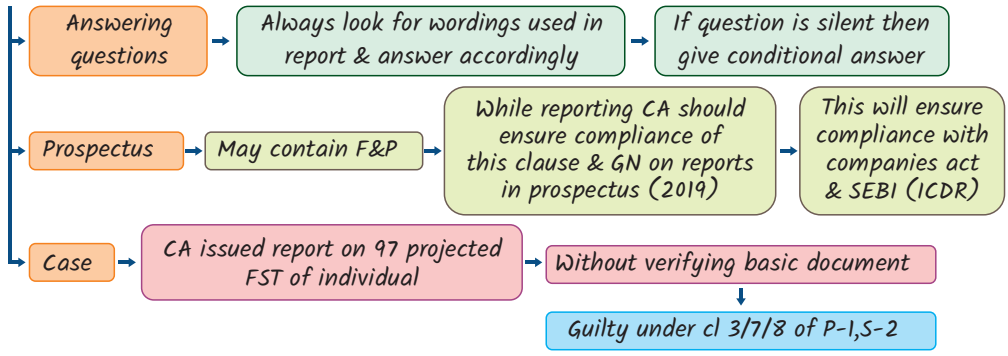
- **If he certifies or submits in his name or in the name of his firm,**
- **a report of an examination of financial statements**
- **unless the examination of such statements and the related records has been made**
  - **by him or**
  - **by a partner or**
  - **an employee in his firm or**

(CNO—PE.1000) CLAUSE 3 (QNO-740.000/741.000/742.000/743.000)

Chart



Continue on next Page...



Clause 3 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he :-

- **Permits his name or the name of his firm**
- **to be used in connection with an estimate of earnings contingent upon future transactions**
- **in manner which may lead to the belief that he vouches for the accuracy of the forecast.**

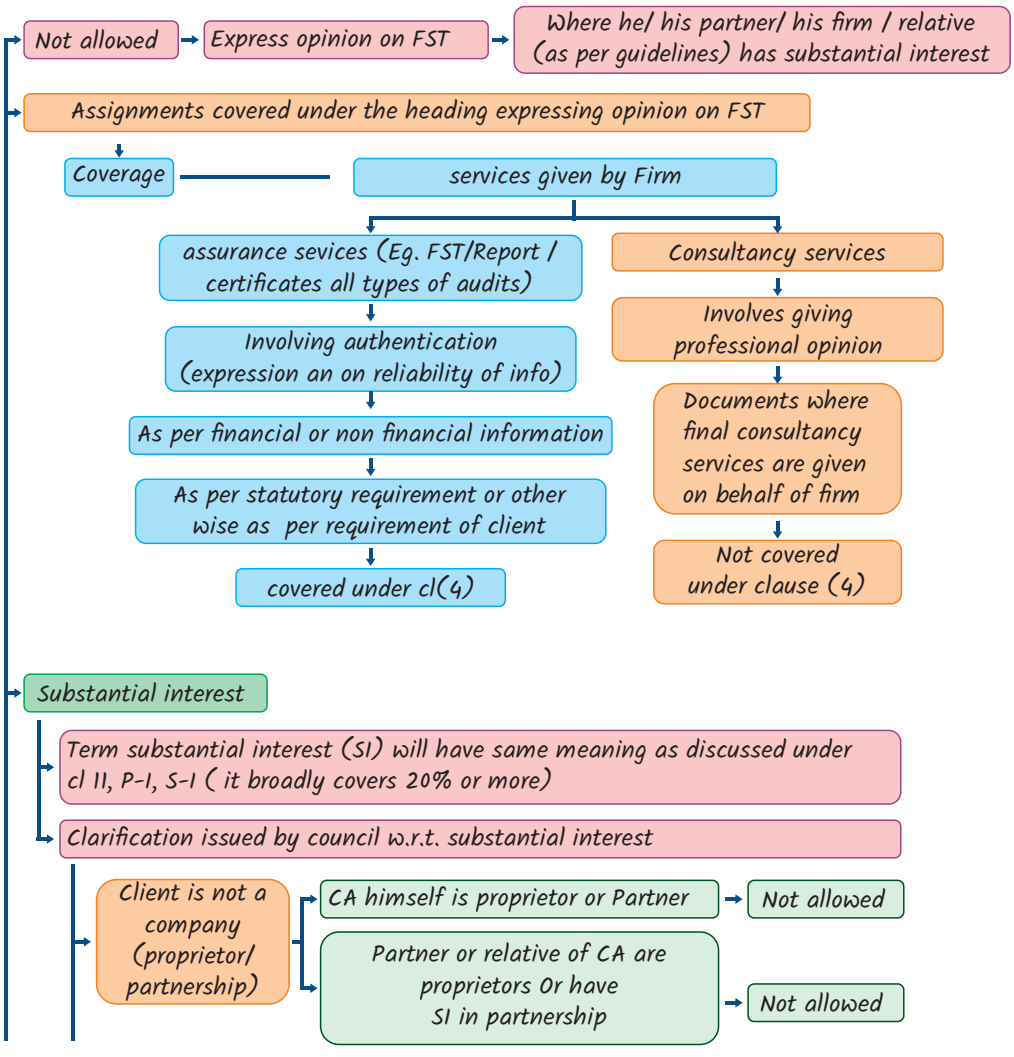
(CNO—PE.1020) CLAUSE 4 **(QNO-744.000/745.000/746.000/747.000/747.050/747.070 / 747.080 / 782.010)**

(MCQ- PE.15, Incs.30.6, Incs.48.4, Incs.51.5)

Chart

CLAUSE 4

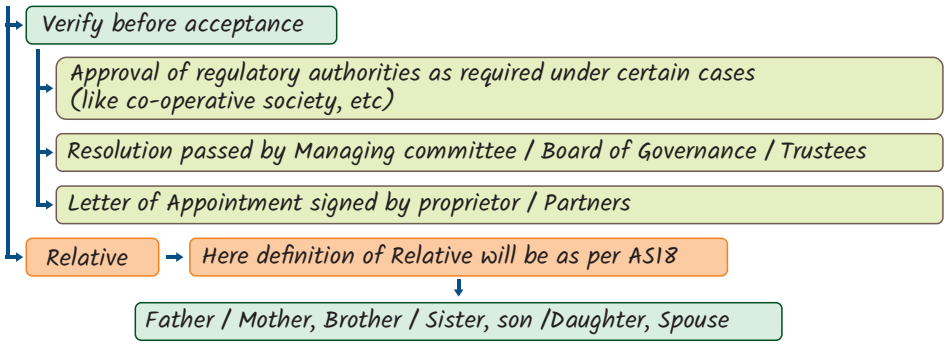
SUBSTANTIAL INTEREST



Continue on next Page...

- Client is a company → ICAI has clarified in following disqualification there is issue of substantial interest
  - Disqualification of officer or employee
  - Disqualification of partner or employee of officer or employee
  - Disqualification of holding security
  - Disqualification of relative being KMP/Director
  - → Not Allowed (Refer, Co. Audit charts for detailed discussion)
- Old Simple Clarification
  - CA part time / full time lecturer → Auditor of college not allowed
  - CA employee → Audit of employer not allowed
  - Partner of CA is trustee / Employee of trust → CA cannot do audit of trust
  - CA is Liquidator → CA cannot do audit of company
  - CA writing books of a/c → Cannot do audit of same enterprise
  - CA Internal auditor → Cannot do
    - Stat audit
    - GST audit
    - Tax audit
    - Cost audit
  - CA leaves directorship → He cannot become auditor for 2 yrs from date of leaving
  - Disqualifications to become tax auditor is given u/s 288 of IT Act
- Recent interesting clarification
  - Statutory auditor related points
    - Stat Auditor can accept system Audit provided it does not involve scrutiny / Review of financial data or Financial info system
    - Stat auditor & tax auditor cannot be valuer of unquoted equity shares
  - Internal auditor related points
    - Internal auditor cannot do accounting of entity
    - Internal auditor of co. can become stat auditor of employee PF trust
    - Internal auditor of employee PF trust cannot become stat auditor in government co. (sensitive position)
  - Bank Auditor related points
    - Stat auditor cannot do concurrent audit
    - Stat auditor of RRB cannot do concurrent audit of sponsor bank
    - Stat auditor cannot do stock audit of same bank or sister concern
    - Stat auditor credit card outstanding amount after due date should not exceed 1 lakh
    - Stat auditor cannot take loan against FD
- Compliances & Verifications before accepting audit
  - Check Compliances before acceptance
    - Statue governing entity
    - Partnership deed/ trust deed/instrument under which entity is constituted

Continue on next Page...



Scope of Word Financial Statement In Clause 4

The words "financial statements" used in this clause would cover both reports and certificates usually given after an examination of the accounts or the financial statement or any attest function under any statutory enactment or for purposes of income-tax assessments.

This would not, however, apply to cases where such statements are prepared by members in employment purely for the information of their respective employers in the normal course of their duties and not meant to be submitted to any outside authority. ***(Not applicable to report on MIS as it is for internal purpose)***

Cases & Remarks

CA Part-time lecturer in a college	He/ his firm not to accept auditor-ship of college.
If CA is employee of concern	He cannot audit financial statements of employer.
A partner of CA is employee/ trustee of trust	CA/ his firm cannot audit financial statements of trust.
CA is appointed as liquidator	He cannot audit statements of Accounts U/s 348 (1) of the Companies Act 2013.
CA is writing books of accounts of the enterprise	He can't audit the financial statements of same enterprise.
CA is internal auditor of a concern	He can't accept statutory auditor ship of same concern.

Clarifications

- ***System Auditor & Valuer***
  - *Whether a statutory* ***auditor*** *can accept the* ***system audit*** *of same entity?*
    Yes, the statutory auditor can accept the assignment of a system audit of the same entity, provided it do not involve any scrutiny/review of financial data and information.
  - *A* ***statutory auditor and tax auditor*** *cannot be* ***valuer of the unquoted equity shares*** *as it would create threats to independence of the auditor, which may not possibly be reduced by application of safeguards.*
- ***Internal Auditor related clarifications***
  - *It is prohibitive to undertake the assignments of* ***internal Audit*** *of a client and entry of the transaction for* ***Accounting*** *simultaneously being violative of the provisions of the `Guidance Note on Independence of Auditors'."*
  - *A CA/CA Firm* ***can act as the internal auditor of a company & statutory auditor of its employees PF Fund*** *under the new Companies Act (2013).*
  - *A CA Firm which has been appointed as the* ***internal auditor of a PF Trust*** *by a Government Company cannot be appointed as its* ***Statutory Auditor.***
- ***Bank Audit related clarifications***
  - ***Concurrent auditor*** *of an entity cannot accept an* ***assignment under any statute***

	which is sponsored by 'X'. *(Many RRBs are sponsored by Indian Banks)* ▪ *A chartered accountant who is the* ***statutory auditor*** *of a bank cannot for the same financial year accept* ***stock audit*** *of the same branch of the bank or any of the branches of the same*
Applicability to all attest functions	*Many new areas of professional work have been added, e.g., Tax Audit, GST Audit, Concurrent Audit of Banks, Concurrent Audit of Borrowers of Financial institutions, Audit of non-corporate borrowers of Banks and Financial Institutions, Audit of Stock Exchange, Brokers, etc. The Council wishes to emphasize that the aforesaid requirement of Clause (4) are equally applicable while performing all types of attest functions by the members.*
Applicability to certification work	*It is not permissible for a member to undertake the assignment of certification, wherein the client is relative of the member. The "relative" for this purpose would refer to the definition mentioned in Accounting Standard (AS)-18.*
Applicability to Consultancy & Advisory	*An accountant is expected to be no less independent in the discharge of his duties as a tax consultant or as a financial adviser than as auditor. In fact, it is necessary that he should bear the same degree of integrity and independence of mind in all spheres of his work. Unless this is done, the accounts of entities audited by Chartered Accountants or statements made by them during the course of assessment proceedings would not be relied upon as correct by the authorities.*
Guidance for cases of substantial interest	*Some of the situations which may arise in the applicability of Clause (4) read with the definition of "Substantial Interest" (see Clause II of Part I of First Schedule).and other statutory prohibitions are discussed below for the guidance of members:-* ➢ ***For Audits of entities not being company*** ***Where the member, his firm or his partner or his relative has substantial interest in the business or enterprise (not being a company).*** *The independence of mind is a fundamental concept of audit and/or expression of opinion on the financial statements in any form and, therefore, must always be maintained. Nothing can substitute for the essential and fundamental requirements of independence. Therefore, the Council's views are clarified in the following circumstances.* ▪ ***An enterprise / concern (not being company) of which a member is either an owner or a partner*** *The holding of interest in the business or enterprise (not being a company) by a member himself whether as sole-proprietor or partner in a firm, in the opinion of the Council, would affect his independence of mind in the performance of professional duties in conducting the audit and/or expressing an opinion on financial statements of such enterprise. Therefore, a member shall not audit financial statements of such business or enterprise.* ▪ ***Where the partner or relative of a member has substantial interest (not being company)*** *The holding of substantial interest by the partner or relative of the member in the business or enterprise (not being a company) of which the audit is to be carried out and opinion is to be expressed on the financial statement, may also affect the independence of mind of the member, in the opinion of Council, in the performance of professional duties. Therefore, the member may, for the same reasons as not to compromise his independence, desist from undertaking the audit of financial statements of such business or enterprise.* ➢ ***For Audits of Companies – Same as disqualifications given in Sec 141(3) of companies act***

Clause 4 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

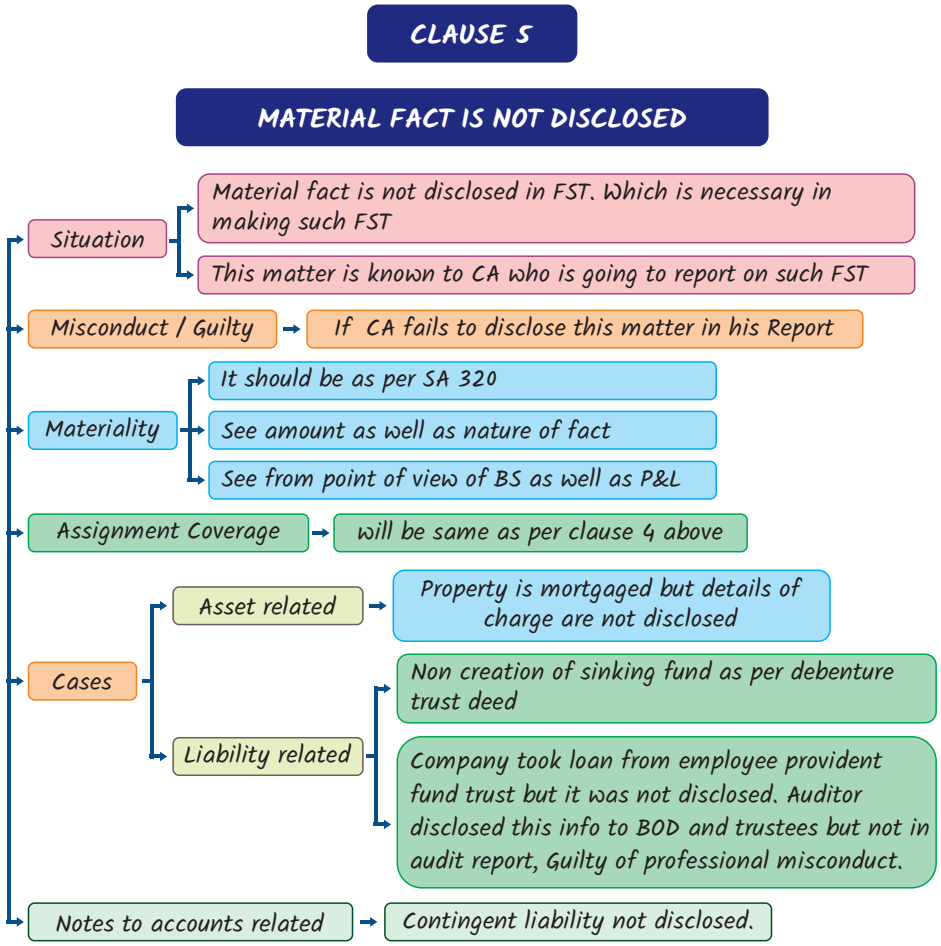
A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he :-

- **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.**

(CNO—PE.1040) CLAUSE 5 TO CLAUSE 9 (MCQ-Incs.39.5, Incs.49.1)

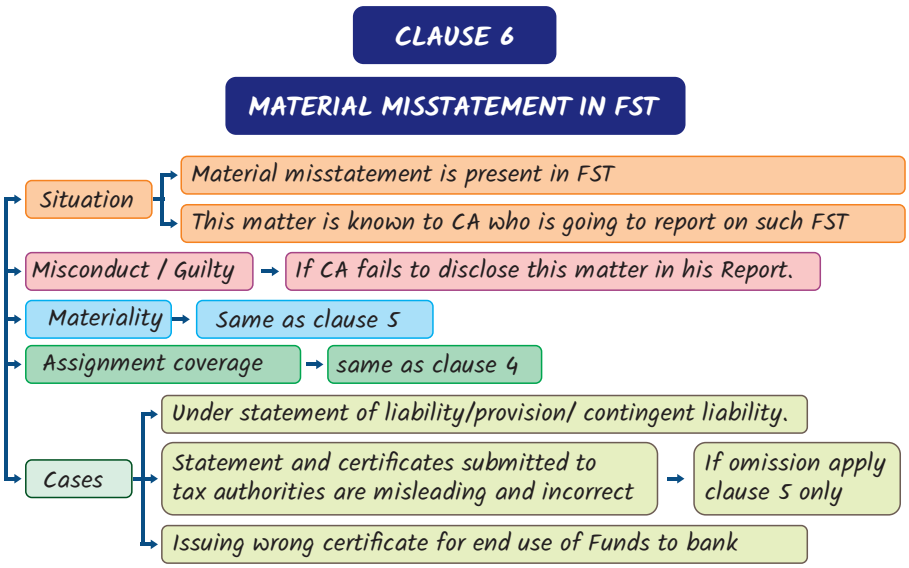
CLAUSE 5 (QNO- 748.000/ 749.000/ 750.000/ 751.000/ 751.500)

Chart



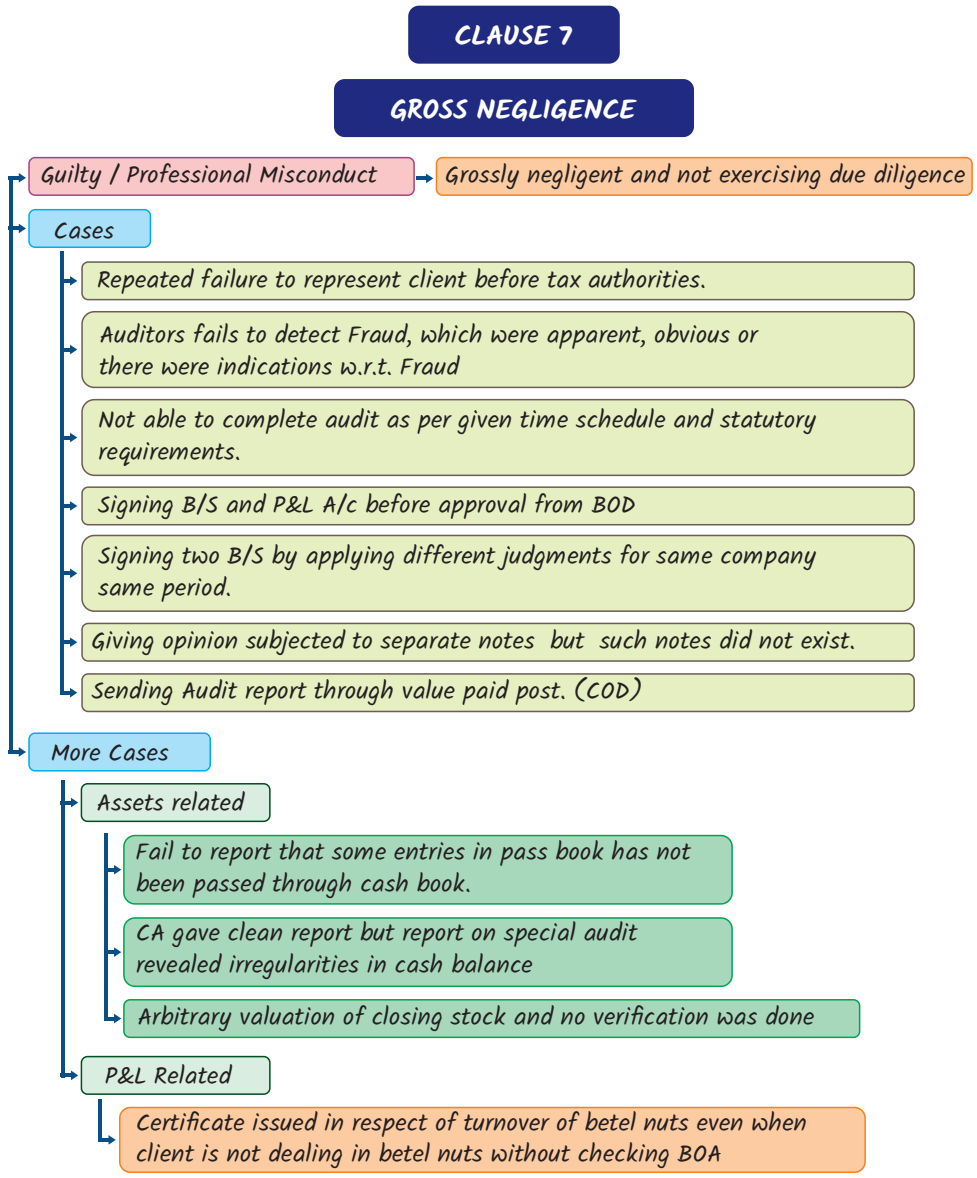
CLAUSE 6 (QNO- 753.000/ 754.000)

Chart



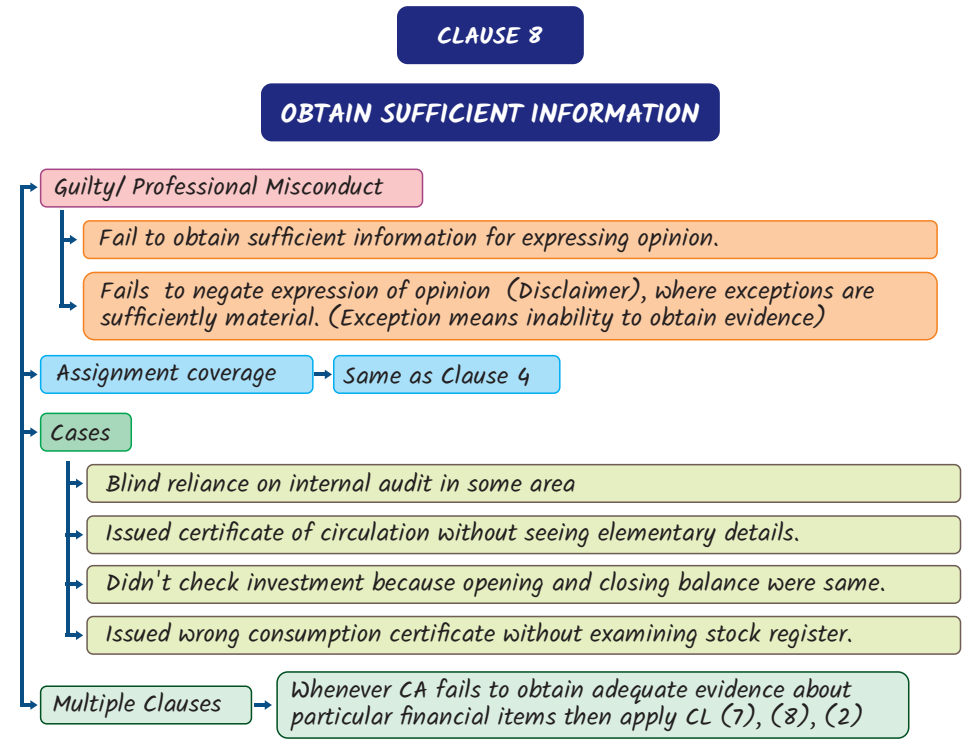
CLAUSE 7 (QNO-755.000/756.000 /756.500)

Chart



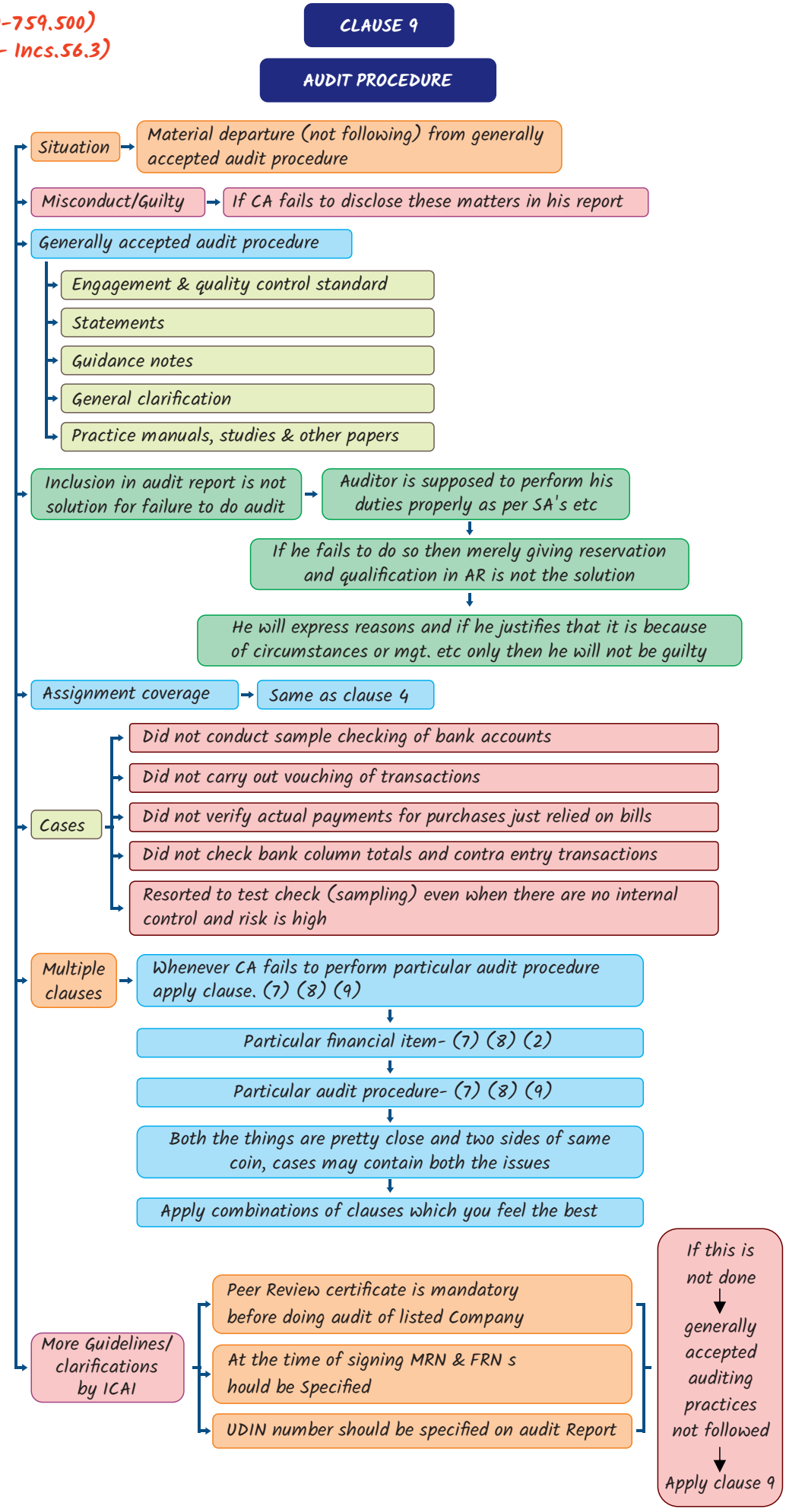
CLAUSE 8 (QNO-757.000 /757.500 / 758.000/ 759.000)

Chart



Chart

(QNO-759,500)
(MCQ- Incs.56.3)



Clauses From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

- **Clause 5**

  A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he
  - **fails to disclose a material fact known to him which is not disclosed in a financial statement,**
  - **but disclosure of which is necessary in making such financial statement not misleading**
  - **where he is concerned with that financial statement in a professional capacity.**

- **Clause 6**

  A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he
  - **Fails to report a material misstatement known to h im to appear in a financial statement**
  - **with which he is concerned in a professional capacity.**

- **Clause 7**

  A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if
  - **he does not exercise due diligence, or is grossly negligent in the conduct of his professional**

Clauses From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

- **Clause 8**

  A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he
  - **Fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.**

- **Clause 9**

  A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he
  - **Fails to invite attention to any material departure from the generally accepted procedure of audit**

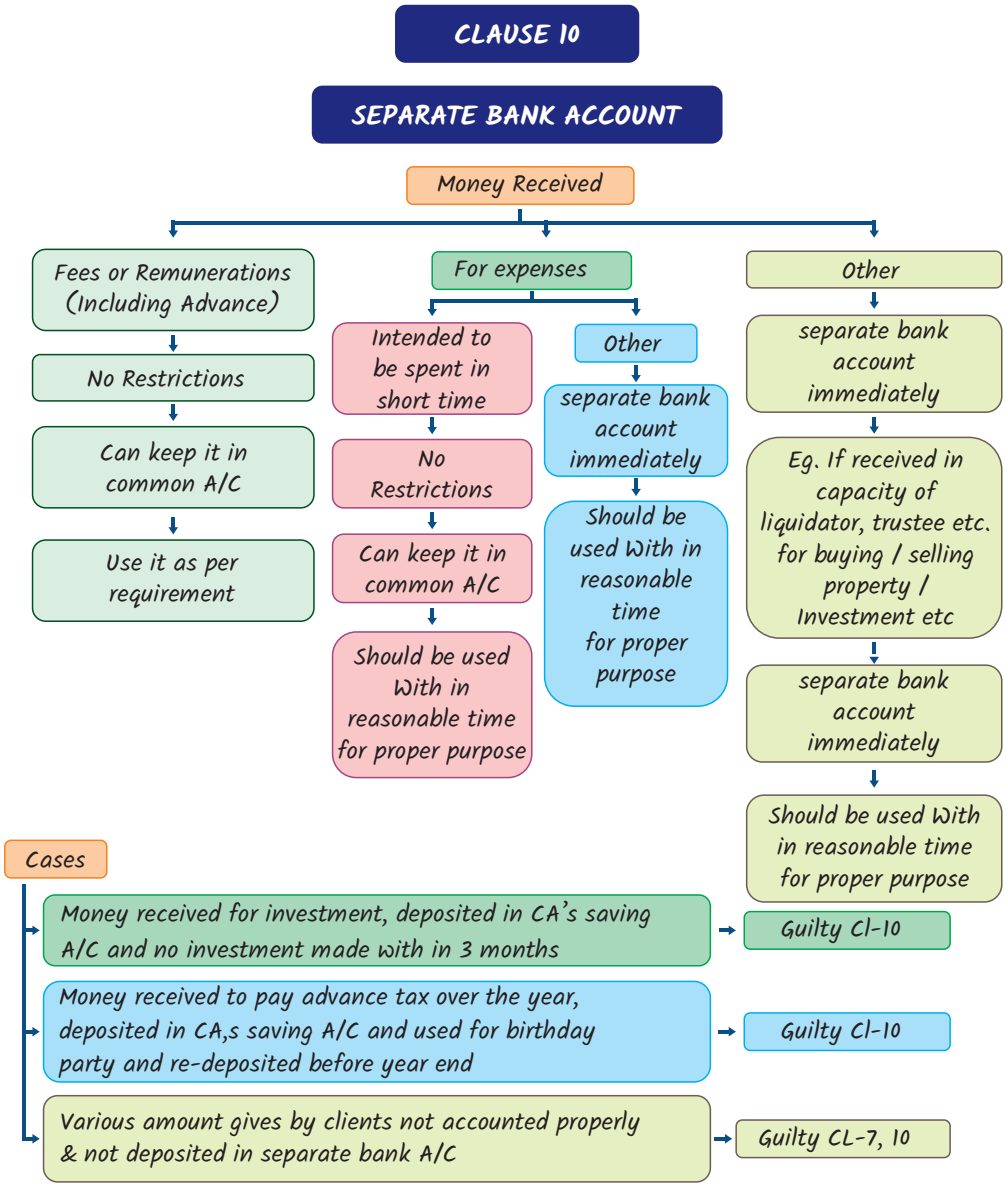
More Guidelines/ Clarification by ICAI

- "**Audit of listed companies** shall now be carried out only by the auditors who have undergone Peer Review Process
  - And have obtained **Peer Review Certificate** from the Peer Review Board.
  - This decision is effective for accounting periods commencing on or after Ist April, 2009."

- **FRN and Membership No. :** The members are required to mention the Membership number and Firm registration number to all reports issued pursuant to any attestation engagements, including certificates, issued by them as proprietor of/ partner in the said firm.

- **Unique Document Identification Number (UDIN) :** The members may note that UDIN is mandatory from Ist July, 2019 on all Corporate/ Non- Corporate Audit, Attest and Assurance Functions. Thus, a member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him.

(CNO—PE.1060)CLAUSE 10 (QNO-760.000/761.000/762.000/763.000/764.000)



Clause 10 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he :-

- ***fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a***

Clarifications By ICAI

In this connection the Council has considered some practical difficulties of the members and the following suggestions have 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. (No need to keep in separate bank account)*
- *Moneys received for expenses to be incurred, for example, payment of prescribed statutory fees, purchase of stamp paper etc., which are intended to be spent within a **reasonably short time need not be put in a separate bank account. For this purpose, the expression; "reasonably short time", would depend upon the circumstances of each case.-***
- *Moneys received for expenses to be incurred which **are not intended to be spent within a reasonably short time as aforesaid, should be put in a separate bank account immediately.***

*Moneys received by a Chartered Accountant, in his **capacity as trustee, executor liquidator, etc.** must be put in a separate bank account immediately.*

SECOND SCHEDULE - PART - II

Chart

SECOND SCHEDULE

PART - II

Applicable to CA's in GENERAL (PRACTICE/SERVICE/OTHERS)

(CNO—PE.1080) CLAUSE I (QNO-765.000/766.000 / 766.500/768.000/769.000)

(MCQ - PE.4 / Incs.44.5)

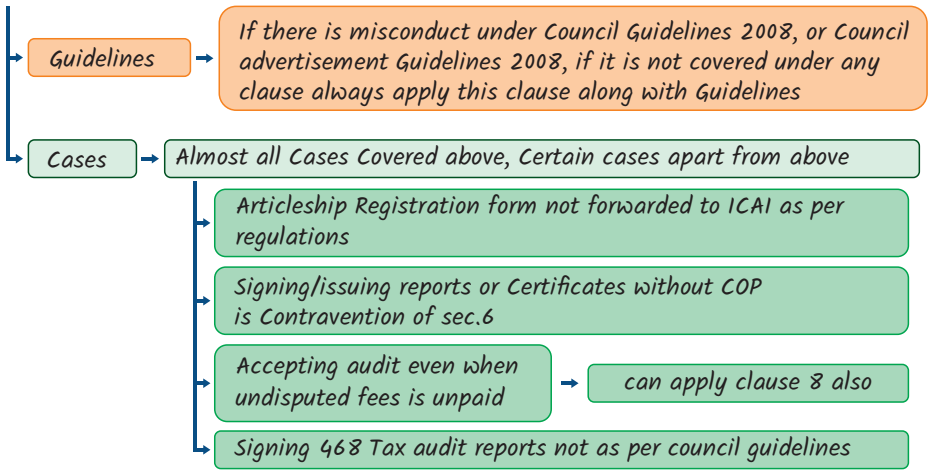
Chart

CLAUSE I

CONTRAVENTION

- Not allowed → Contravene provisions of
  - CA Act 1949
  - Regulations issued under CA Act by ICAI
  - Guidelines issued by ICAI
- Don't apply everywhere → If contravention is not covered under any other clause then it will be covered here (Specific overrides general)
- Regulations Related to Articles (Regulation 47)
  - Articleship registration Related
    - Don't ask for premium
    - Don't ask for Security Deposit from article or his Father
    - Don't ask for Loan from article or his family business
    - Don't register without COP or beyond vacancy
  - Working hours related
    - Flexible hours withdrawn
    - Office hours shall not start after 11:00 A.M or end before 5:00 PM
    - Office hours not before 9:00 AM or after 7:00 PM
    - Working hours shall be 35 hours in a week excluding lunch break
    - If there is exigencies (Need / demand),working hours can increase but not beyond 45 hours per week. Further compensatory leave shall be granted for hours exceeding 35 hrs
  - Other working Related
    - Without prior permission from ICAI cannot pursue other Course/training/business/Occupation
    - Not attend College/other institution during normal working hours (Take into account travel time)
  - Stipend Related (regulation 48)
    - Stipend should be paid Monthly in bank account
    - Either through account payee Cheque or depositing cash
- Regulations related to CA's
  - Complete CPE hrs. (Continuing prof. Education)
  - Advised not to take Coaching classes Between 9:30 AM to 5:30 PM

Continue on next Page...



Regulations Related To Articles

Registration

- Principal should not ask for **premium to provide Articleship.**
- Principal should not take security **deposit from article's father** for Articleship.
- Principal should not **loan from article's family business** for granting Articleship.
- Principal should not **register article without COP or beyond vacancy available.**
- The facility of allowing **flexible office hours stands withdrawn.**

Working hours

- The normal working hours for the articled assistants **shall not start after 11.00 A.M. or end before 5.00 P.M.**
- The **office hours** of the Principal for providing article training to the articled assistants **shall not be generally before 9.00 A.M. or after 7.00 P.M.**
- The **working hours for the articled assistants shall be 35 hours** in a week excluding the lunch break. In case of the **exigencies of work with the Principal,** an articled assistant may be required to work beyond his/her normal working hours. However, under such circumstances, the aggregate number of **working hours shall not exceed 45 hours per week.** The requirement to work beyond 35 hours in a week should not be a practice but only in exceptional circumstances. Further, where the articled assistant is required to work beyond normal working hours, and aggregate of such hours exceed 35 hours per week, he/she shall be entitled to **compensatory leave** calculated with reference to number of completed working hours, over and above, 35 hours per week.

Other Work

- During the working hours, the articled assistant is **not permitted to attend college/other institutions** for pursuing any course including graduation. Accordingly, college timings of such course should **not be such (after taking into account the time required to commute) which clashes with the normal working hours** of the article training.

  Without the previous permission of the Council, obtained on application made in the approved form, **no articled clerk shall, during the period of his service as an articled clerk, take any other course of study or training, whether academic or professional, or engage in any business or occupation.**

Stipend

The **stipend** under this regulation shall be paid by the principal to the articled assistant either (a) by a **crossed account payee cheque every month** against a stamped receipt to be obtained from the articled assistant; or (b) **by depositing the amount every month** in an account opened by the articled

Some Important Regulations Related To CA's

- There is Statement on **CPE hours** under which ICAI keeps announcing requirement for number of hours of continuing professional education required for CAs in practice & those who are not in practice even taking into consideration age and other factors. If this is not complied ICAI can give advance notice and take action against members and this will also a professional misconduct under Schedule 2 Part 2 Clause 1

- **Members of the Institute** who are engaged in coaching be advised not to undertake coaching between 9.30 AM and 5.30 PM

Clause 1 From Bare Act

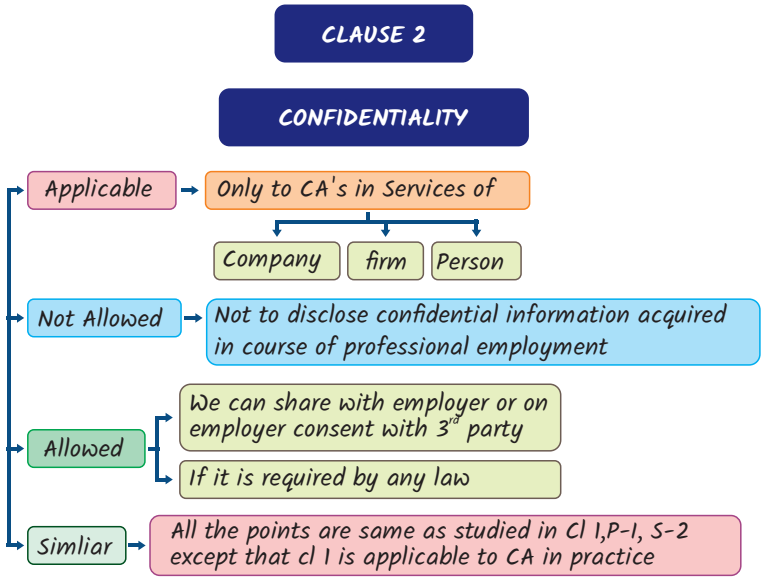
(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he –

- **contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.**

(CNO—PE.1100) CLAUSE 2

Chart



Clause 2 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

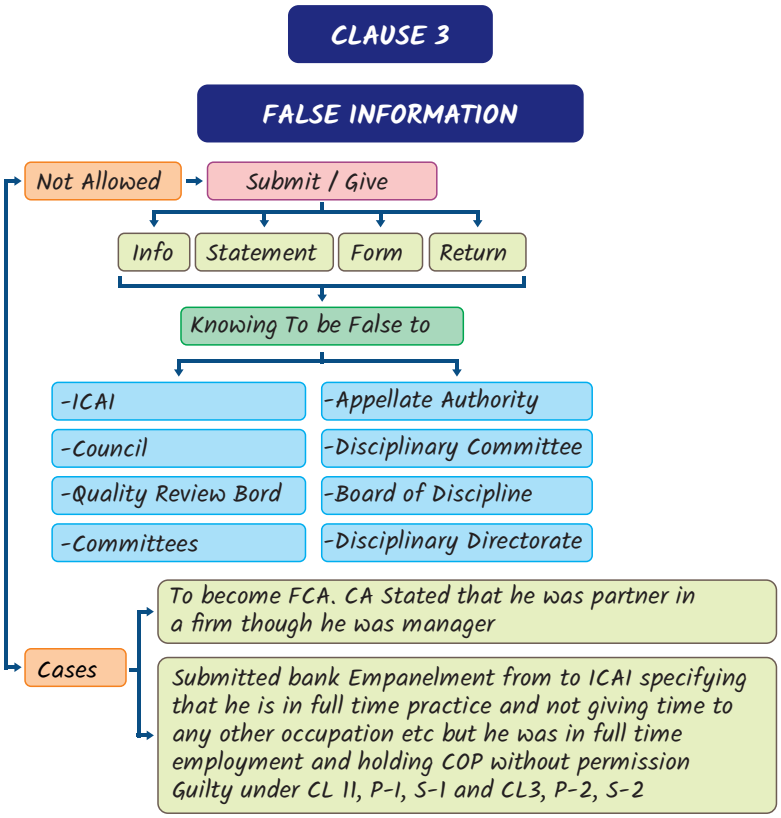
A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he –

- **being an employee of any company, firm or person,**
- **discloses confidential information acquired in the course of his employment except**
- **as and when required by any law for the time being in force or except as permitted by the employer.**

(CNO—PE.1120) CLAUSE 3

(QNO-768.000/769.000/770.000)

Chart



Clause 3 From Bare Act

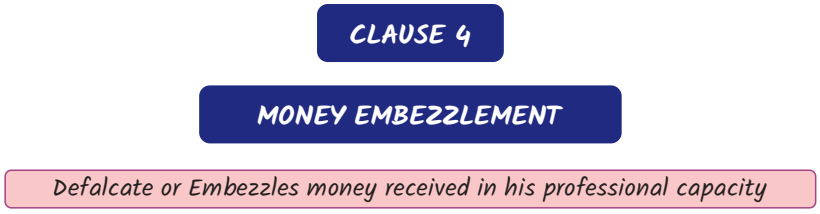
(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he -

- **Includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline. Disciplinary Committee,**

(CNO—PE.1140) CLAUSE 4

Chart



Clause 4 From Bare Act

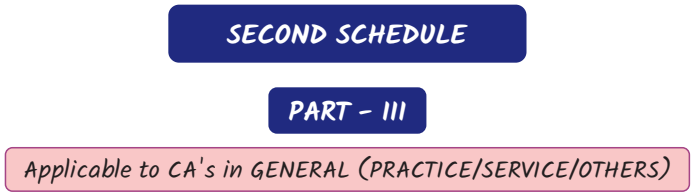
(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he -

- **Defalcates or embezzles money received in his professional capacity.**

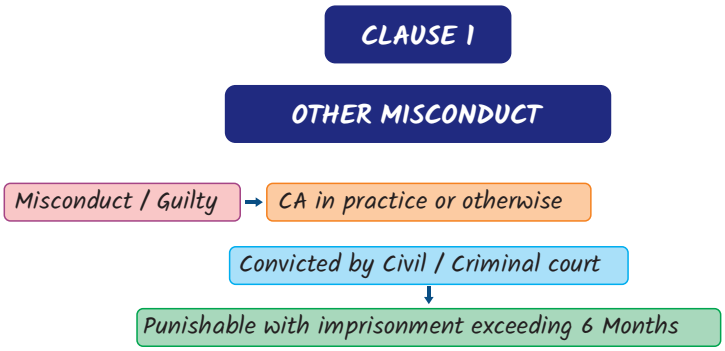
SCHEDULE II - PART - III

Chart



(CNO—PE.1160) CLAUSE 1

Chart



Clause 1 From Bare Act

(Try to write all the contents as given in below clause, to cram language is difficult for few, its not necessary to write each word as it is but content and its meaning should be same with all points covered)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he

- **is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.**

UNIQUE QUESTION

QNO 770.S00	Multiple Cases

PART – 4 COUNCIL GUIDELINES

(CNO—PE.1180) COUNCIL GENERAL GUIDELINES, 2008

(QNO-737.000/ 771.000/ 772.000/773.000/ 774.000/774.010/776.000/ 779.000)

C-BU^{3}NT^{2}LINES to remember council guidelines 2008

COUNCIL GENERAL GUIDELINE 2008

Shortcut- **NUU TUB** of **CLIENTS**

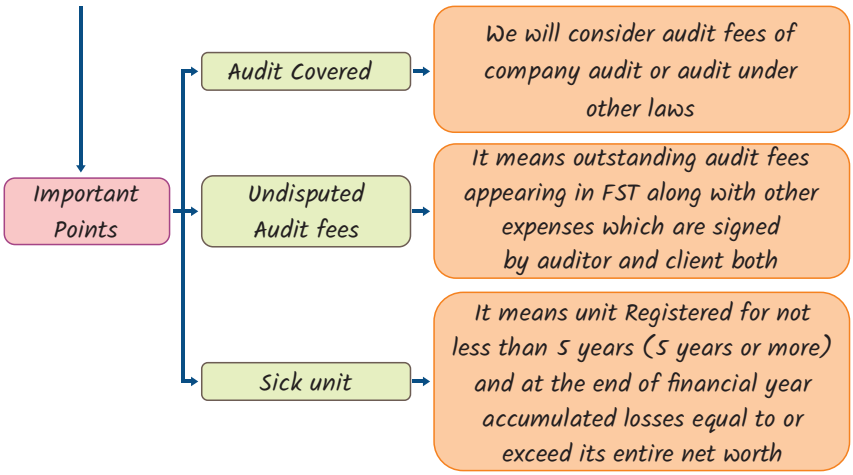
N – **N**o. of company Audit Assignment

- Specified No of Audits (SNA)
  - CA in practice should not hold more than SNA
  - In case of Individual / Proprietary firm SNA is 30
  - We have to see No. of partner at the time of accepting assignment.
  - In case of firm, SNA is No. of partner X 30
  - Limit of one partner can not be used by another partner in Co. Audit, but can be used in tax Audit
  - Zero limit
    - Part time/ Full time employment
    - Part time practice
  - Multiple firms → Assignment in name of CAIP all firm taken together should not exceed 30
- Counting
  - Two types of Co. OPC / Dormant will be excluded [OD]
  - Joint audit will be counted as ONE
  - HO & Branch of same Co. counted as One
  - One or more branches of same Co's will be counted as ONE
  - To ensure compliance, record of audit assignments need to be maintained. It should contain assignments taken on individual name / on his name in partnership firm / on his name in other partnership firm.
- Combined interpretation with Co. act
  - U/S 141 limit is 20
  - It excludes 4 types' of Co's
  - [OSDP] **O**PC/ small/ **d**ormant / **P**vt having PC < 100 cr (in case of pvt co. exemption will be available only when there is no default U/S 92 and 137)
  - In practical life first check limit of 20 excluding 4 types of co. then check limit of 30 excluding 2 types of company
  - It means we can do unlimited audit of OPC & dormant. extra limit of 10 can be used for small & Pvt co. with PC < 100 cr

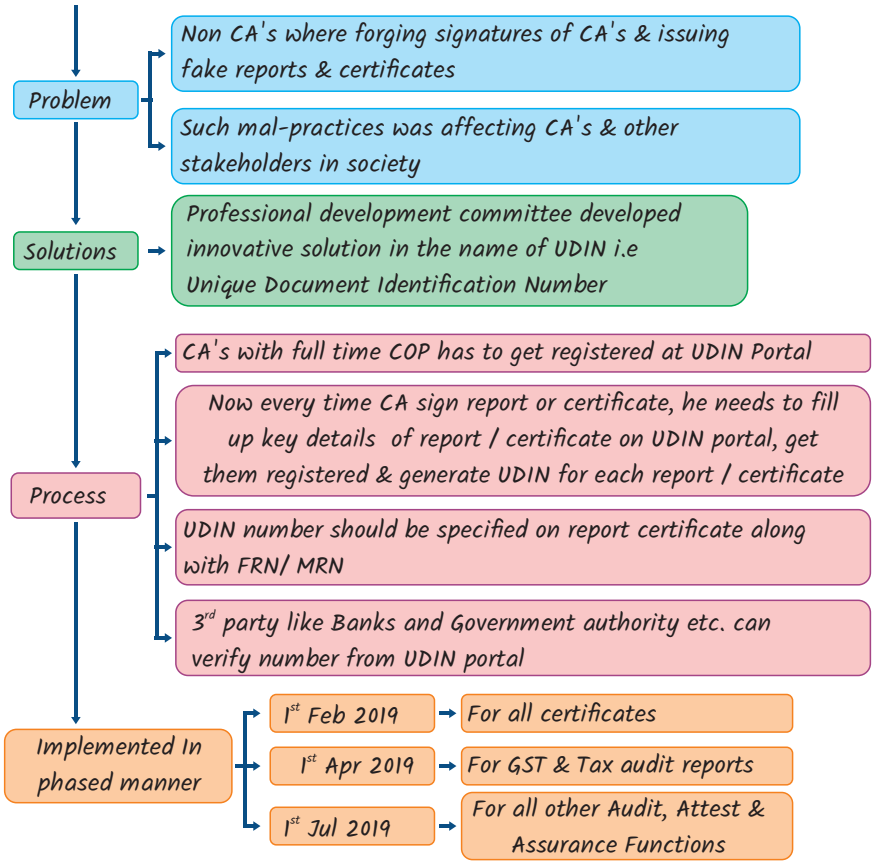
U – **U**ndisputed Audit fees

- Prohibition → CA in practice Should not accept Audit if undisputed audit fees of predecessor auditor is unpaid
- Exception → If unpaid audit fees is of sick unit then prohibition will not be applicable

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U – Unique Document Identification number (UDIN)



T – Maximum Tax audit Assignments

- Specified no. of Audit (SNA)
  - CA in practice should not hold more than SNA
  - In case of Individual / Proprietor firm SNA is 60
  - We have to see No. of partners at the time of accepting assignment
  - In case of firm SNA is No. of partners X 60
  - Limit per Partner will be considered as ZERO, in case, of non-CA partner / Partner is part time or full time employment / Partner practice is in part time practice
  - If CA is practicing as Individual / Proprietary firm and also one or more partnership firm then, aggregate No. of assignments on his name should not exceed 60
  - Limit of one partner can be used by another partner in tax audit. E.g. If there are 10 partners, firm limit is 600, all 600 reports can be signed by 1 partner

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- Counting
  - We will count corporate as well as non-corporate tax audit assignment.
  - If we are doing audit of more than 1FY of same client then each year will be counted as separate audit assignment
  - Following are included
    - 44 AD → Small business
    - 44 ADA → Small profession
    - 44 AE → Small Transport business
  - Joint Audit will be counted as ONE
  - HO & Branch of same co. counted as ONE
  - One or more branches of same co's will be counted as ONE
  - To ensure compliance record of audit assignments need to be maintained. It should contain assignments taken on Individual Name / On his Name in Partnership Firm / On his Name in other Partnership Firm
  - Distribution of assignment can be done in any manner as the firm decided. But Quality of the assignment shall be maintained as per SQC 1.

U – Unjustified Removal of Auditor

- If there is unjustified removal of earlier / predecessor auditor
- He will intimate / complain to council or appropriate committee of ICAI or any person on behalf of them
- They may send direction to incoming auditor to not accept the audit
- It is obligation of Incoming auditor to follow direction

B – Maintenance of Book of Accounts

- Mandatory for all CA's in practice / CA firm
- To maintain proper books of A/c's including Cash book & Ledger
- Irrespective of 44AA or 44AB of Income Tax Act 1961
- This is over & above record of audit assignment as discussed earlier

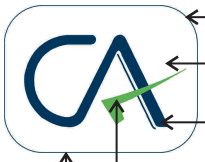
C – Corporate form of Practice

- ICAI allowed corporate form of practice
  - Traditional work of Accounting / Auditing / Taxation
    - Should be done as Individual / Proprietor / Firm
  - Work covered in Mgt. consultancy services (MCS) as discussed in section 2(2) (iv) earlier
    - This can be done in traditional form or in the form of Mgt. consultancy Co. (MCC)

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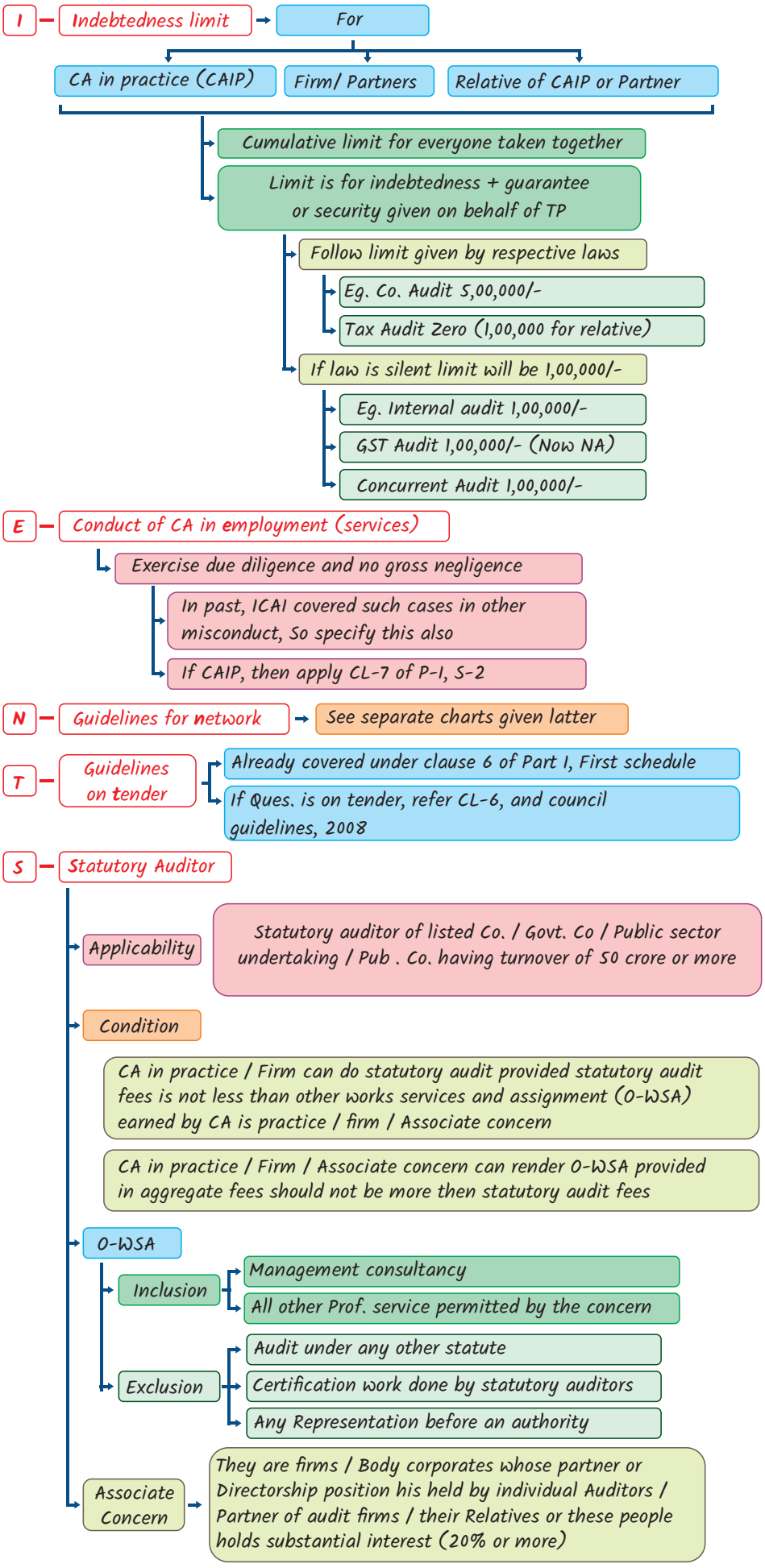
- Formation of MCC
  - Forms & procedure → Issued by ICAI and come into force on 01/10/2006
  - Name Approval → Name should be approved by ICAI
  - Register Co. with ROC
    - Ca's / Relatives can hold equity shares in any quantum
    - CA's can be MD/ WTD / Manager
    - If CA takes this position in any Co. then he will be considered as CA in part time practice
    - But if it is a MCC he will still be in full time practice so he can attest / Report / certificate and train articles
  - Get Co. registered with ICAI
- Functioning of MCC
  - MCC has to give undertaking that they will only provide Management Consultancy services
    - Accounting, Statutory or periodical audits, taxation are not covered in MCS, So these things can not be done by MCC
  - Compliance of section 144 of companies Act 2013
    - If traditional firm of CA in practice is a statutory auditor of a company than his MCC can not provide prohibited services as given under section 144 of companies Act 2013
  - Compliance with clause 6 & 7 → MCC has to give undertakings and then comply with Clause 6 & 7 of Part I of First Schedule
  - Non- Audit Fees → Where traditional firm is giving audit services and MCC is giving consultancy services. Ensure that overall non-audit fees should not exceed audit fees as discussed in these council guidelines 2008

L – Logo



- Rounded rectangle
- White colored background
- CA letters in blue
  - Blue stands out, corporate colour denotes integrity, knowledge, creativity and depth
- Upside down tick mark in green
  - Symbol of wisdom and value
  - Green is for growth and freshness
- Not allowed
  - To change design
  - To change colour
  - To rotate

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I
Indebtedness limit
For
CA in practice (CAIP)
Firm/ Partners
Relative of CAIP or Partner
Cumulative limit for everyone taken together
Limit is for indebtedness + guarantee or security given on behalf of TP
Follow limit given by respective laws
Eg. Co. Audit 5,00,000/-
Tax Audit Zero (1,00,000 for relative)
If law is silent limit will be 1,00,000/-
Eg. Internal audit 1,00,000/-
GST Audit 1,00,000/- (Now NA)
Concurrent Audit 1,00,000/-
E
Conduct of CA in employment (services)
Exercise due diligence and no gross negligence
In past, ICAI covered such cases in other misconduct, So specify this also
If CAIP, then apply CL-7 of P-I, S-2
N
Guidelines for network
See separate charts given latter
T
Guidelines on tender
Already covered under clause 6 of Part I, First schedule
If Ques. is on tender, refer CL-6, and council guidelines, 2008
S
Statutory Auditor
Applicability
Statutory auditor of listed Co. / Govt. Co / Public sector undertaking / Pub . Co. having turnover of 50 crore or more
Condition
CA in practice / Firm can do statutory audit provided statutory audit fees is not less than other works services and assignment (O-WSA) earned by CA is practice / firm / Associate concern
CA in practice / Firm / Associate concern can render O-WSA provided in aggregate fees should not be more then statutory audit fees
O-WSA
Inclusion
Management consultancy
All other Prof. service permitted by the concern
Exclusion
Audit under any other statute
Certification work done by statutory auditors
Any Representation before an authority
Associate Concern
They are firms / Body corporates whose partner or Directorship position his held by individual Auditors / Partner of audit firms / their Relatives or these people holds substantial interest (20% or more)

Guidelines for Corporate Form of Practice

(QNO - 712.500) (MCQ-Incs.51.1)

- ***Name Approval:*** *The name of the Management Consultancy Company is required to be approved by the Institute and such Company has to be registered with the Institute. The guidelines alongwith the prescribed application forms for approval of name and registration, provisions of ethical compliance and other details have been issued and the same will come into force w.e.f 1.10.2006.*
- ***Object of Management Consultancy Company:*** *The Management Consultancy Company shall engage itself only in Management Consultancy & Other Services. The Management Consultancy Company shall give an undertaking that it shall render only Management Consultancy & Other Services prescribed by the Council pursuant to powers under section 2 (2)(iv) of the Chartered Accountants Act, 1949.*
- ***One more mode of practice:*** *The consultancy practice hitherto done in Individual or Firm Status alone is now intended to be permitted in Corporate Form also.*
- ***No Audit:*** *On abundant caution, it may be clarified that no audit practice can be done in Corporate Form.*
- ***No restriction on equity:*** *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.*
- ***Permission to become MD, WTD, Manager of Body Corporate:*** *The Council decided to allow members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate within the meaning of the Companies Act provided that the body corporate is engaged exclusively in rendering Management Consultancy and Other Services permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard.The members can retain full time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company. 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.*
- ***Ethical Compliance:***
  - *Compliance: (i)Once the Management Consultancy Company is Registered with the Institute as per the Guidelines, it will be necessary for such a Company to comply with the following requirements: -*
    - *Prohibited Services: (a)If the individual practitioner / sole-proprietorship firm / partnership firm is the statutory auditor of an entity then the Management Consultancy Company should not accept the internal audit or book-keeping or such other professional assignments, which are prohibited for the statutory auditor firm.*
    - *Non Audit Fees: (b) The Notification No. 1-CA(7)/60/2002 dated 8th March, 2002 (enclosed) in respect of ceiling on Non-audit fees is applicable in relation to a Management Consultancy Company.*
    - *Advertisment & Achievements: (c) The Management Consultancy Company shall comply with clauses (6) & (7) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.*
  - *Undertaking: (ii) The Management Consultancy Company shall give an undertaking that it shall comply with clauses (6) & (7) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.*

Maintenance of Books of account	**Maintain Cash Book & Ledger:** A member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his / its professional practice, proper books of account including the following- (I) a Cash Book; (ii) a Ledger
Appointment of an Auditor in case of non-payment of undisputed fees	**Don't Accept Assignment:** A member of the Institute in practice shall not accept the appointment as auditor of an entity in case the undisputed audit fee of another Chartered Accountant for carrying out the statutory audit under the Companies Act, 2013 or various other statutes has not been paid: **Exception Sick Unit:** Provided that in the case of sick unit, the above prohibition of acceptance shall not apply. **Definition of Undisputed Audit Fees:** Explanation I: For this purpose, the provision for audit fee in accounts signed by both - the auditee and the auditor along with other expenses, if any, incurred by the auditor in connection with the audit, shall be considered as "undisputed audit fees". **Definition of Sick Unit: Explanation 2:** For this purpose, "sick unit" shall mean a unit registered for not less than five years, which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.
Directions in case of unjustified removal of auditors	**Comply with Direction:** A member of the Institute in practice shall follow the direction given, by the Council or an appropriate Committee or on behalf of any of them, to him being the incoming auditor(s) not to accept the appointment as auditor(s), in the case of unjustified removal of the earlier auditor(s).
Unique Document Identification Number (UDIN) Guidelines	**Why UDIN ?:** Whereas, to curb the malpractice of false certification / attestation by the unauthorized persons & to eradicate the practice of bogus certificates and to save various regulators, banks, stakeholders etc. from being misled, the Council of the Institute decided to implement an innovative concept to generate Unique Document Identification Number (UDIN) mandatorily for all kinds of the certificates/GST and Tax Audit Reports and other attest function in phased manner, for which members of the ICAI were notified through the various announcements published on the website of ICAI www.icai.org at the relevant times. **Applicability:** A member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him which made mandatory from the following dates through announcements published on the website of the ICAI www.icai.org at the relevant time: - For all Certificates w.e.f. Ist February, 2019. For all GST and Tax Audit Reports w.e.f. Ist April, 2019. For all other Audit, Assurance and Attestation functions w.e.f. Ist July, 2019
A member of the Institute in practice shall not hold at any time appointment of more than the "specified number of audit assignments" of Companies under Section 141 of the Companies Act 2013.	➢ **Restriction to go beyond SNA:** A member of the Institute in practice shall not hold at any time appointment of more than the "specified number of audit assignments" **(SNA)** of Companies under Section 141 of the Companies Act 2013. ➢ **SNA for FIRM:** Provided that in the case of a firm of Chartered Accountants in practice, the "specified number of audit assignments" shall be construed as the specific number of audit assignments for every partner of the firm. ➢ **SNA if CA is Partner in Multiple Firms:** Provided further that where any partner of the firm of Chartered Accountants in practice is also a partner of any other firm or firms of Chartered Accountants in practice, the number of audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the "specified number of audit assignments" in the aggregate. Provided further where any partner of a firm or firms of Chartered Accountants in practice accepts

one or more audit of Companies in his individual capacity, or in the name of his proprietary firm, the total number of such assignments which may be accepted by all firms in relation to such Chartered Accountant and by him shall not exceed the "specified number of audit assignments" in the aggregate.

- **Explanation of SNA:**

1. For the above purpose, the "specified number of audit assignments" means –
   - **For Individual / Proprietor:**
     (a) in the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, 30 audit assignments whether in respect of private Companies or other Companies, with the exception of one person Companies and dormant companies.
   - **For Partnership Firm:**
     (b) in the case of Chartered Accountants in practice, 30 audit assignments per partner in the firm, whether in respect of private Companies or other Companies, with the exception of One person Companies and dormant companies.

- **Counting of SNA:**

2. In computing the "specified number of audit assignments"-
   - **Joint Audits:** (a) the number of audit of such Companies, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.
   - **Head Office & Branch:** (b) the audit of the head office and branch offices of a Company by one Chartered Accountant or firm of such Chartered Accountants in practice shall be regarded as one audit assignment.
   - **One or more branches:** (c) the audit of one or more branches of the same Company by one Chartered Accountant in practice or by firm of Chartered Accountants in practice in which he is a partner shall be construed as one audit assignment only.
   - **Time of Counting Partners:** (d) the number of partners of a firm on the date of acceptance of audit assignment shall be taken into account.

- **CA in Employment:** A Chartered Accountant in practice, whether in full-time or part time employment elsewhere, shall not be counted for the purpose of determination of "specified number of audit of Companies" by firms of Chartered Accountants.
- **CA in Part Time Practice:** A Chartered Accountant being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the audit assignments of the firm.
- **Record of Assignments:** A Chartered Accountant in practice as well as firm of Chartered Accountants in practice shall maintain a record of the audit assignments accepted by him or by the firm of Chartered Accountants, or by any of the partners of the firm in his individual name or

Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961

- **Maximum number of Tax Audits:** A member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961.
- **For Firm:** Provided that in the case of a firm of Chartered Accountants in practice, the "specified number of tax audit assignments" shall be construed as the specified number of tax audit assignments for every partner of the firm.
- **CA partner in Multiple Firms:**

Provided further that where any partner of the firm is also a partner of any other firm or firms of Chartered Accountants in practice, the number of tax audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the "specified number of tax audit

Provided further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate.

- ***Exlusions from Counting:***

  Provided also that the audits conducted under Section 44AD, 44ADA and 44AE of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments"

- ***Explanation Specified Number of Audits (SNA):***

  For the above purpose, "the specified number of tax audit assignments" means –

  - ***For Individual or Proprietor :*** *in the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, **60 tax audit assignments, in a financial year, whether in respect of corporate or non-corporate assesses.*
  - ***For Partnership Firm :*** *(b) in the case of firm of Chartered Accountants in practice, **60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.*
  - ***Clarification on utilisation of limit of partner by other partner:*** *According to a clarification on Tax Audit Assignments by Committee on Ethical Standards Board) of the Institute, if there are 10 partners in a firm of Chartered Accountants in practice, then all the partners of the firm can collectively sign 600 tax audit reports. This maximum limit of 600 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 600 tax audit reports in case remaining 9 partners are not signing any tax audit report.*
  - ***Each year as separate assignment:*** *In computing the "specified number of tax audit assignments" each year's audit would be taken as a separate assignment.*
  - ***Joint Audits:*** *In computing the "specified number of tax audit assignments", the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.*
  - ***Head Office & Branch Office:*** *The audit of the head office and branch offices of a concern shall be regarded as one tax audit assignment.*
  - ***One or Branches:*** *The audit of one or more branches of the same concern by one Chartered Accountant in practice shall be construed as only one tax audit assignment.*
  - ***Part Time COP Holder:*** *A Chartered Accountant being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the tax audit assignments of the firm.*
  - ***Record:*** *A Chartered Accountant in practice shall maintain a record of the tax audit assignments accepted by him in each assessment year in the format as may be prescribed by the Council.*
  - ***Distribution of Limit as per SQC 1:*** *The limit on number of tax audit assignments per partner in a CA Firm may be distributed between the partners in any manner whatsoever. However, it should be in accordance with the Standard on Quality Control (SQC) 1: Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.*

Guidelines on Tenders	A member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.
Logo Guidelines	The logo consists of letter 'CA' with a tick mark inside a rounded rectangle with white background. The letters CA have been put in blue, the corporate colour which not only stands out on the background but also denotes creativity, innovativeness, knowledge, integrity, trust, truth, stability and depth. The upside down tick mark typically used by Chartered Accountants, has been used to symbolize the wisdom and value of the professional. The green colour in the tick mark signifies growth, prosperity, harmony and freshness. Members are encouraged to use the new logo, as published here as it is. Do not change the design and colours, including the white background. Refrain from rotating or tilting the logo. The correct and incorrect usage of the logo is explained as under: **CORRECT LOGO**  **Do not change the colours**  **Do not change the colours**  **Do not change the colours**  **Do not rotate**  **Do not rotate**  **Do not rotate** 
Appointment of an auditor when he is indebted to a concern	A member of the Institute in practice or a partner of a firm in practice or a firm or a relative of such member or partner shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding Rs 100,000/-
Guidelines for Networking	**Discussed Latter**
Conduct of a Member being an Employee	A member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.
Appointment as Statutory auditor	➢ **Applicability & Condition for Fees of Other Works, Assignements or Services:** A member of the Institute in practice shall not accept the appointment as statutory auditor of Public Sector Undertaking(s) / Government Company(ies) / Listed Company(ies) and other Public Company(ies) having turnover of Rs 50 crores or more in a year where he accepts any other work(s) or assignment(s) or service(s) in regard to the same Undertaking(s) / Company(ies) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same Undertaking / company. ➢ **If any other stingent conditions they will prevail:** Provided that in case appointing authority(ies) / regulatory body(ies) specify(ies) more stringent condition(s) / restriction(s), the same shall apply

instead of the conditions / restrictions specified under these Guidelines.

- **Fees of firm & associates put together:** The above restrictions shall apply in respect of fees for other work(s) or service(s) or assignment(s) payable to the statutory auditors and their associate concern(s) put together.

- **Inclusion & Exclusions:** For the above purpose,
(i) the term "other work(s)" or "service(s)" or "assignment(s)" shall include Management Consultancy and all other professional services permitted by the Council pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 but shall not include:-
(a) audit under any other statute;
(b) certification work required to be done by the statutory auditors; and
(c) any representation before an authority;

- **Definition Associate Concern:** (ii) the term "associate concern" means any corporate body or partnership firm which renders the Management Consultancy and all other professional services permitted by the Council wherein the proprietor and/or partner(s) of the statutory auditor firm and/or their "relative(s)" is/are Director/s or partner/s and/or jointly or severally hold "substantial interest" in the said corporate body or partnership;

- **Definition Relative & Substantial Interest:** (iii) the terms "relative" and "substantial interest" shall have the same meaning as are assigned thereto under Appendix (9) to the Chartered Accountants Regulations, 1988.

- **Manner of Comuptation on Aggregate Basis:** In regard to taking up other work(s) or service(s) or assignment(s) of the undertaking/company referred to above, it shall be open to such associate concern or corporate body to render such work(s) or service(s) or assignment(s) so long as aggregate remuneration for such other work(s) or service(s) or assignment(s) payable to the statutory auditor/s together with fees payable to its associate concern(s) or corporate body(ies) do/does not exceed the aggregate of fee payable for carrying out the statutory audit.

(CNO—PE.1200) COUNCIL GUIDELINES FOR ADVERTISEMENT, 2008 (Mcq - Incs.06.4)

Shortcut

COUNCIL GUIDELINES FOR ADVERTISEMENT, 2008 (AMENDED TIME TO TIME)

Shortcut - **WOW** corona is **DEAD**

- **W** – Write up (WU)
  - Meaning
    - It is written piece of information like article giving info about him and his services
    - It should contain details strictly as specified in guidelines and also comply with condition
    - ICAI will never approve WU or own any responsibility about info in WU
    - Permission of WU is orignally provided under Cl-7, P-I, S-I
  - Info allowed in WU

Continue on next Page...

Particulars	Firm (Proprietor / Partnership)	Individual
1.LOGO 	only CA Logo Allowed	Same
2.Firm Details	Name- FRN- (Mandatory) Year of Establishment- Affiliation with Network-	NA Same
3.No. of Partners / Employees / Articles	Partners- CA's- Other Professionals- Articles- Other employees-	Same except number of partners
4.Personal Details (Partner/ Individual)	-Name- -MRN- (Mandatory) -Age- -Date of ACA- -Date of FCA- -Date of COP- -Other qualification- -Languages- -Passport style photo- -Group position held as Director or MD in MCC-	Same
5.Services Provided	Nature of services without client name and fees	Same
6.Address & Contact Details	Telephone / Mobile No- Professional Address- Website- e-mail-	Same
7.Authentication	Signature- Place & Date-	Same

Further conditions (Fair Value METHOD)

- Font size not exceeding 14
- Not violation of any provision of CA Act, 1949 or any Guidelines of the Council
- Membership No / FRN is mandatory to be mentioned
- No exaggerated claims for the services offered or qualifications or experience
- Not contain testimonials or endorsements or the fees charged
- Honest and truthful
- Not make any disparaging (downgrade) ref. or unsubstantiated comparisons to the work of others
- Not to bring the profession into disrepute

Continue on next Page...

O – Online 3rd Party platform

- Non-CA Entities → Entities like Newspapers, Banks, FI are providing advisory services like taxation etc. which are generally provided by CA's
- Allowed & Not Allowed
  - CA firms CA's can collaborate with them
  - They can provide consultancy service through these websites
  - Name of firm can come without suffix-Chartered Accountants
  - Name of individual CA can also be specified
  - Professional achievements or status should of not be advertised
  - Contact details should not be specified
- Cl 6
  - Earlier ICAI covered website related guidelines under Cl 6
  - So, whenever there is website related clarification refer cl 6 also

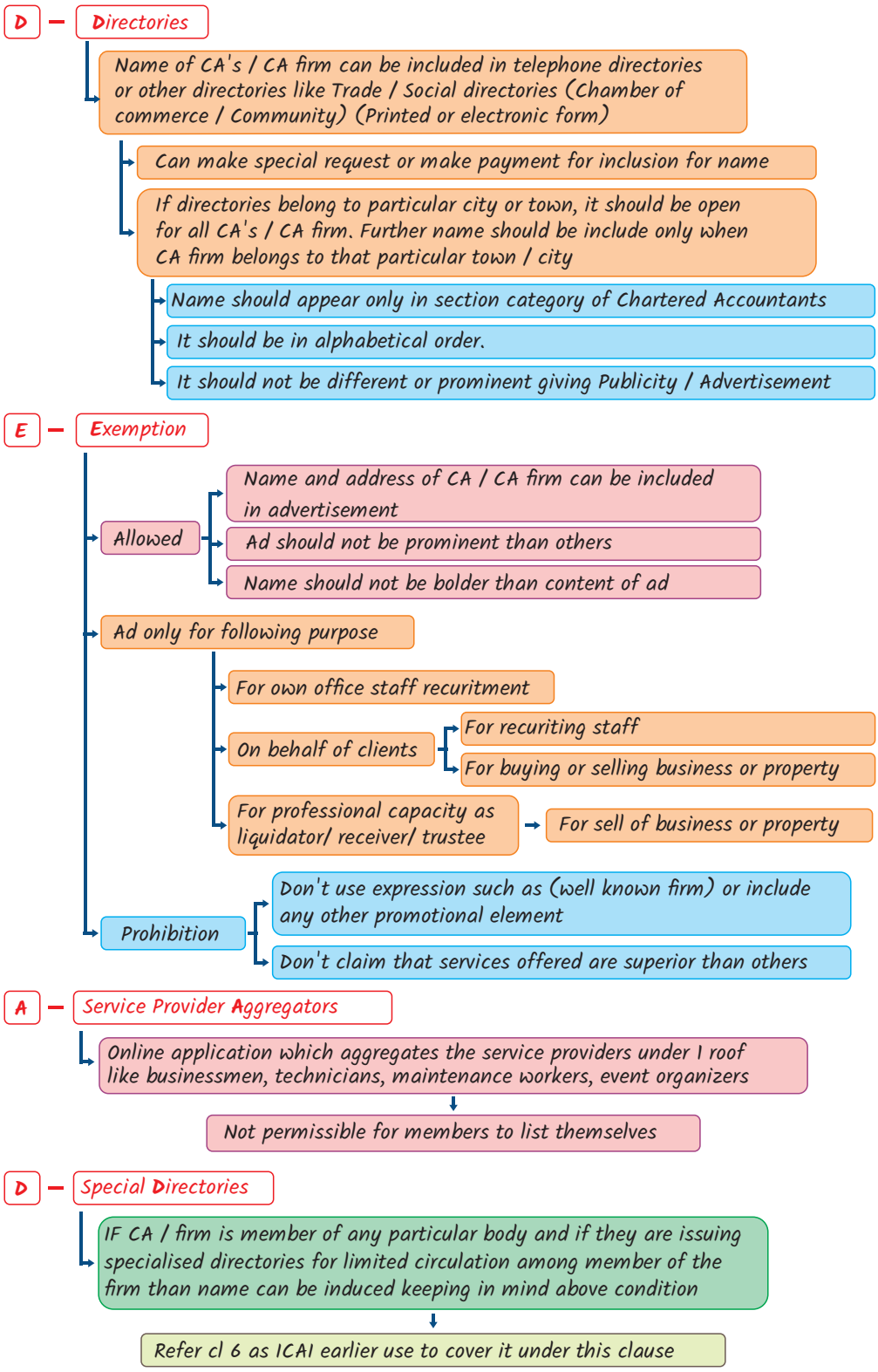
W – Website

- 1 Preliminary matters
  - Free to create their own website
  - No need to intimate any one about website
  - Any standard or actual format for design of website is not given / suggested by ICAI → Any design / format / colour is allowed
- 2 Name & main content of website
  - Information to be allowed
  - Name of the website can be different from firm name but it should be as near as possible to the name of individual name / Trade name / Firm name
  - Members name / Trade name / Firm name
  - Year of establishment
  - Address of Firm / Members Individual (HO & Br)
  - Contact detail
    - Tel. No
    - Fax No.
    - Email ID
  - Partners detail
    - Partner's name
    - Year of Qualification
    - Other Qualification
    - Area of experience (pull basis)
    - Contact details
  - Employee detail
    - Professional / Other Qualification
    - Name
    - Designation
    - Area of experience (pull basis)
    - No. of Article Assistant (pull basis)
    - Display of passport style photograph

Continue on next Page...

- Services
  - Nature of Service rendered (pull basis)
  - Nature of Assignment handled (pull basis)
    - Name of client & fee charged can not be given
  - If required by Law / Regulation in India or outside. Fees charged can also be displayed
  - It should be mentioned on website (In Italics) below such disclosure that it is required under the regulation
  - Online Advices the firm provides whether free of charge or on payment basis
- Other Information
  - Job Vacancy
  - Articles, professional Info. bulletin boards, professional updation, other matters of professional interest
  - Educational video on topic of professional relevance
  - Chats rooms, confidentiality protocol to be observe
  - Can provide link of its page on social networking site, not solicit people to visit on their respective page
  - Link of ICAI regional Council, Branches & website of government / govt. department / regulatory authority / other professional bodies.
  - Link to CA association Rotary / lions. Club / Chamber of commerce is not allowed.
  - Unwanted info (like live cricket score / horoscope etc) should not be Displayed
  - Mandatory Info about last update to be mentioned.
- After Making website.
  - Run on a "Pull "model not a push model
  - Info. In the website cannot be circulated there on through email or any other mode or technique except on specific pull request
  - Not to issue any circular or advertisement of any other material which solicit people to visit there website
  - Permitted to mention there website on there professional Stationery and email
- Secrecy & Compliance
  - Adequate secrecy of the matters of the client
  - It should not contain material variance as per ICAI record
  - Does not amount to soliciting client or professional work
  - Any content / technical feature violates professional code of conduct and ethics or any restriction in the CA Act, direction given by ICAI, then appropriate action by ICAI in terms of its disciplinary mechanism, suo-moto or on complain under CA act 1949

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We have not included bulky text of council advertisement guidelines 2008, as we have covered all details in above chart.

MISCELLANEOUS

(CNO—PE.1220) KNOW YOUR CLIENT (KYC) NORMS (QNO-782.000/ 782.005)

The Council of ICAI approved the following KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attest functions.

Explanation: "Attest Functions" for the purpose of this Announcement will include services pertaining to Audit, Review, Agreed upon Procedures and Compilation of Financial Statements.

Where Client Is An Individual/ Proprietor 1

- **General Information**
  - Name of the Individual
  - Business Description
  - Copy of last Audited Financial Statement
  - PAN No. or Aadhar Card No. of the Individual
- **Engagement Information**
  - Type of Engagement

Where Client Is A Corporate Entity 3

- **General Information**
  - Name and Address of the Entity
  - Name of the Parent Company in case of Subsidiary
  - Business Description
  - Copy of last Audited Financial Statement
- **Regulatory Information**
  - Company PAN No.
  - Company Identification No.
  - Directors' Names & Addresses
  - Directors' Identification No.
- **Engagement Information**
  - Type of Engagement

Where Client Is A Non-Corporate Entity 2

- General Information
  - Name and Address of the Entity
  - Partner's Names & Addresses (with their PAN/Aadhar Card/DIN No.)
  - Business Description
  - Copy of last Audited Financial Statement
  - Copy of PAN No.
- Engagement Information
  - Type of Engagement

These KYC Norms shall be mandatorily applicable for engagements accepted on or after 1st January, 2017.

(CNO—PE.1280) RECOMMENDED SELF-REGULATORY MEASURES

SELF-REGULATORY MEASURES

"DuMB JR" Measures

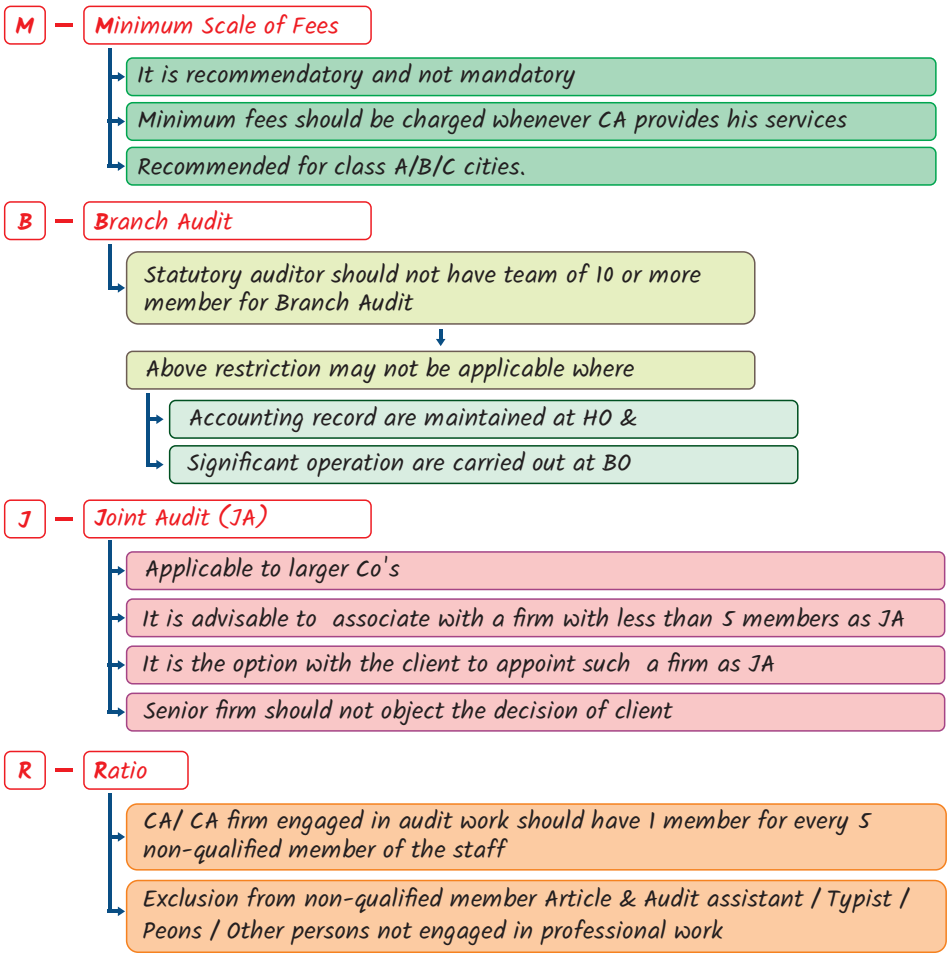
Meaning

- Policies framed by the council to be implemented while doing practice.
- It will help in growing the profession and having equitable workflow for everyone
- It is not mandatory and recommendatory in nature

D – Disclosure of Interest

Auditor should make a disclosure of money received for other services through the medium of other firm in which auditor is Partner/Proprietor

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The more important of these recommendations are as under:

- **Ratio Between Qualified and Unqualified Staff:** In the Council's view, a practicing firm of Chartered Accountants engaged in audit work should have at least one member for every five non-qualified members of the staff, excluding articled and audit clerks, typists, peons and other persons not engaged directly in such professional work.

- **Joint Audit** – In the case of large companies the practice of associating a practicing firm with less than five members as Joint auditors should be encouraged. Where a client desires to appoint such a firm as joint auditor, the senior firm should not object to the same.

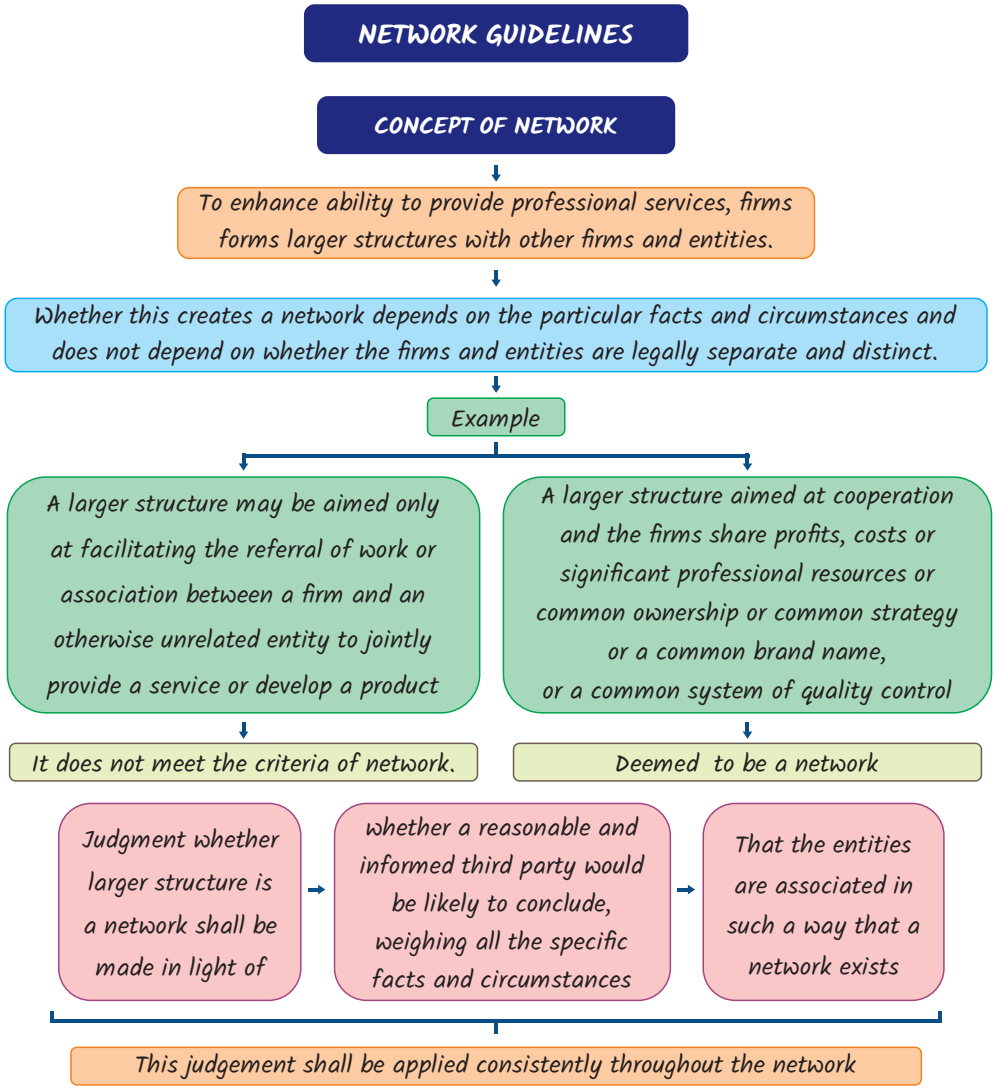
- **Disclosure of Interest by Auditors in other Firms** – The Council has decided that as a good and healthy practice, auditors should make a disclosure of the payments received by them for other services through the medium of a different firm or firms in which the said auditor may be either a partner or proprietor.

- **Branch Audits** – The branch audits of a company should not be conducted by its statutory auditors consisting of ten or more members, but should be conducted by the local firms of auditors consisting of less than ten members. This should not be understood to mean any restriction on the right of the statutory auditors to have access over branch accounts conferred under the Companies Act, 1956 (now Companies Act, 2013). This restriction may not apply in the following cases.
  - where the accounting records of the branches are maintained at the head office of the respective companies, and
  - where significant operations of an undertaking or a company are carried out at its branch office.

NETWORK GUIDELINES

(CNO-PE.1300) CONCEPT OF NETWORK

Chart



Network is a larger structure, but all larger structures may not be network

- To enhance their ability to provide professional services, firms frequently form **larger structures with other firms and entities.** Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct.

  For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is deemed to be a network.

  - **Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.**
  - **The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.**

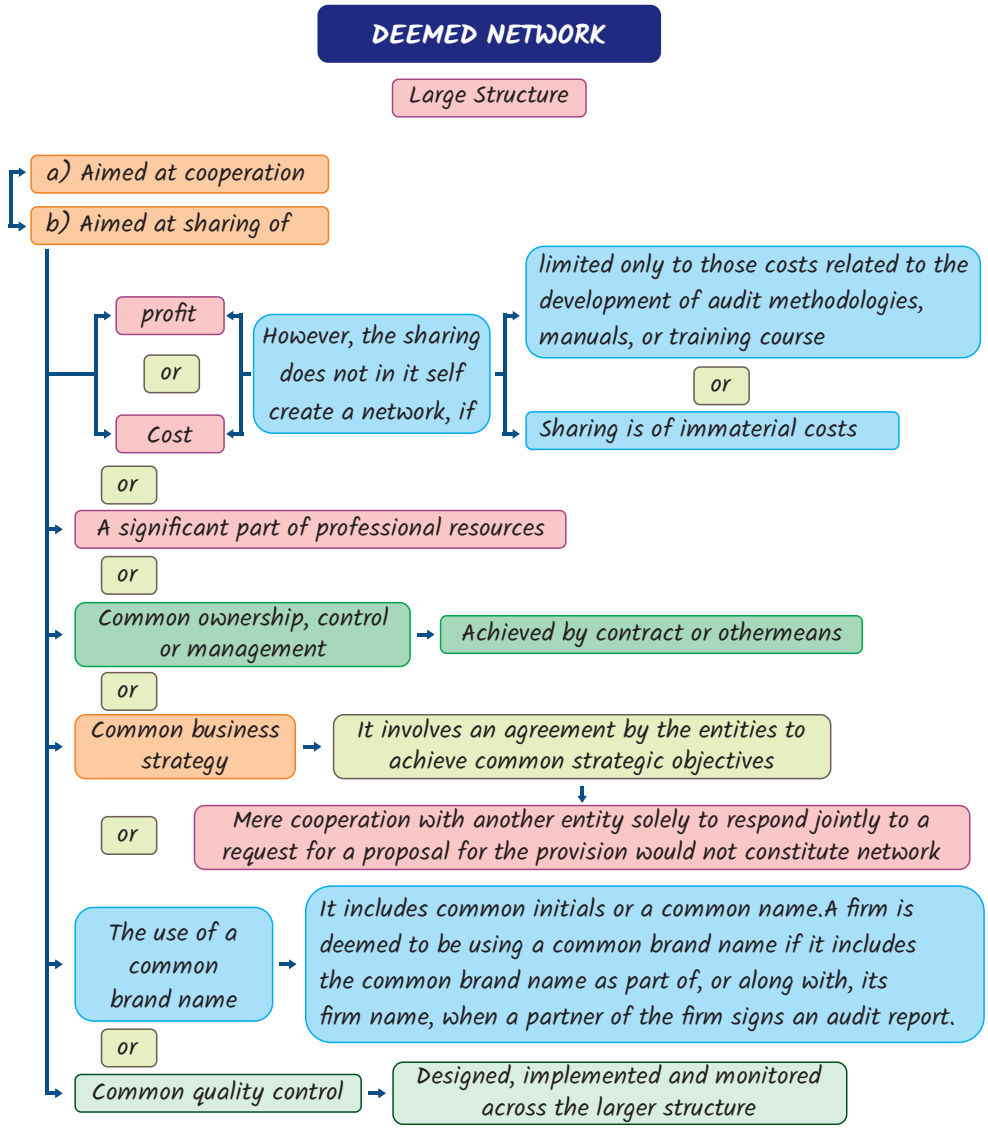
Deemed Network

- Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is deemed to be a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network.
- Where the larger structure is aimed at co-operation and the entities within the structure share a ***significant part of professional resources, it is deemed to be a network.***
  - ***Professional resources include:***
    - Partners and staff;
    - Audit methodology or audit manuals; and Training courses and facilities.
    - Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;
    - Common systems that enable firms to exchange information such as client data, billing and time records;
  - ***Significant part of professional services***

    The determination of whether the professional resources shared are significant, and therefore the firms are network firms, shall be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.
- Where the larger structure is aimed at cooperation and the entities within the structure ***share common ownership, control or management,*** it is deemed to be a network. This could be achieved by contract or other means.
- Where the larger structure is aimed at co-operation and the entities within the structure share a ***common business strategy,*** it is deemed to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision.
- Where the larger structure is aimed at co-operation and the entities within the structure ***share common quality control policies and procedures,*** it is deemed to be a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.
- Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a network. A common brand name includes common initials or a common name. A firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.

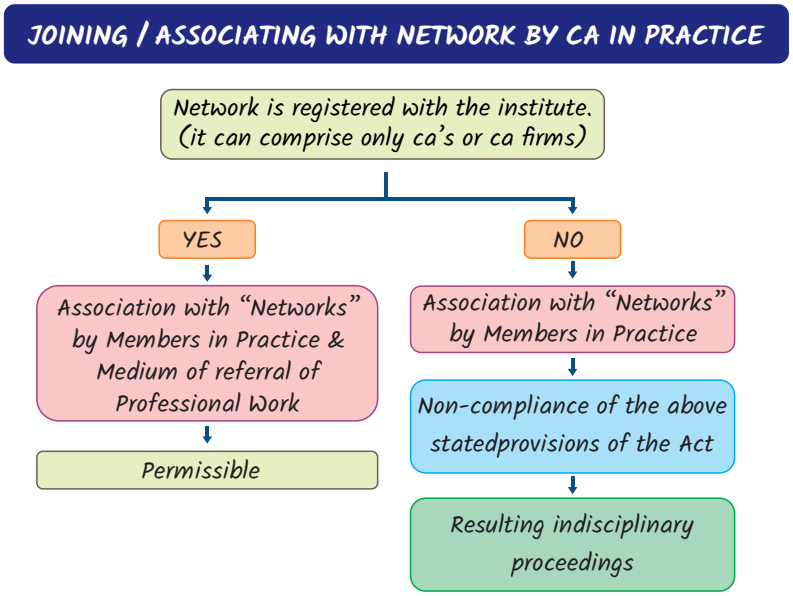
name as part of its firm name, it may give the appearance that it belongs to a network if it makes ***reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such***

- ***Summary (Deemed Network)***



(CNO-PE.1320) JOINING/ASSOCIATION WITH "NETWORKS" BY MEMBERS IN PRACTICE

Chart



It is hereby clarified that associations with "Network" as a medium of referral of professional work is **permissible only if the Network is registered with the Institute,** comprising only of Chartered Accountants/ Chartered Accountant Firms, and governed by the Institute's Network guidelines.

Members attention is also drawn towards following provisions of Chartered Accountants Act, 1949 (hereinafter referred to as the "Act"):

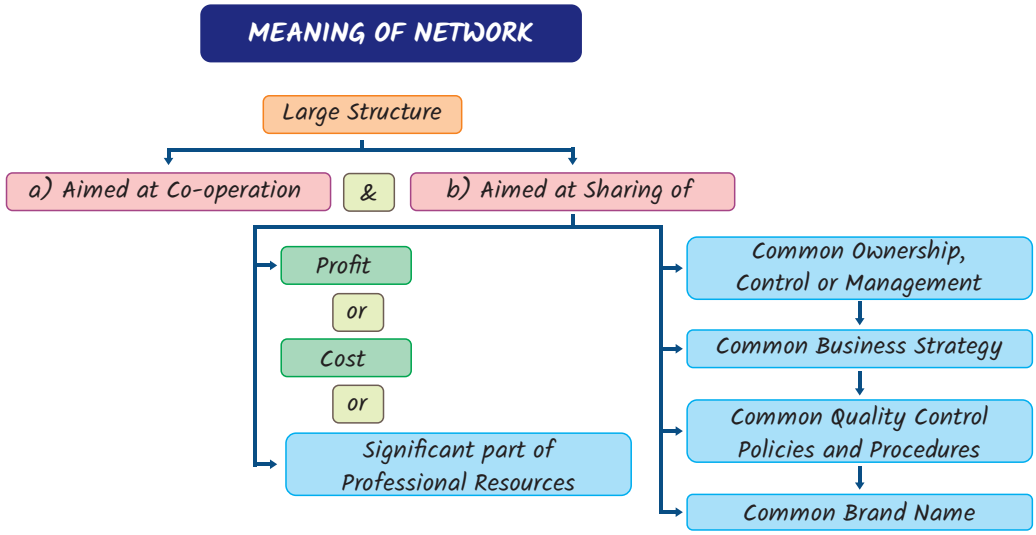
Clause 2 / 3 / 4 / 5 / 6 Part I of First Schedule

In view of the above provisions, it is not permissible for members in practice to join Networks (by whatever name called) other than the Networks registered with the Institute.

Members may note that joining such Networks as mentioned above may resin noncompliance of the above stated provisions of the Act resulting in disciplinary proceedings in accordance with the provisions of the Act.

(CNO-PE.1340) MEANING OF NETWORK & NETWORK FIRM

Chart

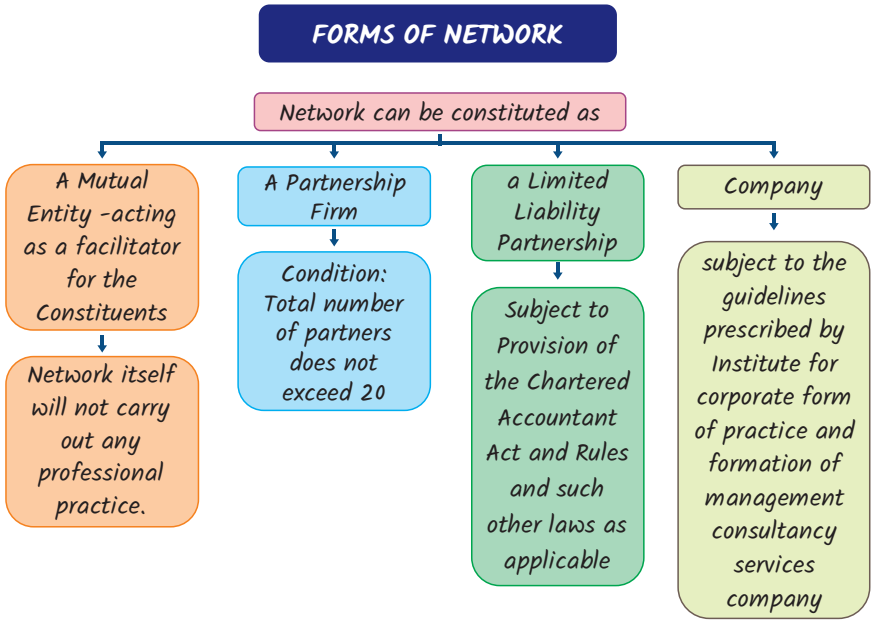


Network – A larger structure (a) That is aimed at co-operation; and (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

(CNO-PE.1360) FORMS OF THE NETWORK

The different forms of Network can be as under:-

- **Types**
  - A network **can be constituted as a mutual entity** which will **act as a facilitator for the constituents** of the Network. In such a case the **Network itself will not carry out any professional practice.**
  - A network can **be constituted as a partnership firm** subject to the **condition that the total number of partners does not exceed twenty.**
  - A network can be constituted as **a Limited Liability Partnership subject to the provision of the Chartered Accountant Act and Rules and such other laws** as may be applicable.
  - A network can be constituted **as company subject to the guidelines prescribed by Institute for**

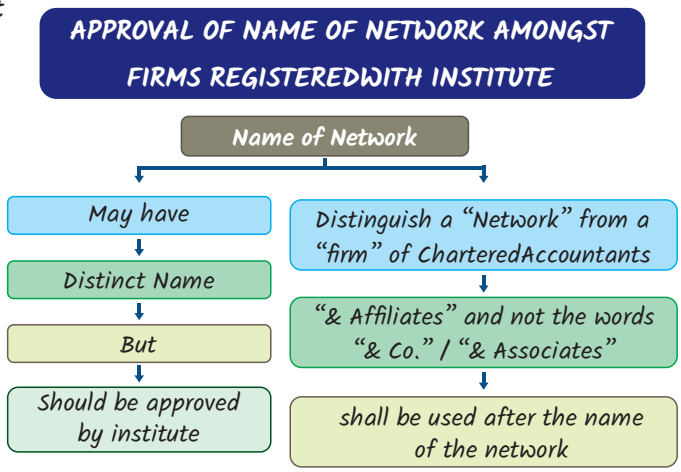


Conditions
1. Network Firms shall consist of sole Practitioner/proprietor, partnership or any such entity of professional accountants as may be permitted by the Act
2. A firm is allowed to join only one network.
Firms having common partners shall join only one Network.

(CNO-PE.1380) APPROVAL OF NAME OF NETWORK AMONGST FIRMS REGISTERED WITH INSTITUTE

Name of Network

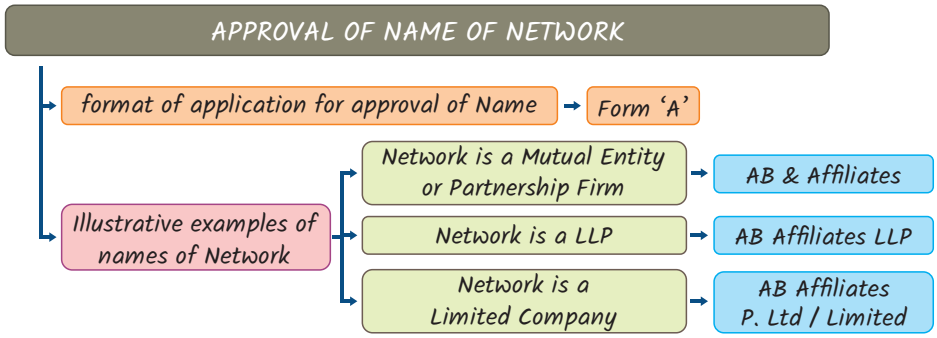
- The Network may have distinct name which should be approved by the Institute.
- To distinguish a "Network" from a "firm" of Chartered Accountants, the words **"& Affiliates"** shall be used after the name of the network and the words "& Co." / "& Associates" shall not be used.
- **Summary Chart**



Approval of Name for Network

(MCQ – PE.14 / Incs.23.3 /

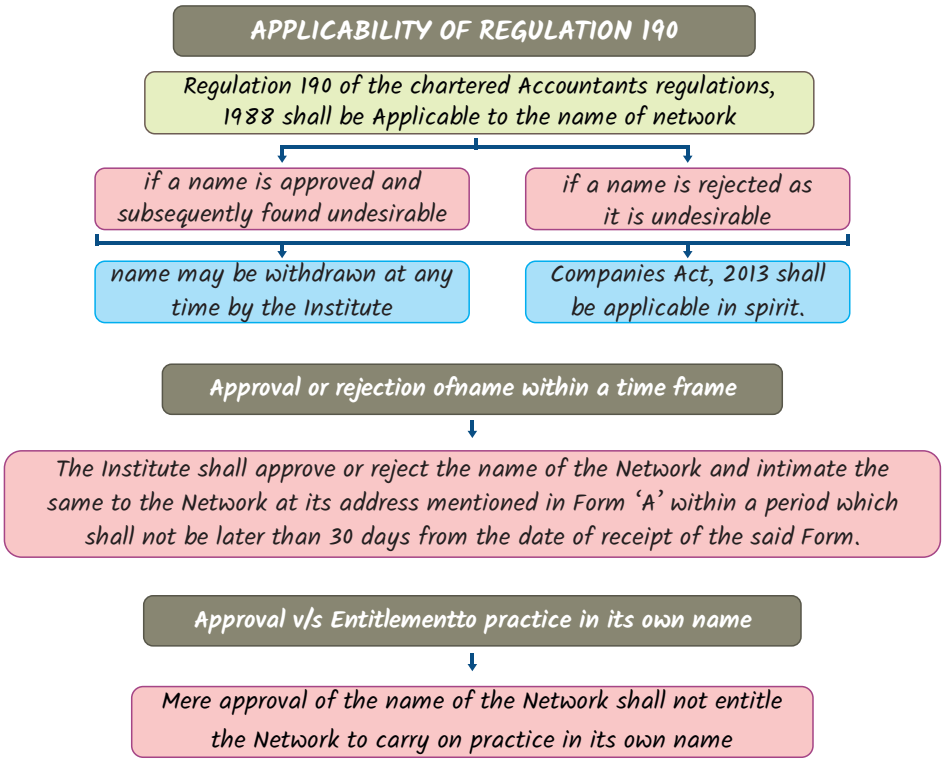
- The prescribed format of application for approval of Name for Network is at Form 'A' (enclosed).
- **Illustrative examples of names of Network: –**
  - If the **Network is a Mutual Entity or Partnership Firm: AB & Affiliates**
  - If the **Network is a LLP: AB Affiliates LLP**
  - If the **Network is a Limited Company: AB Affiliates P. Ltd/Limited**



Applicability of Regulation 190

- Provisions of Regulation 190 of the Chartered Accountants Regulations, 1988 shall be applicable to the name of Network.
  - However, even if a name is approved and subsequently it is found that the same is undesirable then, the said name may be withdrawn at any time by the Institute.
  - The Institute shall reject any undesirable name and the provisions in respect of names of companies as prescribed in the Companies Act, 2013 shall be applicable in spirit.

Summary Chart



Approval or rejection of name within a time frame

- The Institute shall approve or reject the name of the Network and intimate the same to the Network at its address mentioned in Form 'A' within a period which shall not be later than 30 days from the date of receipt of the said Form.

Approval v/s Entitlement to practice in its own name

- Mere approval of the name of the Network shall not entitle the Network to carry on practice in its own name

(CNO-PE.1400) LISTING OF NETWORK WITH ENTITIES OUTSIDE INDIA

Name of Network

LISTING OF NETWORK WITH ENTITIES OUTSIDE INDIA

- **Allowed** → Indian firms can form network along with foreign firms (Entities outside India) and get it listed with ICAI.
- **Form D** → Representatives of Indian firms & foreign firms forming network will have to file Declaration with ICAI in form 'D' within 30 days of date of entering network, arrangement
- **Restriction** → Indian firms/Foreign firms and firms having common partner with these firms shall join only one Network

Filing a declaration with the Institute

The duly authorized representative(s) of the Indian Member firm (s)/Member constituting the Network with entities outside India shall file a declaration with the Institute in Form 'D' for Listing of such Network within 30 days from the date of entering into the Network arrangement.

Joining network with entities outside India- Condition

Proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members as may be permitted by the Act, shall be permitted to join such network with entities outside India provided that the proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members are allowed to join only one network and firms having common partners shall join only one such network.

(CNO-PE.1420) CHANGE IN CONSTITUTION OF REGISTERED NETWORK

CHANGE IN CONSTITUTION OF NETWORK

↓

Entry or exit from network shall be communicated in form C to ICAI within 30 days

Communication of entry or exit from network to the Institute

In case of change in the constitution of registered Network on account of any entry into or exit from the Network, the network shall communicate the same to the Institute by filing Form 'C' within a period of thirty (30) days from the date of change in the constitution.

ETHICAL COMPLIANCE:

Once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular:

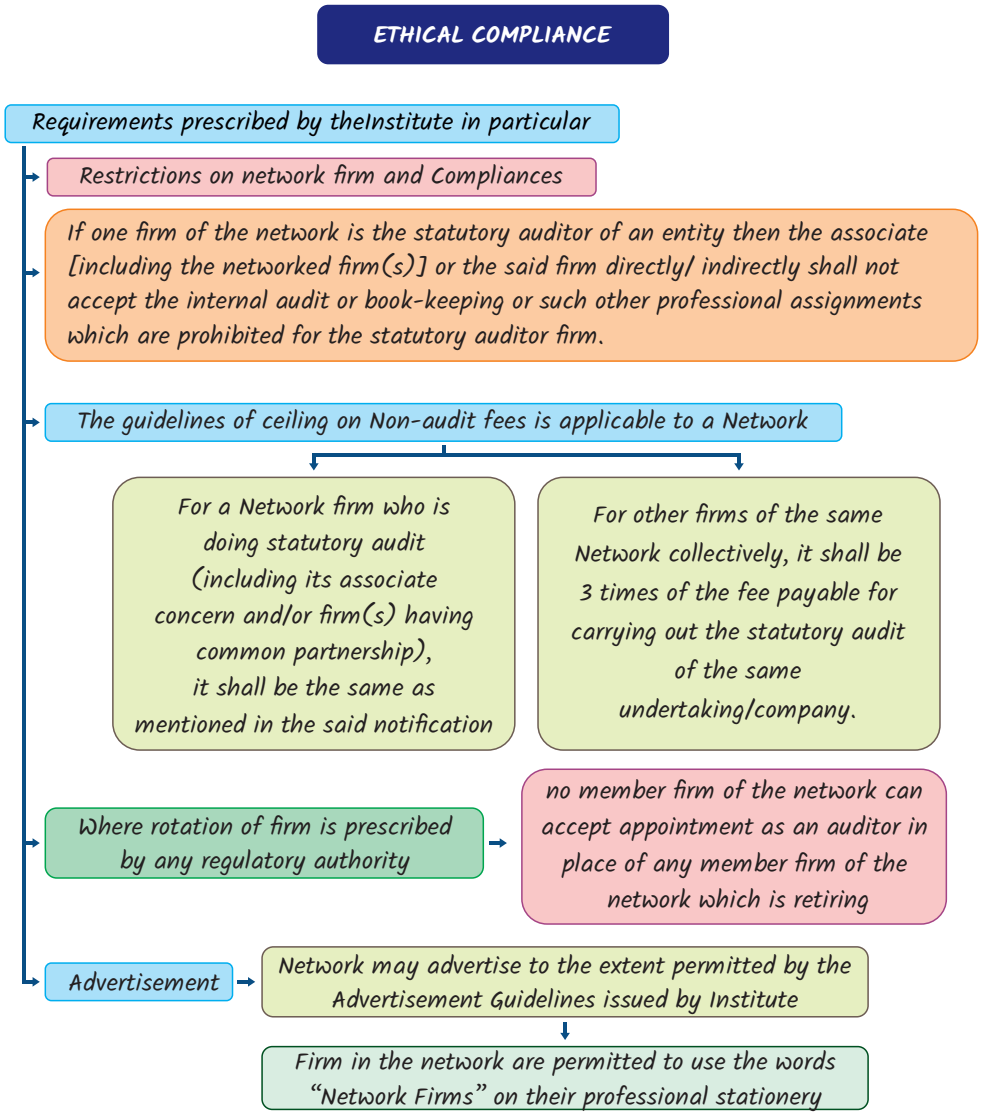
Restrictions on network firm and Compliances

- If one firm of the network is the statutory auditor of an entity then the associate [including the networked firm(s)] or the said firm directly/indirectly shall not accept the internal audit or book-keeping or such other professional assignments which are prohibited for the statutory auditor firm.
- The guidelines of ceiling on Non-audit fees is applicable in relation to a Network as follows:
  - For a Network firm who is doing statutory audit (including its associate concern and/or firm(s) having common partnership), it shall be the same as mentioned in the said notification; and
  - For other firms of the same Network collectively, it shall be 3 times of the fee payable for carrying out the statutory audit of the same undertaking/company.
- In those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.
- The Network may advertise the Network to the extent permitted by the Advertisement Guidelines

issued by Institute. The firms constituting the network are permitted to use the words "Network Firms" on their professional stationery.

- The constituent member firms of a Network and the Network shall comply with all the Ethical Standards prescribed by the Council from time to time.

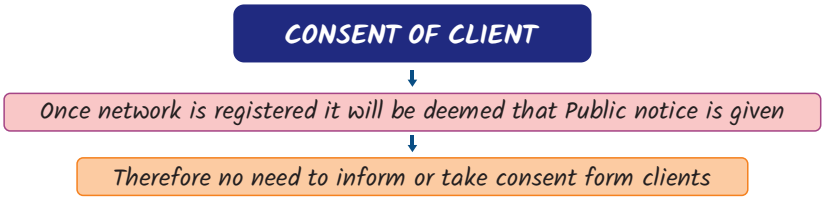
- **Summary Chart**



(CNO-PE.1440) CONSENT OF CLIENT:

Consent deemed to be obtained

The effect of registration of network with Institute will be deemed to be a public notice of the network and therefore consent of client will be deemed to be obtained.



(CNO-PE.1460) FRAMEWORK OF INTERNAL BYELAWS OF NETWORK

To streamline the networking, a network shall formulate operational bye-laws. Bye-laws may contain the following clauses on which the affiliates of the network may enter into a written agreement among themselves:

Clauses Bye-laws may contain

CPL network bye laws by D²RAFT²SMEN

- *Determining **C**ompensation to member firms for resources to be drawn from them*
- *Peer review of the member firms*
- *Library*
- *Dispute settlement procedures through arbitration and conciliation*
- *Development and maintenance of **D**ata bases relevant for different types of assignments*
- *Determining the methodology for drawing **R**esources from each member firm*
- *Administration of the network*
- *Contribution of membership **F**ees to meet the cost of the administration of the network.*
- *Development of **T**raining materials for members of the network*
- *Appointment of a **T**echnical director to whom references can be made*
- *Development of **S**oftware for different types of assignments*
- *Appointment of a **M**anaging Committee, from among the managing partners of the member firms of the network and the terms and conditions under which it should function. The minimum and maximum number of members of the Managing Committee shall also be agreed upon.*
- *Identifying a partner of any of the member firms of the network to be responsible for the assignment (**E**ngagement partner)*
- *Issue of **N**ewsletters for staff and clients*

FRAMEWORK FOR SETTING BYE- LAWS OF NETWORK

Following clause can be incorporated in Bye-Laws

*Shortcut : **CPL** Bye Laws by **D²RAFTSMEN***

C	–	How **C**ompensation will be paid to firms for use of their resources
P	–	Whether **P**eer Review is required for Member firms
L	–	How **L**ibrary will be maintained
D	–	**D**isputes settlement procedures
D	–	**D**atabase for different types of assignments
R	–	How **R**esources will handle Administration of Network
A	–	How will handle **A**dministration of Network
F	–	**F**ees to meet cost of administration of administration
T	–	How **T**raining Material will be developed
T	–	How **T**echnical Director will be appointed
S	–	How **S**oftware will be developed for different types of assignments
M	–	How **M**anaging committee will be appointed
E	–	How to identify **E**ngagement Partner who will handle assignment received by network
N	–	How **N**ews letters for staff & client will be issued

(CNO-PE.1480) REPEAL AND SAVING:

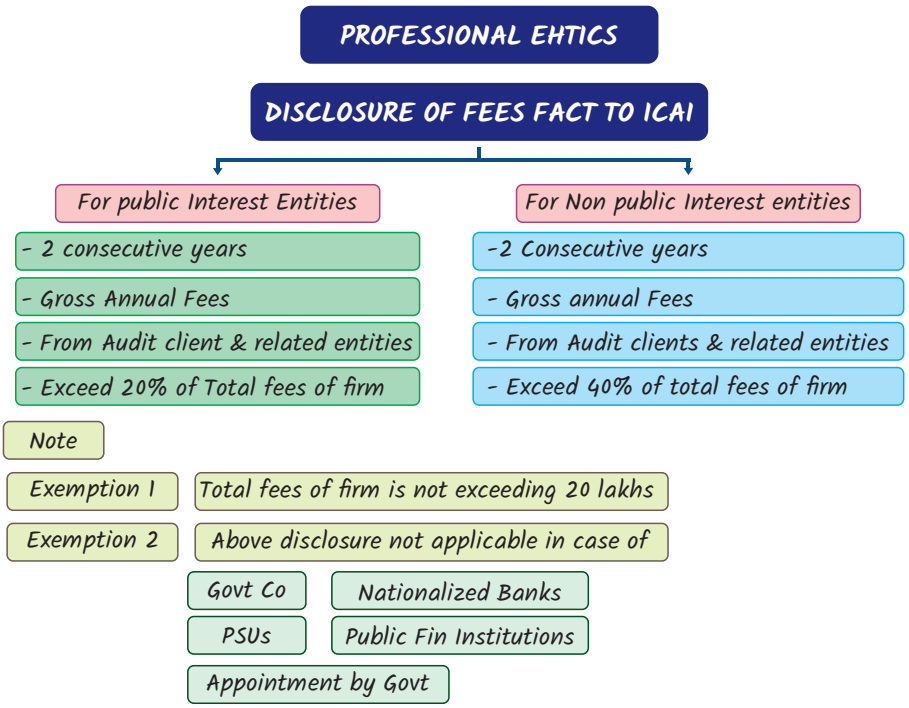
"Rules/ Guideline of Network" stands repealed & Proviso to it

- The erstwhile "Rules/Guidelines of Network" issued by the Institute stands repealed from the date of commencement of these Guidelines.
  - Provided that notwithstanding such repeal, anything done or any action taken or purported to have been done or taken in respect of the erstwhile Rules/Guidelines prior to the date of applicability of these Guidelines shall be deemed to have been done or taken under the corresponding provisions of these Guidelines

(CNO—PE.1500) Fees - Relative Size

Chart

AMENDMENT



Discussion

- **Disclosure requirements: -**

  A) For non Public Interest Entities (PIE)-

  Disclosure is required where for two consecutive years, the gross annual professional fees from an audit client represent more than 40% of the total fees of the firm.

  B) For public interest entities

  Disclosure is required where for two consecutive years, the gross annual professional fees from an audit client represent more than 20% of the total fees of the firm.

  - Exemption from applicability of the provision where total Fees received by Firm does not exceed 20 lacs of rupees.
  - Exemption from the applicability of the provision in the case of audit of government Companies, public undertakings, nationalised banks, public financial institutions, Regulators or where appointments of auditors are made by the Government.
  - Disclosure to the Institute
  - Pre-Issuance review or Post issuance Review: Removed

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